HSBC HOLDINGS PLC
Form 20-F
March 15, 2010

Table of Contents

As filed with the Securities and Exchange Commission on March 15, 2010.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20-F

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

Or

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

For the fiscal year ended December 31, 2009

Or

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

Or

o **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	**United Kingdom**
(Translation of Registrant s name into English)	(Jurisdiction of incorporation or organisation)

8 Canada Square
London E14 5HQ
United Kingdom
(Address of principal executive offices)
Russell C Picot
8 Canada Square
London E14 5HQ
United Kingdom
Tel +44 (0) 20 7991 8888
Fax +44 (0) 20 7992 4880
(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)
Securities registered or to be registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of each class	Name of each exchange on which registered
Ordinary Shares, nominal value US$0.50 each.	London Stock Exchange Hong Kong Stock Exchange Euronext Paris Bermuda Stock Exchange New York Stock Exchange*
American Depository Shares, each representing 5 Ordinary Shares of nominal value US$0.50 each.	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 period covered by the annual report:

Ordinary Shares, nominal value US$0.50 each 17,408,206,768

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

þ Yes o 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.

o Yes þ 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.

þ Yes o 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 þ Accelerated filer o Non-accelerated filer o
(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 o International Financial Reporting Standards as issued by the International Accounting Standards Board þ Other o

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.

o Item 17 o 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).

o Yes þ No

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

Table of Contents

HSBC HOLDINGS PLC
Annual Report and Accounts 2009

Headquartered in London, HSBC is one of the largest banking and financial services organisations in the world. Its international network comprises some 8,000 properties in 88 countries and territories in 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 220,000 shareholders in 121 countries and territories. The shares are traded on the New York Stock Exchange in the form of American Depositary Shares.

HSBC provides a comprehensive range of financial services to more than 100 million customers through four customer groups and global businesses: Personal Financial Services (including consumer finance); Commercial Banking; Global Banking and Markets; and Private Banking.

Certain defined terms
Unless the context requires otherwise, HSBC Holdings means HSBC Holdings plc and HSBC or the Group means 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.

HSBC HOLDINGS PLC
Contents

1 *Detailed contents are provided on the referenced pages.*

HSBC HOLDINGS PLC
Financial Highlights

Highlights / Ratios

For the year

Total operating income down by 11 per cent to US$78,631 million (2008: US$88,571 million).

Net operating income before loan impairment charges and other credit risk provisions down by 19 per cent to US$66,181 million (2008: US$81,682 million).

Underlying group pre-tax profit up by US$15,308 million to US$13,286 million.

Group pre-tax profit down by 24 per cent to US$7,079 million (2008: US$9,307 million).

Profit attributable to shareholders of the parent company up by 2 per cent to US$5,834 million (2008: US$5,728).

Return on average shareholders equity of 5.1 per cent (2008: 4.7 per cent).

Earnings per ordinary share down by 17 per cent to US$0.34 (2008: US$0.41).

At the year-end

Total equity up by 35 per cent to US$135,661 million (2008: US$100,229 million).

Loans and advances to customers down by 4 per cent to US$896,231 million (2008: US$932,868 million).

Customer accounts up by 4 per cent to US$1,159 billion (2008: US$1,115 billion).

Ratio of customer advances to customer accounts 77.3 per cent (2008: 83.6 per cent).

Risk-weighted assets down by 1 per cent to US$1,133 billion (2008: US$1,148 billion).

Dividends and capital position

Total dividends declared in respect of 2009 of US$0.34 per ordinary share, a decrease of 47 per cent on dividends for 2008; fourth interim dividend for 2009 of US$0.10 per ordinary share, no change from 2008.

Core tier 1 ratio of 9.4 per cent and tier 1 ratio of 10.8 per cent.

Rights issue

In April 2009, HSBC Holdings raised £12.5 billion (US$17.8 billion), net of expenses, by way of a fully underwritten rights issue, offering its shareholders 5 new ordinary shares for every 12 ordinary shares at a price of 254 pence per new ordinary share.

Dividends per ordinary share[1]
(US dollars)

Earnings per ordinary share
(US dollars)

For footnotes, see page 5.

Table of Contents

Capital and performance ratios

	2009 %	2008 %
Capital ratios		
Core tier 1 ratio	**9.4**	7.0
Tier 1 ratio	**10.8**	8.3
Total capital ratio	**13.7**	11.4
Performance ratios		
Return on average invested capital[2]	**4.1**	4.0
Return on average total shareholders equity[3]	**5.1**	4.7
Post-tax return on average total assets	**0.27**	0.26
Post-tax return on average risk-weighted assets	**0.58**	0.55
Credit coverage ratios		
Loan impairment charges as a percentage of total operating income	**31.72**	27.24
Loan impairment charges as a percentage of average gross customer advances	**2.82**	2.45
Total impairment allowances outstanding as a percentage of impaired loans at the year-end	**83.2**	94.3
Efficiency and revenue mix ratios		
Cost efficiency ratio[4]	**52.0**	60.1
As a percentage of total operating income:		
net interest income	**51.8**	48.1
net fee income	**22.5**	22.6
net trading income	**12.5**	7.4
Financial ratios		
Loans and advances to customers as a percentage of customer accounts	**77.3**	83.6
Average total shareholders equity to average total assets	**4.72**	4.87

Share information at the year-end

	2009	2008
US$0.50 ordinary shares in issue (million)	**17,408**	12,105
Market capitalisation (billion)	**US$199**	US$114
Closing market price per ordinary share:[6]		
London	**£7.09**	£5.77
Hong Kong	**HK$89.40**	HK$67.81
Closing market price per American Depositary Share[7]	**US$57.09**	US$44.15

	Over 1 year	Over 3 years	Over 5 years
HSBC total shareholder return to 31 December 2009[8]	**128.3**	**103.6**	**120.6**
Benchmarks:			
FTSE 100[9]	127.3	98.0	135.4

MSCI World[10]	116.7	103.6	134.9
MSCI Banks[11]	125.2	70.6	92.3

Return on average invested capital
(per cent)

Cost efficiency ratio
(per cent)

For footnotes, see page 5.

Table of Contents

HSBC HOLDINGS PLC
Financial Highlights (continued)

5-year comparison / Footnotes

Five-year comparison

	2009	2008	2007	2006	2005
	US$m	US$m	US$m	US$m	US$m
For the year					
Net interest income	**40,730**	42,563	37,795	34,486	31,334
Other operating income	**37,901**	46,008	49,806	35,584	30,370
Loan impairment charges and other credit risk provisions	**(26,488)**	(24,937)	(17,242)	(10,573)	(7,801)
Total operating expenses	**(34,395)**	(49,099)	(39,042)	(33,553)	(29,514)
Profit before tax	**7,079**	9,307	24,212	22,086	20,966
Profit attributable to shareholders of the parent company	**5,834**	5,728	19,133	15,789	15,081
Dividends[1]	**5,639**	11,301	10,241	8,769	7,750
At the year-end					
Called up share capital	**8,705**	6,053	5,915	5,786	5,667
Total shareholders equity	**128,299**	93,591	128,160	108,352	92,432
Capital resources[12,13]	**155,729**	131,460	152,640	127,074	105,449
Customer accounts	**1,159,034**	1,115,327	1,096,140	896,834	739,419
Undated subordinated loan capital	**2,785**	2,843	2,922	3,219	3,474
Preferred securities and dated subordinated loan capital[14]	**52,126**	50,307	49,472	42,642	35,856
Loans and advances to customers[15]	**896,231**	932,868	981,548	868,133	740,002
Total assets	**2,364,452**	2,527,465	2,354,266	1,860,758	1,501,970

	US$	US$	US$	US$	US$
Per ordinary share					
Basic earnings[16]	**0.34**	0.41	1.44	1.22	1.18
Diluted earnings[16]	**0.34**	0.41	1.42	1.21	1.17
Dividends	**0.34**	0.93	0.87	0.76	0.69
Net asset value at year-end[17]	**7.17**	7.44	10.72	9.24	8.03
Share information					
US$0.50 ordinary shares in issue (millions)	**17,408**	12,105	11,829	11,572	11,334

	%	%	%	%	%
Financial ratios					
Dividend payout ratio[18]	**100.0**	226.8	60.4	62.3	58.5
Post-tax return on average total assets	**0.27**	0.26	0.97	1.00	1.06

Return on average total shareholders equity	**5.1**	4.7	15.9	15.7	16.8
Loans and advances to customers as a percentage of customer accounts	**77.3**	83.6	89.5	96.8	100.1
Average total shareholders equity to average total assets	**4.72**	4.87	5.69	5.97	5.96
Capital ratios[12]					
Tier 1 ratio	**10.8**	8.3	9.3	9.4	9.0
Total capital ratio	**13.7**	11.4	13.6	13.5	12.8
Foreign exchange translation rates to US$					
Closing £:US$1	**0.616**	0.686	0.498	0.509	0.581
:US$1	**0.694**	0.717	0.679	0.759	0.847
Average £:US$1	**0.641**	0.545	0.500	0.543	0.550
:US$1	**0.719**	0.684	0.731	0.797	0.805

For footnotes, see page 5.

4

Table of Contents

Consolidated 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 2009, there were no unendorsed standards effective for the year ended 31 December 2009 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 2009 are prepared in accordance with IFRSs as issued by the IASB.

HSBC uses the US dollar as its presentation currency because the US dollar and currencies linked to it form the major currency bloc in which HSBC transacts and funds its 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 21), 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 22.

Footnotes to Financial Highlights

1 *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 2008 of US$0.18 was paid on 14 January 2009. The fourth interim dividend for 2008 of US$0.10 was paid on 6 May 2009. First, second and third interim dividends for 2009, each of US$0.08 per ordinary share, were paid on 8 July 2009, 7 October 2009 and 13 January 2010, respectively. Note 12 on the Financial Statements provides more information on the dividends*

declared in 2009. On 1 March 2010 the Directors declared a fourth interim dividend for 2009 of US$0.10 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 5 May 2010 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 26 April 2010, with a scrip dividend alternative. The reserves available for distribution at 31 December 2009 were US$34,460 million.

Quarterly dividends of US$15.50 per 6.20 per cent 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 dollar preference share, were paid on 16 March 2009, 15 June 2009, 15 September 2009 and 15 December 2009.

Quarterly coupons of 8.125 per cent capital securities of

US$0.508 were paid on 15 January 2009, 15 April 2009, 15 July 2009 and 15 October 2009.

2 *The definition of return on average invested capital and a reconciliation to the equivalent GAAP measures are set out on page 19.*

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 *This footnote is intentionally left blank.*

6 *The prices of HSBC Holdings ordinary shares and American Depositary Shares (ADS) have been adjusted for the 5-for-12 rights issue completed in April 2009.*

7 *Each ADS represents five ordinary shares.*

8 *Total shareholder return is defined on page 19.*

9 *The Financial Times Stock Exchange 100 Index.*

10 *The Morgan Stanley Capital International World Index.*

11 *The Morgan Stanley Capital International World Bank Index*

12 *The calculation of capital resources, capital ratios and risk-weighted assets for 2009 and 2008 is on a Basel II basis. 2005 to 2007 comparatives are on a Basel I basis.*

13 *Capital resources are total regulatory capital, the calculation of which is set out on page 289.*

14 *Includes perpetual preferred securities, details of which can be found in Note 32 on the Financial Statements.*

15 *Net of impairment allowances.*

16 *The effect of the bonus element of the rights issue (Note 13 on the Financial Statements) has been included within the basic and diluted earnings per share.*

17 *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.*

18 *Dividends per ordinary share expressed as a percentage of earnings per ordinary share.*

Table of Contents

HSBC HOLDINGS PLC
Cautionary Statement Regarding Forward-Looking Statements

Cautionary statement
The *Annual Report and Accounts 2009* contains certain forward-looking statements with respect to the financial condition, results of operations and business of HSBC.

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 , 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 United States 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 factors include, among others:

changes in general economic conditions in the markets in which HSBC operates, such as:

continuing or deepening recessions and fluctuations in employment beyond those factored into consensus forecasts;

changes in foreign exchange rates, in both market exchange rates (for example, between the US dollar and pound sterling) and government-established exchange rates (for example, between the Hong Kong dollar and US dollar);

the timing of interest rate rises in countries which have reduced policy rates to close to zero and more general volatility in interest rates;

volatility in equity markets, including in the smaller and less liquid trading markets in Asia and Latin America;

lack of liquidity in wholesale funding markets;

illiquidity and downward price pressure in national real estate markets, particularly consumer-owned real estate markets;

the ease with which central banks which have provided liquidity support to financial markets through quantitative easing and extended liquidity schemes are able to withdraw such support and the timing of any withdrawal;

heightened market concerns over sovereign creditworthiness in over-indebted countries;

the impact of lower than expected investment returns on the funding of private and public sector defined benefit pensions;

the effect of unexpected changes in actuarial assumptions on longevity which would influence the funding of private and public sector defined benefit pensions; and consumer perception as to the continuing availability of credit, and price competition in the market segments served by HSBC.

changes in government policy and regulation, including:

the monetary, interest rate and other policies of central banks and other regulatory authorities, including the UK Financial Services Authority, the Bank of England, the Hong Kong Monetary Authority, the US Federal Reserve, the US Securities and Exchange Commission, the US Office of the Comptroller of the Currency, the European Central Bank, the People s Bank of China and the central banks of other leading economies and markets where HSBC operates;

initiatives to change the size, scope of activities and interconnectedness of financial institutions following consideration of the regulatory consultations currently under way;

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;

Table of Contents

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 HSBC operates and the consequences thereof;

general changes in government policy that may significantly influence investor decisions, in particular in markets in which HSBC operates, including financial institutions newly taken into state ownership on a full or partial basis;

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 HSBC s 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 HSBC operates including increased competition from non-bank financial services companies, including securities firms.

factors specific to HSBC:

the success of HSBC in adequately identifying the risks it faces, 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, HSBC s ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and

the success of HSBC in addressing operational, legal and regulatory, and litigation challenges.

Table of Contents

HSBC HOLDINGS PLC
Group Chairman s Statement

Group Chairman s Statement
2009: a year of transition
In a number of important respects, 2009 was a year of transition.

It began with further turbulence in global financial markets but, during the year, the markets pulled back from uncertainty and progressively stabilised as a consequence of the continued, extraordinary and timely actions by governments and central banks.

2009 also saw the deepest contraction in the real economy in any year since the Second World War. However, it was apparent by year end that the worst was over even if confidence remained fragile and recovery would be uneven.

The global macro-economic transition from West to East gathered pace during 2009. At HSBC we have long been convinced that the world s economic centre of gravity is shifting, and the financial crisis has only accelerated this trend.

Nevertheless, huge challenges and risks remain for all of us.

While emerging markets are leading global recovery and seem certain to drive the majority of the world s growth in the generation ahead, recovery in developed markets has been slow to start, and unemployment remains high.

Furthermore, the global rebalancing of demand has barely begun. The financial crisis brought into stark relief the extent of the imbalances, especially between over-consuming Western economies and high-saving emerging markets. Rebalancing requires structural change and international co-operation, and it will take time.

There are also important lessons to learn as we seek to reform the financial system. Few of these lessons are quick or simple, but the need for urgent change is clearer than ever.

Supporting customers and delivering results throughout the cycle
Throughout the crisis, HSBC has remained profitable, financially strong and independently owned by our shareholders.

It is testimony to the quality and strength of HSBC s management team that, in 2009, our underlying performance was significantly ahead of 2008. On an underlying basis, and excluding the impact of the goodwill impairment recorded in 2008, pre-tax profit was US$13.3 billion, 56 per cent higher. On a reported basis, profit before tax was US$7.1 billion, down 24 per cent, in part due to the reversal of fair value accounting gains on our own debt.

That HSBC has reported a pre-tax profit in all three years since the onset of the crisis should be a source of great confidence to our shareholders, our depositors and all of our customers. Our track record of delivering results through adversity, and at all stages of the economic cycle, remains intact.

We continued to enhance our financial strength during 2009. We strengthened our capital base by US$10.2 billion through underlying profit generation. This comfortably covers our dividends declared, which total US$5.9 billion in respect of 2009. The directors have announced a fourth interim dividend of 10 cents per ordinary share, payable on 5 May 2010, and we remain one of the leading payers of dividends in financial services, declaring dividends in respect of the last three years of over US$24 billion in total.

The successful completion of our rights issue in April added US$17.8 billion to shareholders equity and helped to set the tenor for market recovery. Its success demonstrated the strong confidence which you, our shareholders, have in our future and we are profoundly thankful for your support.

We indicated at the time of the rights issue our expectation that, if successful, it would increase our tier 1 ratio by around 150 basis points. I am pleased to report that our tier 1 ratio increased by some 250 basis points to 10.8 per cent at 31 December 2009, largely as a result of the rights issue and internal capital generation. The core tier 1 ratio was 9.4 per cent at the same date, increasing by some 240 basis points.

Throughout the crisis, our strategy has remained clear: to build on our position as the leading

8

international and emerging markets bank. We have also never forgotten that it is our responsibility to make a real contribution to economic and social development, and that our ability to do so is fundamental to our success in delivering sustainable value to our shareholders.

Meeting our commitments to the communities we serve around the world is not some optional extra or by-product of our business it is part of our *raison d être*. In Argentina, which was in the midst of the peso crisis ten years ago, we did not abandon our customers and have remained committed to the market ever since. In 2009, our operations there reported their best-ever underlying performance and resumed paying cash dividends to the Group in January 2010. In mainland China, we are proud of our position as the leading international bank, and we continued to build our strong rural presence during the year. In Indonesia, we nearly doubled our network to support the growing financial needs of personal and business banking customers, and we launched our SME fund in the United Arab Emirates in January 2010. These are just a few examples which illustrate our commitment to helping people prepare for the future, building prosperity and security for their families and communities.

Robust corporate governance and unrivalled management experience

In 2009 we announced that, as Group Chief Executive, Michael Geoghegan would take responsibility for developing strategy as part of his overall responsibilities for the performance of the Group s business. We relocated the principal office of the Group Chief Executive to Hong Kong and, on 1 February 2010, he succeeded Vincent Cheng as Chairman of The Hongkong and Shanghai Banking Corporation Limited. This underscores our commitment to our emerging markets businesses and reflects the historic shift now taking place in the global economy.

HSBC s corporate headquarters remain in the UK, where we continue to benefit from being at the heart of one of the world s pre-eminent financial centres. From this base, as Chairman, I spend an increasing amount of my time engaging with policymakers and regulators throughout the world on behalf of the Group, on the growing number of policy issues which are crucial for the banking industry in general and for HSBC in particular.

At HSBC, we have an extremely strong, diverse and engaged Board and the international experience and expertise of our management team is something which sets us apart. We are committed to delivering effective supervision and to compliance with the principles set out in the Walker Review in the UK. During 2009, we also took further steps to strengthen our top management team. Sandy Flockhart was appointed Chairman, Personal and Commercial Banking, with responsibility for Personal Financial Services, Commercial Banking and Insurance, HSBC s Latin American and African businesses, and most Group functions. Stuart Gulliver was appointed Chairman, Europe, Middle East and Global Businesses and assumed responsibility for Private Banking, adding to his responsibilities for Global Banking and Markets. Douglas Flint assumed additional responsibilities for Regulation and Compliance in an expanded role as Chief Financial Officer, Executive Director, Risk and Regulation. Peter Wong was appointed Chief Executive of The Hongkong and Shanghai Banking Corporation Limited, succeeding Sandy Flockhart.

I would like to thank Vincent Cheng for his tremendous contribution over the past five years as Chairman of The Hongkong and Shanghai Banking Corporation Limited, and look forward to continuing to work with him as a main Board member and Chairman of HSBC Bank (China) Company Limited.

I would also like to say thank you on behalf of the Board to three of our directors, José Luis Durán, William Fung and Sir Mark Moody-Stuart, who will retire by rotation at the 2010 Annual General Meeting and will not seek re-election. It has been a privilege to work with each of them and all of us on the Board are extremely grateful for their counsel and support.

Learning the lessons from the crisis

In 2009, the G20 set out its clear belief that sustainable globalisation and rising prosperity will require an open world economy based on market principles, effective regulation, and strong global institutions. At HSBC, we agree that these principles are critical for the common good. It is vital that the industry should engage constructively in the debate about how this should work in practice and HSBC is participating fully in these discussions. In our view, the overall objective must be to deliver three effective market mechanisms.

Competitive product provision is fundamental to economic and social development. In the recent past, attempts to drive ever greater profits from the same source resulted in distorted products, lack of transparency and over-complexity. The industry needs to learn the lessons from this and deliver a market which provides financial services that are competitive, transparent and responsive to genuine customer needs.

Table of Contents

HSBC HOLDINGS PLC
Group Chairman s Statement (continued)

Group Chairman s Statement

The market for capital has also suffered from clear distortions in recent years. There has been too great an emphasis on short-term gains, often accompanied by shareholder pressure to increase leverage in order to boost returns, and a dangerous underpricing of risk. This resulted in unsustainable returns, which in some cases proved to be illusory. Banks must be appropriately capitalised, sufficiently liquid and not overstretched, and getting this right will be crucial in delivering the sustainable financial system we need for the future.

Partly because of these problems in other areas of the marketplace, the third area requiring urgent reform is the market for talent. There is understandable public anger in some countries as a result of the practices at certain banks and, in particular, because of the egregious reward of management failure. We have witnessed unacceptable distortions from rewards linked to unsustainable or illusory day-one revenues which encouraged excessive risk-taking; to multi-year guaranteed bonuses with no performance criteria. Over the last three years I have spoken publicly about my concerns regarding remuneration and I will set out our principles at HSBC.

Rewarding sustainable performance

First, for any bank to be sustainable it must strike the right balance in serving the long-term interests of its stakeholders. It must deliver sustainable returns to shareholders on their investment; it must maintain the capital strength needed to support the customers and economies it serves; and it must reward its employees appropriately. My own experience is that colleagues want to know that their job makes a difference and contributes to social and economic development; reward is simply not the only motivating factor. Nonetheless it is important, and companies have a clear responsibility to treat their employees appropriately.

It therefore follows that remuneration must be firmly tied to sustainable performance and must not reward failure. It should be properly aligned with risk which remains on the balance sheet, and subject to deferral and to clawback in case performance later proves to be unsatisfactory.

Second, in order to maintain long-term competitive advantage, remuneration must be market-based. Underpaying ultimately results in a company losing some of its best people. HSBC is domiciled in the UK but we have around 300,000 employees in 88 countries and territories. We have to think internationally, and remuneration policy is no exception. Similarly, if pre-eminent financial centres like London are to remain home to firms like HSBC, those of us who care for its future must reflect the reality of the global marketplace in our thinking and approach.

Third, an independent Remuneration Committee should conduct rigorous international benchmarking on compensation and consult appropriately on its conclusions. These are the principles we have followed in determining HSBC s rewards this year.

Our executive Directors have a combined 178 years of service a track record almost without parallel in the industry. I believe there is no better management team in banking and it is no coincidence that HSBC has remained profitable throughout the financial crisis and paid dividends when few other banks did. Indeed, for 2009, our total dividends to shareholders once again comfortably exceed total bonus awards. We have not needed taxpayers money; on the contrary, HSBC has contributed nearly £5 billion in tax to the UK economy over the past five years.

At HSBC, we firmly believe that bonuses are a legitimate and proper element of reward providing, of course, awards fully satisfy the principles set out above. The G20 has set out clear guidance which HSBC wholly supports, and we comply with the Financial Services Authority s remuneration code of practice. Indeed, our decision to defer 100 per cent of executive Director bonuses in respect of 2009 over three years exceeds these guidelines.

Proper pay for proper performance includes ensuring market-based pay for employees over time. The Board expects fixed pay in banking to increase as a proportion of total compensation, especially for important risk and supervisory functions. This is a process we intend to see through at HSBC, and our management team is no exception.

The Board fully appreciates that, in these extraordinary times, remuneration is enormously sensitive and particularly so when the absolute numbers involved are large by any standards, even if they are not in comparison with some other companies of HSBC s standing. Our practice is clear and transparent and this year s executive awards are set out in the Directors Remuneration Report published today. We absolutely believe that the decisions we have taken on this year s remuneration awards are right for all of our stakeholders.

Building a sustainable financial system for the future

As policymakers and industry participants take the

Table of Contents

necessary steps to improve the way our markets work, there are also some important over-arching challenges which we must address.

It is imperative to strike the right balance between strengthening the financial system and supporting economic growth. De-risking the banking system, if taken too far, will throttle recovery and drive risk into other, unregulated parts of the capital markets. It is in the collective public interest to get this balance right. We must not rush to implement hastily conceived responses and policy must be co-ordinated internationally if we are to manage risk better in a truly global industry.

Policymakers also need to evolve new macroeconomic tools which will assist them to manage the supply of credit, as well as the cost of credit, in the economy. I believe a key element of this involves managing bank capital on a countercyclical basis which strikes the right balance between financial system stability and the prospects for economic growth. We cannot deliver a sustainable financial system without improving the wider framework for macroeconomic management too.

Finally, in the context of a wide-ranging discussion on the appropriate size and shape of banks, we must recognise that corporate structure and liquidity management are at least as important as size *per se*. This debate has sometimes been given the unhelpful shorthand too big to fail , but the reality is more complex than the headlines suggest. We believe that the financial system needs banks which are big enough to cope by having a diversified business portfolio, helping to reduce risk and to generate consistent returns. There has likewise not been enough consideration given to the need for banks to be broad enough to serve those global customers who have increasingly diverse financial needs. In short, it is undesirable and impractical to prescribe some ideal model for a bank. The crisis clearly demonstrated that systemic importance is not a function of size or business focus.

HSBC has always believed in having a transparent structure based on separately capitalised subsidiaries, takes a conservative approach to liquidity management, and has built a business with the scale to provide broad, diversified services to its global customers. While the detail and timing of regulatory change remain uncertain, we are confident that our focus on these fundamentals positions us strongly and competitively to respond to the challenges ahead.

S K Green, *Group Chairman*
1 March 2010

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review

Principal activities / Strategic direction / Challenges and uncertainties
Principal activities

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US$199 billion at 31 December 2009.

Through its subsidiaries and associates, HSBC provides a comprehensive range of banking and related financial services. Headquartered in London, HSBC operates through long-established businesses and has an international network of some 8,000 properties in 88 countries and territories in six geographical regions: Europe; Hong Kong; Rest of Asia-Pacific; the Middle East; North America and Latin America. Previously, the Middle East was reported as part of Rest of Asia-Pacific. Within these regions, a comprehensive range of financial services is offered to personal, commercial, corporate, institutional, investment and private banking clients. Services are delivered primarily by domestic banks, typically with large retail deposit bases, and by consumer finance operations.

Taken together, the five largest customers of HSBC do not account for more than one per cent of HSBC s income.

The Group has contractual and other arrangements with numerous third parties in support of its 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 444).

Strategic direction

HSBC s strategic direction reflects its position as The world s local bank , combining the largest global emerging markets banking business and a uniquely cosmopolitan customer base with an extensive international network and substantial financial strength.

The Group s strategy is aligned with the key trends which are shaping the global economy. In particular, HSBC recognises that, over the long term, developing markets are growing faster than the mature economies, world trade is expanding at a greater rate than gross domestic product and life expectancy is lengthening virtually everywhere. HSBC s strategy is focused on delivering superior growth and earnings over time by building on the Group s heritage and skills. Its origins in trade in Asia have had a considerable influence over the development of the Group and, as a consequence, HSBC has an established and longstanding presence in many countries. The combination of local knowledge and international breadth is supported by a substantial financial capability founded on balance sheet strength, largely attributable to the scale of the Group s retail deposit bases.

HSBC is, therefore, continuing to direct incremental investment primarily to the faster growing markets and, in the more developed markets, is focusing on businesses and customer segments which have international connectivity. A policy of maintaining HSBC s capital strength and strong liquidity position remains complementary to these activities and is the foundation of decisions about the pace and direction of investment.

The Group has identified three main business models for its customer groups and global businesses that embody HSBC s areas of natural advantage:

- businesses with international customers for whom connections with developing markets are crucial Global Banking and Markets, Private Banking, the large business segment of Commercial Banking and the mass affluent segment of Personal Financial Services;

- businesses with local customers where service efficiencies can be enhanced through global scale the small business segment of Commercial Banking and the mass market segment of Personal Financial Services; and

- products where global scale is possible by applying the Group s efficiency, expertise and brand product platforms such as global transaction banking.

The means of executing the strategy and making greater use of the linkages within the Group are clear:

the HSBC brand and global networks will be leveraged to reach new customers and offer further services to existing clients;

efficiency will be enhanced by taking full advantage of local, regional and global economies of scale, in particular by adopting a common systems architecture wherever possible; and

objectives and incentives will be aligned to motivate and reward staff for being fully engaged in delivering the strategy.

Challenges and uncertainties

Current economic and market conditions may adversely affect HSBC s results

HSBC s earnings are affected by global and local economic and market conditions. The dislocation in

Table of Contents

financial markets which began in August 2007 put financial institutions under considerable pressure. Market turbulence was accompanied by recessionary conditions in developed economies and a slowdown in emerging countries, with serious adverse consequences for asset values, employment, consumer confidence and levels of economic activity. The global economy entered the most severe downturn for 80 years in 2008.

Governments and central banks took concerted action to make substantial funds and deposit guarantees available to boost liquidity and confidence in their financial systems, stimulate lending and support institutions which were judged to be at risk of failing. In addition, governments extended fiscal stimulus programmes and central banks reduced interest rates. As a consequence, conditions eased in 2009 and most leading developed economies began to emerge from recession, although the pace and depth of recovery was uneven across economies and asset markets. The financial services industry continued to face an unusually high degree of uncertainty.

Despite some evidence of stabilisation in housing market conditions during 2009, the dramatic declines of the previous two years, particularly in the US and the UK, continued to affect adversely the credit performance of real estate-related exposures. Higher unemployment undermined consumer confidence and this, coupled with the deterioration in house prices, led to lower spending which weakened economies. This resulted in significant write-downs of related asset values by financial institutions, including HSBC. These write-downs, both of direct lending exposures and of asset-backed securities, caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger competitors and, in some cases, to fail.

Economic conditions remain fragile, and the risk exists that major economies may suffer a double dip recession in which the improvements seen in a number of important markets reverse. This could have an adverse effect on HSBC s operating results. In particular, the Group may face the following challenges in connection with these events:

HSBC s ability to assess the creditworthiness of its customers or to estimate the values of its assets may be impaired if the models and techniques it uses become less accurate in their predictions of future behaviour, valuations or estimates. The process HSBC uses to estimate losses inherent in its credit exposure or assess the value of certain assets requires difficult,
subjective and complex judgements. These include forecasts of economic conditions and how predicted economic scenarios may impair the ability of HSBC s borrowers to repay their loans or affect the value of assets. As a consequence, this process may be less capable of making accurate estimates which, in turn, may undermine the reliability of the process;

the demand for borrowing from creditworthy customers may diminish should economic activity slow;

a prolonged period of low interest rates will constrain net interest income earned by HSBC on its excess deposits;

HSBC s ability to borrow from other financial institutions or to engage in funding transactions on favourable terms, or at all, could be adversely affected by any renewed disruption in the capital markets or deteriorating investor sentiment;

market developments may continue to depress consumer confidence and may cause further declines in credit card usage and adverse changes in payment patterns, leading to increases in delinquencies and default rates, write-offs and loan impairment charges beyond HSBC s expectations;

loan impairment allowances and write-offs would be likely to rise in the event of a double dip recession as consumer confidence weakened and business failures increased;

HSBC expects to face increased regulation and supervision of the financial services industry, following new proposed regulatory measures in countries in which it operates;

trade and capital flows may contract as a result of protectionist measures being introduced in certain markets; and increased government ownership and control over financial institutions and further consolidation in the financial industry which could significantly alter the competitive landscape.

As a global financial institution, HSBC is exposed to these developments across all its businesses, both directly and through their impact on its customers and clients. Local variations exist, however, reflecting regional circumstances and presenting challenges to HSBC which are specific to those areas. HSBC s strong balance sheet and capital position, its roots in emerging markets and

Challenges and uncertainties

its links with the developed world provide it with the platform to continue to grow, taking opportunities to expand its operations in existing markets and connect local customers internationally.

Europe

In the UK, the contraction in economic output appears to have ceased with the country emerging slowly from recession in the last quarter of 2009. However, economic indicators remain weak and the risk of the country slipping back into recession in 2010 remains, thus delaying the recovery. Government measures to tackle the record levels of national debt, including taxation increases and public spending cuts, are also likely to result in a slower recovery than from other recessions. Political involvement in the regulatory environment and the major financial institutions in which the state has a direct financial interest will continue. Government demands for increased credit to support the economic recovery coupled with regulatory actions to diminish the banking sector s reliance on short-term wholesale funding will increase competition for deposits, narrowing margins. The combination of slow economic recovery, government intervention and increased competition for deposits will maintain pressure on profitability within HSBC s retail business model. Credit quality is expected to improve in some sectors, however, as the economy returns to growth but could suffer a reversal should there be any further increase in unemployment in 2010.

In France, following government stimulus measures, the economy has started recovering with gross domestic product (GDP) growing slightly from the second quarter of 2009 and the number of companies in default stabilising. Although unemployment is rising and there are concerns about the public deficit, household consumption remains robust and continues to drive the economy. HSBC s retail business model depends on banking fees and a consolidation of the recovery observed in the financial markets in 2009 will help sustain profitability. Credit quality is expected to remain stable for personal customers due to the quality of the client base, though the outlook for commercial credit remains less certain.

Outside the UK and France, conditions are likely to remain difficult in some of the countries in which HSBC currently operates in Europe and volatility is expected to continue, in particular as markets focus on potential sovereign credit deterioration.

Hong Kong and Rest of Asia-Pacific

In Asia-Pacific, Hong Kong remains HSBC s key market, and through the financial crisis has continued to generate relatively high returns on capital. HSBC will invest to maintain its competitive position in Hong Kong while continuing to support its growing franchises in other markets in the region. The slowdown in commercial activity, which precipitated the coordinated government stimulus packages, affected fee-based businesses, and continuing low interest rates have left deposit spreads compressed. However, HSBC is now seeing more lending demand as regional economies emerge from recession and equity markets and cross-border trade flows improve. HSBC attracted higher deposits in 2009 despite intensified competition for liquidity, and this added to the challenges of finding opportunities to deploy the deposits where credit demand remained muted. A recent increase in lending has started to ease some of these pressures. Emerging markets in Asia-Pacific currently offer the brightest prospects, with GDP growth in mainland China and India, in particular, expected to be strong in 2010.

As the world s fastest growing region, Asia is expected to drive incremental growth in the global recovery. Inflation triggered by rising output prices and increased demand remains a concern which has prompted regulatory interventions in the form of cooling measures to manage asset growth and prevent, as far as possible, asset bubbles emerging. Mainland China has been prominent in taking a lead in this area. HSBC s strong liquidity position in the region remains key to the Group s ability to expand as well as increase margins when interest rates begin to rise again, the timing of which remains uncertain. Regional markets are likely to remain competitive due to the growing presence of large domestic and regional banks, for example, the mainland Chinese banks in Hong Kong.

Middle East

After a very difficult year, there are signs that the conditions for a recovery in Middle East economic activity have begun to emerge. Assuming an average oil price in excess of US$70 a barrel, public finances in the key oil producing states such as Saudi Arabia, Qatar and the United Arab Emirates (UAE) should improve, allowing governments to maintain and even accelerate fiscal stimulus programmes.

Investment spending is also likely to pick up after last year s slowdown, although ongoing difficulty accessing funding will impede the pace of capital spending growth for the public and private sector alike. Tight financing conditions as well as a sharp fall in asset prices in some parts of the region will also weigh on an expected increase in private consumption levels.

Provided the external environment continues to strengthen, regional non-commodity exporters such as Egypt should see the recent downturn in demand for tourism and trade services slowly reverse, offering additional support for growth.

With most regional economies basing their monetary regimes around a US dollar-peg, interest rates are expected to remain at historically low levels across much of the region in 2010. Coupled with growth in government spending and gains in global commodity prices, this may result in a rise in inflation. After the sharp economic downturn of 2009, however, the increase in price pressure is unlikely to be pronounced.

North America

In 2009, the economic backdrop in the US continued to be characterised by tight credit conditions, reduced economic growth and a weak housing market. Against this, market confidence began to increase, beginning in the second quarter of the year, stemming largely from government initiatives to restore faith in the capital markets, and the benefits to borrowers of the prolonged period of low Federal funds rates. The latter put pressure on spreads earned on HSBC s deposit base, however. As the disruption to financial markets eased, evidence emerged of contracting credit spreads and improved liquidity during 2009, beginning in the second quarter of the year, enabling many companies to issue debt and raise new capital.

The reduction in uncertainty helped capital markets to recover and stock markets to rise. Signs of stabilisation in house prices, most notably in the lower price ranges, began to emerge in the third quarter of the year. An improvement in unemployment and a sustained recovery in the housing market continue to remain critical to consumer confidence and a broader US economic recovery. Although consumer confidence has improved, it remains depressed on a historical basis, driven by declines in household income and wealth and the job market remaining difficult. It is likely that these conditions will continue to constrain the Group s results into 2010, although the degree to which this happens remains uncertain.

On 14 January 2010, the US Administration announced its intention to propose a Financial Crisis Responsibility Fee to be assessed against financial institutions with more than US$50 billion on consolidated assets for at least 10 years. It is not possible to assess the financial impact of this proposal, however, until final legislation has been enacted.

Latin America

Economic activity in Latin America was affected by the global economic recession in 2009. The region s weighted average GDP is expected to fall by 2.7 per cent in the year, though growth may resume in 2010 given the outlook for world trade and a rebound in economic activity. Unemployment rates in the region rose in 2009 and it is probable that this trend will continue, albeit at a slower pace as economies begin to recover. Inflation fell due to falling commodity prices and lower demand. These effects will begin to reverse in 2010 and consequently inflation may rise.

HSBC is positioning itself to grow in select customer markets, though challenges remain to expanding business volumes. Margin pressures are expected to continue throughout the region due to fierce competition for prime customers and lower interest rates than the historical averages. Any further reduction in GDP and increase in unemployment will negatively affect business activity, compounded by uncertainty surrounding presidential elections in Costa Rica, Colombia and Brazil in 2010 and in Peru and Argentina in 2011.

Liquidity and funding risks are inherent in HSBC s business

HSBC s business model is founded upon having ready access to financial resources whenever required to meet its obligations and grow its business. To this end, HSBC 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 modest amounts of long-term wholesale funding. In addition, HSBC holds portfolios of highly liquid assets diversified by currency and maturity to enable it to respond to unusual liquidity requirements.

Where markets become illiquid, the value at which financial instruments can be realised is highly uncertain, and although processes are available to estimate fair values, they require substantial elements of judgement, assumptions and estimates (which may change over time). The risk of illiquidity, therefore, may reduce capital resources as valuations decline. Actions or the threat of actions by third parties and independent market participants, such as rating agency downgrades of instruments to which HSBC has exposure, can result in reduced

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

Challenges and uncertainties

liquidity and valuations of those instruments. 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. Rating agencies which determine HSBC s credit ratings and thereby influence the Group s cost of funds, take into consideration the effectiveness of HSBC s liquidity risk management framework.

The market conditions that the financial services industry experienced during the height of the crisis were reflected in decreased liquidity, reduced availability of long-term wholesale market funding, pressure on capital and extreme price volatility across a wide range of asset classes. Illiquidity prevented the realisation of some asset positions and constrained risk distribution in ongoing banking activities. The market conditions also 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.

HSBC s Global Banking and Markets 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. At the height of the financial crisis, HSBC made substantial write-downs and recognised impairments on illiquid legacy credit and structured credit positions. Although during 2009 there was some moderation in market conditions, it is difficult to predict if this trend will continue and, if conditions worsen, which of HSBC s markets, products and other businesses will be affected. Any repeat of these factors could have an adverse effect on the Group s results.

Reform of the regulatory environment presents risks to HSBC

There are potential strategic and structural risks to the organisation, nature and scope of the Group s business activities and opportunities posed by many of the proposals for regulatory reform being debated both internationally and domestically in response to the recent financial crisis. A consensus has emerged among the G-20 nations that institutions that would pose a systemic risk if they were to fail should be subject to enhanced regulation in markets in which they have a substantial presence. HSBC is likely to be considered a systemically significant institution in its key markets. The Basel Committee on Banking Supervision (The Committee) has issued a comprehensive reform package to address the lessons of the crisis which includes proposals on strengthening global capital and liquidity regulations and the resolution of systemically significant cross-border banks. The Committee s paper entitled Strengthening the Resilience of the Banking Sector proposes changes to both the composition of capital and the risk coverage of the capital framework, as well as the introduction of a leverage ratio and measures to promote the build up of capital buffers. The stated intention of these proposals is to promote a more resilient banking sector, to improve the banking sector s ability to absorb shocks, to improve risk management and to strengthen bank transparency and disclosure. The proposals on liquidity aim to elevate the resilience of internationally active banks to liquidity stresses, as well as increasing international harmonisation of liquidity risk supervision. A study of the impact of all these proposals on individual banks, and the financial services industry as a whole, is taking place in the first half of 2010 in parallel with a consultation process. The Committee is then seeking to agree proposals by the end of 2010 for implementation by the end of 2012.

At the same time, the European Commission, the UK Tripartite Authorities (HM Treasury, the Bank of England and the Financial Services Authority (FSA)), the US Government and others have made a number of proposals for adjustments in their regulatory regimes which could affect entities in the HSBC Group. HSBC is engaged actively in discussions with its regulators, both directly and through industry bodies, on the appropriate regime to be applied to various activities and entities, taking into account the interaction of global and local regulations. The precise nature, extent, form and timing of any regulatory changes, as well as the degree to which there will be effective consultation among the various jurisdictions involved, are highly uncertain and thus it is not possible to determine or estimate the likely actual impact on the Group s business and activities. Major areas where reform is being actively discussed, all of which could affect HSBC s business and activities, are possible capital surcharges for systemically important banks, greater emphasis on standalone national subsidiaries, reduced interconnectedness within the system, changes to capital regulations affecting both capital and capital requirements, changes in compensation practices, restrictions on certain types of financial products, and greater separation of retail and wholesale activities.

HSBC Bank, like all authorised institutions in the UK, is subject to a Special Resolutions Regime under the Banking Act 2009 which gives wide powers in respect of UK banks and their parent

16

companies to HM Treasury, the Bank of England and the FSA in circumstances where any such UK bank has encountered or is likely to encounter financial difficulties.

HSBC is subject to political and economic risks in the countries in which it operates

HSBC operates through an international network of subsidiaries and affiliates in 88 countries and territories around the world. Its results are, therefore, 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, limits on dividend flows and tax in the jurisdictions in which it operates. These factors may also negatively affect revenues from the trading of securities and investment in securities, and credit quality in lending portfolios. 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. HSBC prepares its accounts in US dollars, but because a substantial portion of its assets, liabilities, assets under management, revenues and expenses are denominated in other currencies, changes in foreign exchange rates have an effect on its reported income, cash flows and shareholders equity.

HSBC has significant exposure to counterparty risk both within the financial sector and to other risk concentrations

HSBC has exposure to virtually all major industries and counterparties, and it routinely executes 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 HSBC to credit risk in the event of default by its counterparty or client. HSBC s ability to engage in routine transactions to fund its operations and manage its risks could be adversely affected by the actions and commercial soundness of other financial services institutions. 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 difficulties, defaults and losses. Where counterparty risk has been mitigated by taking collateral, HSBC s credit risk may remain high if the collateral it holds cannot be realised or has to be liquidated at prices
which are insufficient to recover the full amount of its loan or derivative exposure.

HSBC operates in a highly competitive environment, and competition could intensify as a result of current global market conditions and possible changes thereto

The financial crisis has begun to re-shape the banking landscape globally and those institutions which have emerged the strongest have reinforced both the importance of a core retail and commercial deposit funding base and strong capitalisation.

At the height of the crisis, financial institutions requiring support from governments in a variety of ways were characterised broadly as being dependent on short-term wholesale funding which failed to roll over due to market concerns about the quality of the assets being funded. As a consequence, financial firms have sought to reduce the proportion of their balance sheets funded in the wholesale markets. As a result, competition for retail deposits and tighter balance sheet control have resulted in re-pricing of loans and advances. Although the financial industry s renewed focus on building retail deposit bases has resulted in greater price competition in terms of interest rates offered, the strength of HSBC s brand and its longstanding conservative balance sheet structure and its relationship-based approach have enabled the Group to increase deposits in the current environment.

Further consolidation is expected to take place through portfolio disposals, the sale of banks and financial institutions weakened by the crisis, or the consolidation of smaller institutions which lack the scale to compete in a world of higher capital and liquidity requirements.

In addition, the crisis has reinforced a global economic shift towards emerging markets. It is now expected that much of the growth in financial services will be in emerging markets as their economies continue to grow and the relative penetration of banking activities increases.

HSBC is 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 its ability to operate. These issues require the Group 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 it is 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 HSBC, or subject HSBC to regulatory enforcement actions, fines or penalties or reputational damage.

Operational risks are inherent in HSBC s business

HSBC is exposed to many types of operational risk, including fraudulent and other criminal activities (both internal and external), breakdowns in processes or procedures and systems failure or non availability. HSBC is also subject to the risk of disruption of its business arising from events that are wholly or partially beyond its 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 HSBC relies on outside suppliers or vendors to provide services to it and its customers.

The reliability and security of HSBC s information and technology infrastructure and its customer databases are crucial to maintaining the service availability of 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 the Group s ability to service its clients, could breach regulations under which HSBC operates and could cause long-term damage to its business and brand.

HSBC is subject to tax-related risks in the countries in which it operates, which could have an adverse effect on its operating results

HSBC is subject to the substance and interpretation of tax laws in all countries in which it operates. Tax risk is the risk associated with changes in tax law or the interpretation of tax law. It also includes the risk of changes in tax rates and the risk of consequences arising from failure to comply with procedures required by tax authorities. Failure to manage tax risks could lead to increased tax charges, including financial or operating penalties.

Key performance indicators

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

As a prerequisite for the vesting of Performance Shares, the Remuneration Committee must satisfy itself that HSBC Holdings financial performance has shown a sustained improvement in the period since the award date. In determining this, the Remuneration Committee will take account of all relevant factors but, in particular, will compare HSBC s financial key performance indicators (KPI s) with the equivalent measures within the total shareholder return (TSR) comparator group.

Financial KPIs

In assessing progress in delivering the Group s strategy and monitoring HSBC s performance, management reviews the financial KPIs described below. These KPIs are complemented by a range of secondary benchmarks which are relevant to reviewing performance against plan and at the business level.

HSBC has published a number of key targets against which performance is measured. Financial targets have been set as follows: a return on average total shareholders equity over the medium term of between 15 per cent and 19 per cent; the cost efficiency ratio to be between 48 per cent and 52 per cent; and HSBC s TSR to be in the top half of that achieved by the comparator group. The cost efficiency ratio has been set as a range within which the business is expected to remain in order to accommodate both returns to stakeholders and the need for continued investment in support of future business growth.

In the light of market conditions and proposed changes to capital requirements currently being considered by various governmental and regulatory bodies, HSBC believes return on average total shareholders equity over the medium term is more likely to be around the lower end of the target range. Once regulatory proposals are in definitive form HSBC intends to publish a revised target range.

Financial KPIs trend analysis

	2009	2008	2007	2006	2005
	%	%	%	%	%
Revenue growth[1]	**(19.0)**	3.4	20.8	13.4	12.2
Revenue mix[2]					
Net interest income	**61.5**	52.1	47.8	52.8	54.4
Net fee income	**26.7**	24.5	27.9	26.3	25.1
Other income[3]	**11.8**	23.4	24.3	20.9	20.5
Cost efficiency[4]	**52.0**	60.1	49.4	51.3	51.2
Credit performance as measured by risk adjusted margin[5]	**3.5**	4.8	6.0	6.3	6.3
Return on average invested capital[6]	**4.1**	4.0	15.3	14.9	15.9
Return on average total shareholders equity[7]	**5.1**	4.7	15.9	15.7	16.8
Dividends per share growth[8]	**(46.9)**	(28.9)	11.1	11.0	10.6
	US$	US$	US$	US$	US$
Basic earnings per ordinary share[9]	**0.34**	0.41	1.44	1.22	1.18

For footnotes, see page 149.

	Over 1 year	**Over 3 years**	**Over 5 years**
Total shareholder return			
HSBC TSR	**128.3**	**103.6**	**120.6**
Benchmarks:			
FTSE 100	127.3	98.0	135.4
MSCI World	116.7	103.6	134.9
MSCI Banks	125.2	70.6	92.3

Revenue growth provides an important guide to the Group s success in generating business. In 2009, total revenue declined by 19 per cent to US$66.2 billion. On an underlying basis, revenue grew by 8 per cent, reflecting the resilience of HSBC s income generating capabilities in these difficult economic circumstances.

Revenue mix represents the relative distribution of revenue streams between net interest income, net fee income and other revenue. It is used to understand how changing economic factors affect the Group, to highlight dependence on balance sheet utilisation for income generation and to indicate success in cross-selling fee-based services to customers with deposit and loan facilities. This understanding assists management in making business investment decisions.

Cost efficiency is a relative measure that indicates the consumption of resources in generating revenue. Management uses this to assess the success of technology utilisation and, more generally, the productivity of the Group s distribution platforms and sales forces.

Credit performance as measured by risk-adjusted margin is an important gauge for assessing whether credit is correctly priced so that the returns available after recognising impairment charges meet the Group s required return parameters.

Return on average invested capital measures the return on the capital investment made in the business, enabling management to benchmark HSBC against competitors.

Return on average total shareholders equity measures the return on average shareholders investment in the business. This enables management to benchmark Group performance against competitors and its own targets. In 2009, the ratio was 5.1 per cent or 0.4 percentage points higher than in 2008.

HSBC aims to deliver sustained **dividend per share growth** for its shareholders. The total dividend for 2009, based on the year to which the dividends relate (rather than when they were paid), amounts to US$0.34 per ordinary share, a reduction of 47 per cent on 2008.

Basic earnings per share (EPS) is a ratio that shows the level of earnings generated per ordinary share. EPS is one of two KPIs used in rewarding employees and is discussed in more detail in the Director s Remuneration Report on page 334. EPS for 2009 was US$0.34, a decline of 17 per cent on 2008.

Total shareholder return is used as a method of assessing the overall return to shareholders on their investment in HSBC, and is defined as the growth in share value and declared dividend income during the relevant period. TSR is a key performance measure in rewarding employees. In calculating TSR, dividend income is assumed to be invested in the underlying shares. The TSR benchmark is an index set at 100 and measured over one, three and five years for the purpose of comparison with the performance of a group of competitor banks which reflect HSBC s range and breadth of activities. As the comparator group includes companies listed on overseas markets, a common currency is used to ensure that TSR is measured on a consistent basis. The TSR levels at the end of 2009 were 128.3, 103.6 and 120.6 over one, three and five years respectively. HSBC s performance did not meet the target of being in the top half of the comparator group over any of the required time periods.

Management believes that financial KPIs must remain relevant to the business so they may be changed over time to reflect changes in the Group s composition and the strategies employed.

Non-financial KPIs

HSBC has chosen four non-financial KPIs which are important to the future success of the Group in delivering its strategic objectives. These non-financial KPIs are reported within HSBC on a local basis.

Employee engagement

Employee engagement is a measure of employees emotional and rational attachment to HSBC. It is critical to the long-term success of the Group and, as such, an employee engagement target was included in the 2009 objectives for Group executives (see Directors Remuneration Report, page 334).

In 2009, HSBC conducted the third Global People Survey of its workforce worldwide. The 2009 participation rate of 91 per cent was one of the highest in the industry.

The Group s employee engagement score rose from 67 per cent in 2008 to 71 per cent in 2009. In achieving 71 per cent, HSBC exceeded its target for 2009 of 69 per cent and the external global and sector averages. HSBC aspires to progressively improve its engagement score to best in class levels by 2011.

The 2009 survey covered 14 aspects. Employees rated HSBC above the external global average across all aspects.

Brand perception

In order to manage the HSBC brand most effectively, the Group tracks brand health among Personal Financial Services and Business Banking customers in each of HSBC s major markets. The survey is conducted on a consistent basis by accredited independent third-party organisations. A weighted scorecard of brand measures produces an overall score for each market on a 100-point scale, which is then benchmarked against HSBC s main competitors. The scores from each market are then weighted according to the risk-adjusted revenues in that market to obtain the overall Group score.

In 2009, Personal Financial Services customers judged HSBC s brand to be 6 points stronger than its competitors, up from 4 points in 2008 and above the target. Business Banking customers also judged the brand to be 6 points higher than HSBC s competitors, the same as in 2008.

Customer recommendation

Customer recommendation is an important driver of business growth for HSBC. HSBC uses a consistent measure of customer recommendation around the world to continue to improve the services provided by the Group to customers of Personal Financial Services and Business Banking. This measurement is carried out by accredited independent third-party organisations and the resulting recommendation scores are benchmarked against competitors. A 100 point scale is used to measure the score.

The 2009 customer recommendation score for Personal Financial Services increased from +1 to +2 compared with a target of +3.

Business Banking customer recommendation was also +2 points ahead of HSBC s competitors but below the target of +4.

IT performance and systems reliability

HSBC tracks two key measures as indicators of IT performance; namely, the number of customer transactions processed and the reliability and resilience of systems measured in terms of service availability targets.

Number of customer transactions processed

The number of customer transactions processed reflects the dependency on IT of the delivery channels that customers use to interact with HSBC. Monitoring the volumes by channel enables the Group to allocate resources appropriately. Despite a fall in total volumes, the transition of customer transactions from labour intensive channels (branch/call centre) to automated channels (credit card, internet, self-service and other e-channels) continued in 2009. The following chart shows the 2005 to 2009 volumes per delivery channel:

Table of Contents

Number of customer transactions (millions)

Percentage of IT services meeting or exceeding targets

HSBC s IT function establishes with its end-users service levels for systems performance, such as systems running 99.9 per cent of the time or credit card authorisations within two seconds, and monitors the achievement of each of these commitments. The following chart shows the percentage of IT services meeting or exceeding the agreed service targets by region. All regions continue to show sustained improvement over the period.

Percentage of IT services meeting or exceeding targets

Reconciliation of reported and underlying profit before tax

HSBC measures its performance internally on a like-for-like basis by eliminating the effects of foreign currency translation differences; acquisitions and disposals of subsidiaries and businesses; 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; and, in 2007, gains from the dilution of the Group s interests in associates, all of which distort year-on-year comparisons. HSBC refers to this as its 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 2008 and 2007 used in the 2009 and 2008 commentaries, respectively, are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

- the income statements for 2008 and 2007 at the average rates of exchange for 2009 and 2008, respectively; and
- the balance sheets at 31 December 2008 and 2007 at the prevailing rates of exchange on 31 December 2009 and 2008, respectively.

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 HSBC s underlying performance in 2009 with 2008, and 2008 with 2007. Equivalent tables are provided for each of HSBC s customer groups and geographical segments in their respective sections below.

The foreign currency translation differences were mainly due to the relative strengthening of the US dollar compared with its value in 2008, and were most significant in Europe due to the size of HSBC s operations in the UK.

The following acquisitions and disposals affected both comparisons:

- the gain on sale of HSBC s UK merchant acquiring business to a joint venture 49 per cent owned by the Group in June 2008 and the gain on sale of the residual stake in June 2009;
- the disposal of seven French regional banking subsidiaries in July 2008;
- the disposal of the stake in Financiera Independencia S.A.B. de C.VB (Financiera Independencia) in Mexico in November 2008; and
- the acquisition of PT Bank Ekonomi Raharja Tbk (Bank Ekonomi) in May 2009.

Table of Contents

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

Reconciliation of profit / Financial summary > Income statement
Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
HSBC	**2008 as reported US$m**	**2008 adjust-ments[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjust-ments[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**42,563**	**(65)**	**(2,062)**	**40,436**	**53**	**241**	**40,730**	**(4)**	**1**
Net fee income	**20,024**	**(58)**	**(1,315)**	**18,651**	**6**	**(993)**	**17,664**	**(12)**	**(5)**
Changes in fair value[14]	**6,570**	**(6,570)**			**(6,533)**		**(6,533)**	**(199)**	
Gains on disposal of French regional banks	**2,445**	**(2,445)**						**(100)**	
Other income[15]	**10,080**	**(680)**	**(1,597)**	**7,803**	**298**	**6,219**	**14,320**	**42**	**80**
Net operating income[16]	**81,682**	**(9,818)**	**(4,974)**	**66,890**	**(6,176)**	**5,467**	**66,181**	**(19)**	**8**
Loan impairment charges and other credit risk provisions	**(24,937)**	**6**	**709**	**(24,222)**		**(2,266)**	**(26,488)**	**(6)**	**(9)**
Net operating income	**56,745**	**(9,812)**	**(4,265)**	**42,668**	**(6,176)**	**3,201**	**39,693**	**(30)**	**8**
Operating expenses (excluding goodwill impairment)	**(38,535)**	**68**	**2,655**	**(35,812)**	**(31)**	**1,448**	**(34,395)**	**11**	**4**
Goodwill impairment	**(10,564)**			**(10,564)**		**10,564**		**100**	**100**
Operating profit	**7,646**	**(9,744)**	**(1,610)**	**(3,708)**	**(6,207)**	**15,213**	**5,298**	**(31)**	**410**

Income from associates	**1,661**		**25**	**1,686**		**95**	**1,781**	**7**	**6**
Profit before tax	**9,307**	**(9,744)**	**(1,585)**	**(2,022)**	**(6,207)**	**15,308**	**7,079**	**(24)**	**757**

2008 compared with 2007

HSBC	2007 as reported US$m	2007 adjustments & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjust-ments[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	37,795	(389)	(4)	37,402	250	4,911	42,563	13	13
Net fee income	22,002	(239)	(152)	21,611	18	(1,605)	20,024	(9)	(7)
Changes in fair value[14]	3,055	(3,055)			6,570		6,570	115	
Gains on disposal of French regional banks					2,445		2,445		
Other income[15]	16,141	(1,232)	(269)	14,640	703	(5,263)	10,080	(38)	(36)
Net operating income[16]	78,993	(4,915)	(425)	73,653	9,986	(1,957)	81,682	3	(3)
Loan impairment charges and other credit risk provisions	(17,242)	31	113	(17,098)	(6)	(7,833)	(24,937)	(45)	(46)
Net operating income	61,751	(4,884)	(312)	56,555	9,980	(9,790)	56,745	(8)	(17)
Operating expenses (excluding goodwill impairment)	(39,042)	514	301	(38,227)	(198)	(110)	(38,535)	1	
Goodwill impairment						(10,564)	(10,564)		

Operating profit	22,709	(4,370)	(11)	18,328	9,782	(20,464)	7,646	(66)	(112)
Income from associates	1,503	(12)	107	1,598		63	1,661	11	4
Profit before tax	24,212	(4,382)	96	19,926	9,782	(20,401)	9,307	(62)	(102)

For footnotes, see page 149.

22

Table of Contents

Financial summary

Consolidated income statement

2009 compared with 2008

Reported pre-tax profits in 2009 fell by 24 per cent to US$7.1 billion and earnings per share declined to US$0.34. Return on average shareholders equity remained broadly at 2008 levels at 5.1 per cent (2008: 4.7 per cent).

On an underlying basis, profit before tax increased by US$15.3 billion compared with 2008. The difference between reported and underlying results is explained on page 21. 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$10.6 billion in 2008, was 56 per cent or US$4.7 billion higher.

The increase in profit before tax was driven by strong growth in net operating income in Global Banking and Markets, 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 HSBC s business in North America continued to record a loss, performance improved as write-downs in Global Banking and Markets reduced and loan impairment charges in Personal Financial Services 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 the 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 HSBC s 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.

Table of Contents

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

Financial summary > Income statement
Consolidated income statement

	2009 US$m	2008 US$m	2007 US$m
Interest income	**62,096**	91,301	92,359
Interest expense	**(21,366)**	(48,738)	(54,564)
Net interest income	**40,730**	42,563	37,795
Fee income	**21,403**	24,764	26,337
Fee expense	**(3,739)**	(4,740)	(4,335)
Net fee income	**17,664**	20,024	22,002
Trading income excluding net interest income	**6,236**	847	4,458
Net interest income on trading activities	**3,627**	5,713	5,376
Net trading income	**9,863**	6,560	9,834
Changes in fair value of long-term debt issued and related derivatives[18]	**(6,247)**	6,679	2,812
Net income/(expense) from other financial instruments designated at fair value	**2,716**	(2,827)	1,271
Net income/(expense) from financial instruments designated at fair value	**(3,531)**	3,852	4,083
Gains less losses from financial investments	**520**	197	1,956
Gains arising from dilution of interests in associates			1,092
Dividend income	**126**	272	324
Net earned insurance premiums	**10,471**	10,850	9,076
Gains on disposal of French regional banks		2,445	
Other operating income	**2,788**	1,808	1,439
Total operating income	**78,631**	88,571	87,601
Net insurance claims incurred and movement in liabilities to policyholders	**(12,450)**	(6,889)	(8,608)
Net operating income before loan impairment charges and other credit risk provisions	**66,181**	81,682	78,993

Loan impairment charges and other credit risk provisions	**(26,488)**	(24,937)	(17,242)
Net operating income	**39,693**	56,745	61,751
Employee compensation and benefits	**(18,468)**	(20,792)	(21,334)
General and administrative expenses	**(13,392)**	(15,260)	(15,294)
Depreciation and impairment of property, plant and equipment	**(1,725)**	(1,750)	(1,714)
Goodwill impairment		(10,564)	
Amortisation and impairment of intangible assets	**(810)**	(733)	(700)
Total operating expenses	**(34,395)**	(49,099)	(39,042)
Operating profit	**5,298**	7,646	22,709
Share of profit in associates and joint ventures	**1,781**	1,661	1,503
Profit before tax	**7,079**	9,307	24,212
Tax expense	**(385)**	(2,809)	(3,757)
Profit for the year	**6,694**	6,498	20,455
Profit attributable to shareholders of the parent company	**5,834**	5,728	19,133
Profit attributable to minority interests	**860**	770	1,322

For footnote, see page 149.

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. HSBC continued to expand its presence in Rest of Asia-Pacific through organic growth and strategic investment.

HSBC s 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 per cent, 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.

Table of Contents

In Europe, HSBC reported an increase in profit before tax on an underlying basis, driven by Global Banking and Markets 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 Personal Financial Services and Commercial Banking 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 Global Banking and Markets.

In Latin America, the decline in pre-tax profits was driven by an increase in loan impairment charges in Personal Financial Services and Commercial Banking and lower revenues in Personal Financial Services, partly offset by a strong performance in trading and Balance Sheet Management in Global Banking and Markets. The lower revenues in Personal Financial Services were in part due to the continued curtailment of personal unsecured credit exposures, following the Group s adverse experience in 2008, with net interest income also adversely affected by declining interest rates and narrowing spreads.

With the exception of Personal Financial Services, 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$10.6 billion goodwill impairment charge in North America recorded in 2008;
- the non-recurrence of a US$2.4 billion gain on the sale of French regional banks in 2008;
- fair value losses relating to own credit spreads of US$6.5 billion in 2009 compared with gains of US$6.6 billion in 2008;
- a US$72 million fraud loss relating to Bernard L Madoff Investment Securities LLC (Madoff Securities) in 2009, which was in addition to the US$984 million charge reported in 2008;
- loss from write-downs in legacy securities and structured credit positions amounting to US$0.3 billion in 2009 compared with US$5.4 billion in 2008;
- the acquisition in 2008 of the subsidiary, Project Maple II B.V., which owned the Group s headquarters at 8 Canada Square, and the subsequent sale of the company and leaseback of the property in 2009, resulting in gains of US$0.6 billion in 2009 and US$0.4 billion in 2008;
- the sale of the card merchant-acquiring business in the UK, resulting in gains of US$0.3 billion in 2009 and US$0.4 billion 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$0.5 billion in 2009; and
- the tax expense of US$0.3 billion in 2009, which was lower than in previous years as a result of the geographic distribution of income. The Group 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.

2008 compared with 2007

Reported pre-tax profits in 2008 fell by 62 per cent to US$9.3 billion and earnings per share declined to US$0.47. In a year characterised by a significant deterioration in the credit markets and by unprecedented illiquidity in most asset classes, return on average total shareholders equity fell to 4.7 per cent.

The fall in profit before tax was exacerbated by recognition of a US$10.6 billion impairment charge which wrote off in full the goodwill carried on the balance sheet in respect of the Group s investment in its North America Personal Financial Services business. This non-cash charge arose substantially in the second half of 2008 as heightened risk premia in the market increased discount rates and cash flows estimated from ongoing activities fell as the US economy continued to decline and the outlook for the business deteriorated.

On an underlying basis, profit before tax declined by 102 per cent compared with 2007. The difference between the reported and underlying results is explained on page 21. Except where stated otherwise, the commentaries in the Financial Summary are on an underlying basis.

Performance in Asia was strong, generating profit before tax of US$11.9 billion, broadly in line with results excluding the dilution gains which arose in 2007 when HSBC did not participate in share offerings by its mainland China associates. Within Asia, Global Banking and Markets results were strongly ahead, driven by foreign exchange, Rates and securities services. Balance Sheet Management revenues rose significantly from positioning ahead of interest rate cuts, and were especially strong in Europe despite losses from the defaults of certain financial sector companies. With the exception of Personal Financial Services, which incurred significant losses in North America, all customer groups remained profitable. Commercial Banking and Private Banking delivered results broadly in line with 2007, while Global Banking and Markets profits declined.

Performance was overshadowed by a US$7.8 billion rise in loan impairment charges and other credit risk provisions, largely from the US consumer finance business, and a further US$5.4 billion in trading write-downs on illiquid legacy positions in credit trading, leveraged and acquisition finance and monoline credit exposure in Global Banking and Markets. Increases in loan impairment charges and other credit risk provisions in Personal Financial Services and Commercial Banking, the latter rising rapidly in the second half of 2008 from a low base, occurred as the global economy slowed. Global Banking and Markets also experienced a rise in loan impairment charges and other credit risk provisions as refinancing options dried up for a number of companies as the market for long-term asset financing became increasingly illiquid. The market turmoil also led to impairments on equity securities in the available-for-sale portfolio.

The following items were significant:

- the non-recurrence of US$1.1 billion of gains which arose in 2007 on the dilution of the Group s stakes in various associates;
- a US$3.6 billion increase (from US$3.0 billion in 2007 to US$6.6 billion) in fair value gains from wider credit spreads recorded predominantly on HSBC s own long-term debt designated at fair value. These gains reported in the Other segment, are not allocated to customer groups and are not included within regulatory capital calculations;
- the gain of US$2.4 billion on the sale of the French regional banks; and
- a charge against trading income of US$984 million following the fraud in December 2008 relating to Madoff Securities.

Group performance by income and expense item

Net interest income

	2009	2008	2007
Net interest income[19] (US$m)	**40,730**	42,563	37,795
Average interest-earning assets (US$m)	**1,384,705**	1,466,622	1,296,701
Gross interest yield[20] (per cent)	**4.48**	6.23	7.12
Net interest spread[21] (per cent)	**2.90**	2.87	2.86
Net interest margin[22] (per cent)	**2.94**	2.90	2.91

For footnotes, see page 149.

2009 compared with 2008

Reported net interest income of US$40.7 billion fell by 4 per cent 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 HSBC s 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 Corporation (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

Table of Contents

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, the Group sourced an increasing proportion of its funding from customer accounts, and consequently reduced its 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.

2008 compared with 2007

Reported net interest income of US$42.6 billion rose by 13 per cent compared with 2007, 13 per cent on an underlying basis.

Growth in net interest income was driven by significantly higher revenues in Balance Sheet Management, in part reflecting favourable positioning to take advantage of falling interest rates. Lending and deposit balances also grew strongly, while progressive reductions in central bank reference rates led to a decline in both asset yields and the cost of funds. Overall, spreads narrowed on an underlying basis.

Average interest-earning assets increased to US$1,467 billion, led by growth in average loans and advances to customers. This was mainly due to an increase in average term lending balances in Europe and Asia.

An increase in average interest-bearing liabilities was driven by growth in average customer accounts, notably in Europe. HSBC attracted substantial deposits from customers who valued HSBC s perceived strength at a time of global financial market turmoil and customers also expressed a preference for security and liquidity following declines in equity markets.

Interest rates were cut aggressively in many countries during 2008, as central banks reduced their reference rates as part of stimulus programmes introduced in response to deteriorating economic conditions. This contributed to a decline in asset yields. The cost of funds also fell, but this was less significant than the decline in yields as spreads narrowed overall on an underlying basis.

In North America, net interest income was also adversely affected by rises in loan modifications designed to reduce the payment burden on the Group s customers, and impaired loans.

Net fee income

	2009	2008	2007
	US$m	US$m	US$m
Cards	**4,625**	5,844	6,496
Account services	**3,592**	4,353	4,359
Funds under management	**2,172**	2,757	2,975
Broking income	**1,617**	1,738	2,012
Credit facilities	**1,479**	1,313	1,138
Insurance	**1,421**	1,771	1,836
Global custody	**988**	1,311	1,404
Imports/exports	**897**	1,014	866
Underwriting	**746**	325	367
Remittances	**613**	610	556
Corporate finance	**396**	381	409
Unit trusts	**363**	502	875
Trust income	**278**	325	299
Mortgage servicing	**124**	120	109
Maintenance income on operating leases	**111**	130	139
Taxpayer financial services	**87**	168	252

Other	**1,894**	2,102	2,245
Total fee income	**21,403**	24,764	26,337
Less: fee expense	**(3,739)**	(4,740)	(4,335)
Net fee income	**17,664**	20,024	22,002

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

Financial summary > Group performance > Net fee income / Net trading income

2009 compared with 2008

Reported net fee income decreased by 12 per cent to US$17.7 billion, 5 per cent 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 Global Banking and Markets. 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 Private Banking 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 accompanied the considerable reconstruction and refinancing of corporate balance sheets in 2009.

2008 compared with 2007

Reported net fee income declined by 9 per cent to US$20 billion, 7 per cent lower on an underlying basis.

Lower equity market-related revenues, notably in Hong Kong, were driven by weakened investor sentiment, and reflected in the fall in the aggregate of broking income, global custody and unit trust income. Similarly, fund management fees declined as equity markets retreated and lower performance fees were earned.

HSBC announced revisions to its credit card fee charging policies in the US in 2007, and this fed through as expected in the form of a substantial decline in overlimit fees, further compounded by lower cash advance and interchange fee income as a result of reduced volumes. In the UK, the divestment in 2008 of the card acquiring business resulted in reduced card acquiring fees. Offsetting these factors were rises in card fees in Hong Kong, the Middle East, India and Turkey.

Fee income from credit facilities rose, notably in the Middle East, in line with customer volumes. Growth in fee income from trade and supply chain products reflected higher volumes and customer acquisition in India and, to a greater extent in the Middle East, increased activity driven by commodity price inflation.

Net trading income

	2009	2008	2007
	US$m	US$m	US$m
Trading activities	**5,240**	2,988	4,521
Net interest income on trading activities	**3,627**	5,713	5,376
Other trading income hedge ineffectiveness:			
on cash flow hedges	**90**	(40)	(77)

on fair value hedges	**(45)**	5	19
Non-qualifying hedges	**951**	(1,122)	(5)
Losses on Madoff Securities fraud		(984)	
Net trading income[23,24]	**9,863**	6,560	9,834

For footnotes, see page 149.

2009 compared with 2008

Reported net trading income increased by 50 per cent to US$9.9 billion, 83 per cent 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 per cent 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 HSBC 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$984 million 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$429 million on credit default swap transactions in parts of the Global Banking portfolio. In 2008, gains of US$912 million 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, HSBC reclassified US$17.9 billion 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, additional gains of US$1.5 billion would have been recorded in 2009 (2008: losses of US$3.5 billion). See Impact of Market Turmoil , pages 151 to 195.

2008 compared with 2007

Reported net trading income fell by 33 per cent to US$6.6 billion, 32 per cent lower on an underlying basis.

Net income from trading activities declined by 81 per cent, driven by the continuing effect of the market turmoil which led to US$5.4 billion of write-downs on legacy monoline credit exposures, credit trading and leveraged and acquisition finance loans. More information about the losses, the associated assets and residual exposure is provided in Impact of Market Turmoil on pages 151 to 195.

Record foreign exchange trading income was due to increased customer volumes and market volatility across all regions, as investors sought to reduce risk in the second half of 2008, driving growth in global foreign exchange trading as demand for assets denominated in US dollars and Japanese Yen increased.

Rates trading income rose substantially, with record revenues in the first half of 2008 due to favourable positioning against movements in interest rate yield curves as central banks responded to the market turmoil by lowering short-term interest rates. Revenues were also boosted by an increased number of deals, widening spreads and increased customer demand for trading and hedging products.

The decline in equities trading income reflected weaker equity markets, particularly in Hong Kong, where demand for structured equity products fell. In addition, following the alleged fraud at Madoff Securities, HSBC wrote off the value of units it held in funds that had invested with the company and took a US$984 million charge. The units had been acquired in connection with various financing transactions HSBC had entered into with institutional clients.

The decline in non-qualifying hedges related to mark-to-market losses on cross-currency swaps as the US dollar appreciated and on interest rate swaps as interest rates fell in late 2008.

Widening credit spreads led to further gains on credit default swap transactions in parts of the Global Banking portfolio.

Net income from financial instruments designated at fair value

	2009	2008	2007
	US$m	US$m	US$m
Net income/(expense) arising from:			
financial assets held to meet liabilities under insurance and investment contracts	**3,793**	(5,064)	2,056
liabilities to customers under investment contracts	**(1,329)**	1,751	(940)
HSBC s long-term debt issued and related derivatives	**(6,247)**	6,679	2,812
Change in own credit spread on long-term debt	**(6,533)**	6,570	3,055
Other changes in fair value[25]	**286**	109	(243)
other instruments designated at fair value and related derivatives	**252**	486	155
Net income/(expense) from financial instruments designated at fair value	**(3,531)**	3,852	4,083
Financial assets designated at fair value at 31 December	**37,181**	28,533	41,564
Financial liabilities designated at fair value at 31 December	**80,092**	74,587	89,939

For footnote, see page 149.

HSBC designates 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 HSBC s issued debt securities and related derivatives managed in conjunction with those debt securities, which is recognised in Interest expense .

HSBC principally uses 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$63 billion (2008: US$59 billion) of the Group s 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 losses are ignored in the calculation of regulatory capital;

for US$15 billion (2008: US$11 billion) of financial assets held to meet liabilities under insurance contracts, and certain liabilities under investment contracts with discretionary participation features; and

for US$8 billion (2008: US$7 billion) of financial assets held to meet liabilities under unit-linked and other investment contracts, as well as the associated liabilities.

2009 compared with 2008

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

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

On an underlying basis, HSBC reported income of US$3.0 billion in 2009 compared with an expense of US$2.6 billion in 2008. The large difference between the reported and underlying results is due to the exclusion of the effect of credit spread-related

Table of Contents

movements in the fair value of HSBC s own long-term debt from underlying performance.

Income of US$3.8 billion was recorded due to a fair value movement on assets held to back insurance and investment contracts, compared with an expense of US$4.8 billion 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$1.3 billion in 2009 compared with an income of US$1.5 billion 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.

2008 compared with 2007

Reported net income from financial instruments designated at fair value decreased by US$231 million to US$3.9 billion in 2008.

On an underlying basis, in particular excluding a large income from movements in the fair value of the Group s own long-term debt, a net expense of US$2.7 billion was recorded, compared with income of US$1.1 billion in 2007.

A negative movement of US$5.1 billion was recorded in the fair value of assets held to back insurance and investment contracts, compared with a positive reported movement of US$2.1 billion in 2007. This reflected investment losses driven by falling equity and bond markets, predominantly affecting the value of assets held in unit-linked and participating funds in Hong Kong, France and the UK. The negative movement in fair value is partially offset by a corresponding reduction in Net insurance claims and movement in liabilities to policyholders , where unit-linked policyholders in particular participate in the investment performance experienced on the investment portfolios held to support the liabilities.

For assets held to meet liabilities under investment contracts the corresponding reduction in the liability to customers is also reported within net income from financial instruments designated at fair value. A reduction of US$1.8 billion in the fair value of liabilities held under investment contracts compared with a reported increase in the fair value of liabilities of US$940 million in 2007.

Gains less losses from financial investments

	2009	2008	2007
	US$m	US$m	US$m
Net gain from disposal of:			
debt securities	**463**	19	120
equity securities	**407**	1,216	1,864
other financial investments	**8**	4	14
	878	1,239	1,998
Impairment of available-for-sale equity securities	**(358)**	(1,042)	(42)
Gains less losses from financial investments	**520**	197	1,956

2009 compared with 2008

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

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

Table of Contents

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

Financial summary > Group performance > Gains less losses from financial investments / Net earned insurance premiums / OOI

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.

2008 compared with 2007

Reported gains less losses of US$197 million from financial investments during 2008 were 90 per cent lower than in 2007, 93 per cent lower on an underlying basis. A reduction in net gains from disposals was compounded by significant impairments recognised on equity securities held in the available-for-sale portfolio as certain investments were marked down to reflect the prevailing market conditions.

The redemption of Visa shares following its initial public offering (IPO) resulted in significant gains, and there were further gains from the sale of MasterCard shares. These were more than offset by losses in Principal Investments and the non-recurrence of various significant gains in 2007, mostly in respect of Euronext, the European stock exchange, and a credit bureau in Brazil.

Declining equity markets caused impairments to be recognised against a number of strategic investments in Asia, held in the available-for-sale portfolio and on private equity investments, mainly in Europe. The market turmoil in the US also led to impairments against investments in various US financial institutions.

Net earned insurance premiums

	2009	2008	2007
	US$m	US$m	US$m
Gross insurance premium income	**10,991**	12,547	11,001
Reinsurance premiums	**(520)**	(1,697)	(1,925)
Net earned insurance premiums	**10,471**	10,850	9,076

2009 compared with 2008

Reported net earned insurance premiums amounted to US$10.5 billion, a decrease of 3 per cent compared with 2008. On an underlying basis, net earned insurance premiums increased by 3 per cent. 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, HSBC retained its position as the leading bancassurer and net earned insurance premiums increased 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 HSBC.

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$1.1 billion 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.

2008 compared with 2007

Reported net earned insurance premiums amounted to US$10.9 billion, 20 per cent higher than in 2007. HSBC acquired the remaining interest in HSBC Assurances in France in March 2007 and, in October 2007, sold the Hamilton Insurance Company Limited and Hamilton Life Assurance Company Limited in the UK. On an underlying basis, net earned insurance premiums increased by 14 per cent.

Growth in net earned insurance premiums was driven by a continued strong performance from the UK life assurance business, mainly as a result of higher sales of the Guaranteed Income Bond, a non-linked product that was launched in June 2007. The introduction of enhanced life assurance benefits to certain pension products, which led to these products being reclassified as insurance contracts, also resulted in higher premiums.

The Hong Kong insurance business also performed well with respect to premium growth, due to stronger sales of products with DPF and an increase in regular premiums partly offset by a reduction in unit-linked premiums.

In France, HSBC Assurances performed well in a declining market, as three promotional campaigns during the year contributed to growth in sales of policies with DPF. However, a significant one-off reinsurance transaction undertaken during 2008 caused net earned insurance premiums to decrease compared with 2007.

Other operating income

	2009	2008	2007
	US$m	US$m	US$m
Rent received	**547**	606	630
Gains/(losses) recognised on assets held for sale	**(115)**	(130)	5
Valuation gains/(losses) on investment properties	**(24)**	(92)	152
Gain on disposal of property, plant and equipment, intangible assets and non-financial investments	**1,033**	881	213
Change in present value of in-force long-term insurance business	**605**	286	(145)
Other	**742**	257	584
Other operating income	**2,788**	1,808	1,439

2009 compared with 2008

Reported other operating income of US$2.8 billion was 54 per cent higher than in 2008. This included a US$280 million gain related to the sale of the remaining stake in the card merchant-acquiring business in the UK, compared with a US$425 million gain in 2008 from the sale of the first tranche. In 2008 results also included gains of US$71 million related to the sale of HSBC s stake in Financiera Independencia. On an underlying basis, other operating income rose by 163 per cent, 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$1.5 billion 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$576 million were recognised in respect of the sale and leaseback of 8 Canada Square, London which was effected through the disposal of HSBC s entire shareholding in Project Maple II B.V. (PMII) to the

National Pension Service of Korea. In 2008, HSBC reported a gain of US$416 million in respect of the purchase of PMII. See Note 23 on the Financial Statements.

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 HSBC s introduction of enhanced benefits to existing pension products in the UK, resulted in favourable movements in PVIF.

In Hong Kong, a gain of US$110 million 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

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

Financial summary > Group performance > Net insurance claims / Loan impairment charges

the US, gains from the extinguishment of certain debt issued by HSBC s mortgage securitisation vehicles in the UK and lower costs associated with the provision of support to certain money market funds.

2008 compared with 2007

Reported other operating income of US$1.8 billion was 26 per cent higher than in 2007. This included gains of US$425 million on the sale of the card merchant acquiring business in the UK and US$71 million on the sale of HSBC s entire stake in Financiera Independencia, a Mexican consumer lending company. On an underlying basis, other operating income fell by 23 per cent.

The difficult property market conditions in the UK led to a loss in value of a property fund, lower income from the sale of property fund assets and a reduction in Group real estate disposals in 2008.
Similarly, in Hong Kong revaluation gains on investment properties did not recur.

Life assurance enhancements to pension products resulted in increased present value of inforce long-term insurance (PVIF) business, which also benefited from the non-recurrence of regulatory changes in 2007 in the UK.

During 2008, HSBC recognised a gain of US$416 million in respect of the purchase of the subsidiary of Metrovacesa which owned the property and long leasehold comprising 8 Canada Square, London.

Other operating income declined, driven by losses on sale of the Canadian vehicle finance business and other loan portfolios in 2008, in addition to the non-recurrence of gains on disposal of fixed assets and private equity investments in 2007.

Net insurance claims incurred and movement in liabilities to policyholders

	2009	2008	2007
	US$m	US$m	US$m
Insurance claims incurred and movement in liabilities to policyholders:			
gross	**12,560**	9,206	9,550
reinsurers share	**(110)**	(2,317)	(942)
net[26]	**12,450**	6,889	8,608

For footnote, see page 149.

2009 compared with 2008

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

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$310 million were made to strengthen reserves in the UK motor book and the Irish reinsurance business during 2009. The UK motor insurance business was placed into run-off in September 2009.

2008 compared with 2007

Reported net insurance claims incurred and movement in liabilities to policyholders decreased by 20 per cent to US$6.9 billion. HSBC acquired the remaining interest in HSBC Assurances in France in March 2007 and, in October 2007, sold Hamilton Insurance Company Limited and Hamilton Life Assurance Company Limited in the UK. On an underlying basis, net insurance claims incurred and movement in liabilities to policyholders fell by 22 per cent.

The reduction in net insurance claims incurred and movement in liabilities to policyholders primarily reflected the impact of markedly weaker investment markets worldwide. This led to a reduction in liabilities to policyholders on unit-linked and, to a certain extent, participating policies.

The decline arising from market value movements was partially offset by an increase in claims incurred and movement in liabilities to policyholders driven by new business growth, most significantly in France, the UK and Hong Kong. In addition, 2007 was affected by the implementation of an FSA regulatory change, which led to lower gross liability valuations in that year, along with a reduction in the corresponding reinsurers share.

A significant increase in the reinsurers share of claims incurred and movement in liabilities to policyholders was primarily driven by the above regulatory change plus an increase in a reserve provision on a unit-linked product in Hong Kong, which was fully reinsured. In addition, a significant one-off reinsurance transaction was undertaken in France during 2008.

Loan impairment charges and other credit risk provisions

	2009 US$m	2008 US$m	2007 US$m
Loan impairment charges			
New allowances net of allowance releases	**25,832**	24,965	18,182
Recoveries of amounts previously written off	**(890)**	(834)	(1,005)
	24,942	24,131	17,177
Individually assessed allowances	**4,458**	2,064	796
Collectively assessed allowances	**20,484**	22,067	16,381
Impairment of available-for-sale debt securities	**1,474**	737	44
Other credit risk provisions	**72**	69	21
Loan impairment charges and other credit risk provisions	**26,488**	24,937	17,242
	%	%	%
As a percentage of net operating income excluding the effect of fair value movements in respect of credit spread on own debt and before loan impairment charges and other credit risk provisions	**36.4**	33.2	22.7
Impairment charges on loans and advances to customers as a percentage of gross average loans and advances to customers	**2.8**	2.5	2.0
	US$m	US$m	US$m
Customer impaired loans	**30,606**	25,352	19,582
Customer loan impairment allowances	**25,542**	23,909	19,205

2009 compared with 2008

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

HSBC s aggregate outstanding customer loan impairment allowances at 31 December 2009 of US$25.5 billion represented 3 per cent of gross customer advances (net of reverse repos and settlement accounts), compared with 2.6 per cent at the end of 2008.

Loan impairment charges declined in certain businesses, notably Personal Financial Services in North America and Commercial Banking in Hong Kong, but this was more than offset by increases elsewhere, primarily on individually significant loans within Global Banking and Markets and more broadly on Commercial Banking 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 per cent decline in gross loans and advances to customers which was driven mainly by the run-off of the US consumer finance portfolios.

In the US Personal Financial Services business, loan impairment charges declined by 11 per cent to US$14.2 billion, 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 per cent. 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 Global Banking and Markets. 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 HSBC judged to be significantly in excess of the likely ultimate cash losses.

Loan impairment charges declined in Personal Financial Services in the US but rose in Commercial Banking outside Hong Kong and in Global Banking and Markets.

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

In UK Personal Financial Services, 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 HSBC continued to benefit from very limited exposure to buy-to-let and self-certified mortgages. HSBC s 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 per cent in 2009, compared with 59 per cent in 2008.

In the Middle East, loan impairment charges increased markedly from US$280 million to US$1.3 billion as the region experienced a significant economic contraction in activity,
predominantly in real estate and construction, which particularly affected the UAE. Commercial Banking 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 Personal Financial Services, particularly in the credit card and personal lending portfolios.

In Latin America, portfolios were affected by the weaker economic environment for much of the year. In Personal Financial Services, loan impairment charges rose by 12 per cent to US$2.0 billion, with increased delinquencies in credit cards, mortgages, vehicle finance and payroll loans due to higher unemployment. In the Brazilian Commercial Banking 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 Personal Financial Services. In Commercial Banking, 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 per cent to US$500 million as the economic environment improved in 2009, credit conditions recovered and international trade volumes improved.

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

2008 compared with 2007

Reported loan impairment charges and other credit risk provisions were US$24.9 billion in 2008, an increase of 45 per cent over 2007, 46 per cent on an underlying basis.

A deterioration in credit quality was experienced across all customer groups and geographical regions as the global economy slowed. The rise in Group loan impairment charges and other credit risk provisions also reflected an underlying

8 per cent increase in lending to customers (excluding the financial sector and settlement accounts).

Loan impairment charges rose significantly in the US by 38 per cent to US$16.3 billion, due to credit quality deterioration across all US portfolios in Personal Financial Services.

In the US consumer lending portfolio, loan impairment charges rose as delinquency rates deteriorated sharply and the economy declined markedly in the second half of 2008, most notably in the first lien portfolio. This was particularly apparent in the geographical regions most affected by house price depreciation and rising unemployment rates. In mortgage services, loan impairment charges rose as 2005 and 2006 vintages matured and moved into the later stages of delinquency. This was partly offset by the benefit of lower balances as run-off continued, albeit at a slowing pace as house price depreciation restricted refinancing options for customers. In HSBC USA, loan impairment charges rose as credit quality worsened across the real estate secured portfolio and private label cards. Delinquencies rose in the prime first lien residential mortgage portfolio, Home Equity Line of Credit and Home Equity Loan second lien portfolios. The higher delinquency rate for prime first lien mortgages was in part due to lower balances following US$7.0 billion of portfolio sales during the year.

Loan impairment charges in the US card and retail services portfolios rose, again driven by increasing unemployment, portfolio seasoning, higher levels of personal bankruptcy filings and continued weakness in the US economy which was most apparent in regions with the most significant declines in house prices and rising unemployment.

Loan impairment charges in Commercial Banking in North America more than doubled from a low base in 2007, due to deterioration across the commercial real estate, middle market and corporate banking portfolios in the US and, to a lesser extent, higher loan impairment charges against firms in the manufacturing, export and commercial real estate sectors in Canada.

In the UK, a modest decline in loan impairment charges in Personal Financial Services reflected the non-recurrence of a methodology change at HFC in 2007 which resulted in higher impairment charges. Credit quality in the Personal Financial Services portfolio remained broadly stable, reflecting early risk mitigation through the tightening of lending controls and the sale of non-core credit card portfolios during the year. Credit quality in the unsecured portfolios deteriorated slightly in 2008, particularly in the second half of the year, due to the weakening UK economy. Loan impairment charges in the commercial portfolio rose in 2008 as the weakening property market led to higher impairment charges against construction companies and businesses dependent upon the real estate sector, particularly in the final quarter of the year. Impairment charges against banks rose due to some exposure to the Icelandic banks in 2008. In addition, rising levels of personal indebtedness resulted in lower releases and recoveries of charges than in 2007.

Higher loan impairment and other credit risk provisions within Global Banking and Markets in Europe reflected increased charges against certain corporate accounts and impairment recorded on available-for-sale debt securities.

In Mexico, loan impairment charges rose by US$513 million or 69 per cent, primarily in the credit card portfolio. This was due to a combination of higher lending volumes from organic expansion and higher delinquency rates which were driven by a deterioration in credit quality as the portfolio continued to season and move into the later stages of delinquency. Management took action to enhance collection activity and improve the quality of new business. Impairment charges in the commercial portfolio also rose due to credit quality deterioration among small and medium-sized enterprises as the economy weakened.

In Hong Kong, the rise in loan impairment charges was driven by weakness in parts of the export sector within the commercial portfolio in the second half of 2008. In Global Banking and Markets, credit impairment charges within Balance Sheet Management principally reflected losses on debt securities and paper issued by financial institutions previously rated at investment grade which failed in the year.

In Rest of Asia-Pacific, the growth in loan impairment charges reflected a combination of the expansion of consumer lending and credit quality deterioration in India and the Middle East. In addition, higher impairment charges in Commercial Banking were driven by a deterioration in credit quality in the second half of the year.

For the Group as a whole, the aggregate outstanding customer loan impairment allowances at 31 December 2008 of US$23.9 billion represented 2.6 per cent of gross customer advances (net of reverse repos and settlement accounts), compared with 2 per cent at 31 December 2007.

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

Financial summary > Group performance > Operating expenses
Operating expenses

	2009	2008	2007
	US$m	US$m	US$m
By expense category			
Employee compensation and benefits	**18,468**	20,792	21,334
Premises and equipment (excluding depreciation and impairment)	**4,099**	4,305	3,966
General and administrative expenses	**9,293**	10,955	11,328
Administrative expenses	**31,860**	36,052	36,628
Depreciation and impairment of property, plant and equipment	**1,725**	1,750	1,714
Amortisation and impairment of intangible assets	**810**	733	700
Goodwill impairment		10,564	
Total operating expenses	**34,395**	49,099	39,042

	At 31 December		
	2009	2008	2007
Staff numbers (full-time equivalent)			
Europe	**76,703**	82,093	82,166
Hong Kong	**27,614**	29,330	27,655
Rest of Asia-Pacific[27]	**87,141**	89,706	80,523
Middle East[27]	**8,281**	8,453	8,050
North America	**35,458**	44,725	52,722
Latin America	**54,288**	58,559	64,404
Total staff numbers	**289,485**	312,866	315,520

For footnote, see page 149.

2009 compared with 2008

Reported operating expenses fell by US$14.7 billion to US$34.4 billion, with the most significant feature being the non-recurrence of the goodwill impairment charge of US$10.6 billion in 2008 to fully write off goodwill in Personal Financial Services in North America. Excluding this and on an underlying basis, operating expenses fell by 4 per cent. Underlying operating expenses excluding goodwill impairment fell by 4 per cent.

Employee compensation and benefits fell by 4 per cent 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$499 million which was partly offset by increased regular pension costs. There were higher performance-related costs in Global Banking and Markets 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$355 million in the UK and US$45 million in France. The taxes will be payable and accounted for in 2010 once the legislation is enacted. For further details, see page 326.

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 HSBC 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 the 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.

Table of Contents

2008 compared with 2007

Reported operating expenses increased by US$10.1 billion to US$49.1 billion, due to an impairment charge of US$10.6 billion to fully write off goodwill in Personal Financial Services in North America. Excluding this, operating expenses remained broadly in line on both reported and underlying bases.

Employee compensation and benefits fell marginally. Lower discretionary bonuses reflected weaker performance in the current economic conditions. A review of actuarial assumptions on employees defined benefit pensions resulted in lower service costs in the UK. The restructuring of the consumer finance business in North America led to reduced headcount and lower costs. This was partially offset by higher salaries and increased headcount to support business expansion, mainly in Asia. Restructuring costs were incurred primarily in Latin America and Europe.

Premises and equipment costs increased primarily in the UK and the Rest of Asia-Pacific region, driven by investment in technology and extensions and improvements to the branch and ATM networks. As a consequence, repairs and maintenance costs rose. Commercial property rental costs also increased as a result of higher prices, new rentals and sale and leaseback deals.

General and administrative expenses decreased, primarily due to a one-off recovery of US$110 million of previous years transactional taxes in Brazil and the non-recurrence of a number of one-off items in 2007, most notably (i) ex-gratia payments made in the UK in respect of overdraft fees, (ii) the provision for reimbursement of certain charges on historic will trusts and other related services in the UK, (iii) the indemnification agreement with Visa ahead of Visa s IPO, and (iv) restructuring charges in the US consumer finance business incurred in 2007. These were partly offset by an increase in the Financial Services compensation scheme levy in the UK and an increase in a litigation provision in Asia.

Goodwill impairment amounting to US$10.6 billion was booked following the continued deterioration in economic and credit conditions in North America. For further information see Note 22 on the Financial Statements.

Cost efficiency ratios

	2009	2008	2007
	%	%	%
HSBC	**52.0**	60.1	49.4
Personal Financial Services	**51.7**	76.4	50.3
Europe	**68.7**	62.7	64.8
Hong Kong	**34.9**	32.2	27.2
Rest of Asia-Pacific[27]	**81.2**	81.5	77.9
Middle East[27]	**53.5**	53.2	61.1
North America	**38.1**	106.8	42.3
Latin America	**66.7**	59.7	61.3
Commercial Banking	**46.4**	43.0	44.8
Europe	**47.4**	44.2	49.3
Hong Kong	**33.7**	26.2	24.9
Rest of Asia-Pacific[27]	**47.0**	45.9	47.5
Middle East[27]	**33.8**	32.0	34.5
North America	**47.7**	46.1	45.1
Latin America	**57.0**	55.0	54.3

For footnote, see page 149.

Table of Contents

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

Financial summary > Group performance > Share of profit in associates and joint ventures / Economic profit
Share of profit in associates and joint ventures

	2009	2008	2007
	US$m	US$m	US$m
Associates			
Bank of Communications Co., Limited	**754**	741	445
Ping An Insurance (Group) Company of China, Limited	**551**	324	518
Industrial Bank Co., Limited	**216**	221	128
The Saudi British Bank	**172**	251	216
Other	**42**	63	159
Share of profit in associates	**1,735**	1,600	1,466
Share of profit in joint ventures	**46**	61	37
Share of profit in associates and joint ventures	**1,781**	1,661	1,503

2009 compared with 2008

The share of profit in associates and joint ventures was US$1.8 billion, an increase of 7 per cent on 2008, and 6 per cent on an underlying basis.

HSBC s share of profits from Ping An Insurance (Group) Company of China, Limited (Ping An Insurance) increased by 62 per cent as a result of the non-recurrence of Ping An Insurance s 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 per cent underlying increase in share of profit in associates and joint ventures.

HSBC s share of profits from the Bank of Communications Co., Limited (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.

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.

2008 compared with 2007

Share of profit in associates and joint ventures was US$1.7 billion, an increase of 11 per cent compared with 2007, and 4 per cent on an underlying basis.

This increase was driven by higher contributions from Bank of Communications, Industrial Bank, and The Saudi British Bank, partly offset by lower profits from Ping An Insurance.

HSBC s share of profits from Bank of Communications rose by 52 per cent to US$741 million, primarily driven by increased margins, as yields rose following higher base rates in mainland China through most of 2008, and balance sheet growth. Growth in revenues from the asset custody business, financial advisory services and bank card transactions also drove higher profits.

HSBC s share of profits from Ping An Insurance decreased by 43 per cent, primarily due to the impairment of its investment in Fortis, following significant declines in its market value.

Profits from The Saudi British Bank were higher by 16 per cent due to strong balance sheet growth, particularly in the lending portfolio, augmented by higher fees from cards, account services and trade.

Profits from Industrial Bank grew by 72 per cent, driven by increased investment income and balance sheet growth.

The share of profits from joint ventures rose due to growth in HSBC Saudi Arabia Ltd and the recognition of profits in HSBC Merchant Services UK Ltd, the new merchant acquiring venture with Global Payments Inc.

An adjustment to the embedded value of HSBC Assurances in 2007 did not recur.

Table of Contents

Gains arising from dilution of interests in associates

In 2007, HSBC s associates, Industrial Bank, Ping An Insurance and Bank of Communications in mainland China, Financiera Independencia in Mexico and Techcombank in Vietnam issued new shares for which HSBC did not subscribe. As a consequence of the new monies raised by the associates, HSBC s share of their underlying assets increased by US$1.1 billion, notwithstanding the reduction in the Group s interests. These gains were presented in the income statement as Gains arising from dilution of interests in associates , and should be regarded as exceptional.

Economic profit

HSBC s internal performance measures include economic profit, a calculation which compares the return on financial capital invested in HSBC by its shareholders with the cost of that capital. HSBC prices its 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 generated. Economic profit generated is used by management as one input in deciding where to allocate capital and other resources.

In seeking to drive long-term sustainable risk-based performance, HSBC emphasises the trend in economic profit ahead of absolute amounts within business units. The Group s long-term cost of equity is reviewed annually and for 2009 remained at 10 per cent. The following commentary on economic profit is on a reported basis.

The economic loss decreased by US$0.2 billion. Profit attributable to shareholders reflected a significant negative fair value movement in own debt of US$6.5 billion as credit spreads tightened, compared with an equivalent gain of US$6.6 billion in 2008, and the non-recurrence of a goodwill impairment charge of US$10.6 billion in 2008.

Average invested capital decreased by 1 per cent. The additional equity raised through the rights issue was offset by the effect of the goodwill impairment charge at the end of 2008 and losses on structural foreign exchange exposures, the result of a stronger US dollar.

Economic spread increased by 0.1 percentage points, the result of an increase in return on invested capital of 2 per cent and a decrease in the cost of capital in dollar terms of 1 per cent compared with 2008.

	2009 US$m	**%[28]**	2008 US$m	%[28]
Average total shareholders equity	**115,431**		122,292	
Adjusted by:				
Goodwill previously amortised or written off	**8,123**		8,152	
Property revaluation reserves	**(799)**		(828)	
Reserves representing unrealised losses on effective cash flow hedges	**385**		997	
Reserves representing unrealised losses on available-for-sale securities	**16,189**		9,163	
Preference shares and other equity instruments	**(3,538)**		(2,685)	
Average invested capital[29]	**135,791**		137,091	
Return on invested capital[30]	**5,565**	**4.1**	5,497	4.0
Benchmark cost of capital	**(13,579)**	**(10.0)**	(13,709)	(10.0)
Economic loss and spread	**(8,014)**	**(5.9)**	(8,212)	(6.0)

For footnotes, see page 149.

Table of Contents

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

Financial summary > Balance sheet > Movement in 2009
Consolidated balance sheet
Consolidated balance sheet as at 31 December 2009

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
ASSETS			
Cash and balances at central banks	**60,655**	52,396	21,765
Trading assets	**421,381**	427,329	445,968
Financial assets designated at fair value	**37,181**	28,533	41,564
Derivatives	**250,886**	494,876	187,854
Loans and advances to banks	**179,781**	153,766	237,366
Loans and advances to customers	**896,231**	932,868	981,548
Financial investments	**369,158**	300,235	283,000
Other assets	**149,179**	137,462	155,201
Total assets	**2,364,452**	2,527,465	2,354,266
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	**124,872**	130,084	132,181
Customer accounts	**1,159,034**	1,115,327	1,096,140
Trading liabilities	**268,130**	247,652	314,580
Financial liabilities designated at fair value	**80,092**	74,587	89,939
Derivatives	**247,646**	487,060	183,393
Debt securities in issue	**146,896**	179,693	246,579
Liabilities under insurance contracts	**53,707**	43,683	42,606
Other liabilities	**148,414**	149,150	113,432
Total liabilities	**2,228,791**	2,427,236	2,218,850
Equity			
Total shareholders equity	**128,299**	93,591	128,160
Minority interests	**7,362**	6,638	7,256
Total equity	**135,661**	100,229	135,416

Total equity and liabilities	**2,364,452**	2,527,465	2,354,266

A more detailed consolidated balance sheet is contained in the Financial Statements on page 355.

Movement from 31 December 2008 to 31 December 2009

Total assets amounted to US$2.4 trillion, 6 per cent lower than at 31 December 2008. After excluding the effect of currency movements, underlying total assets declined by 11 per cent, driven by a reduction in the fair value of derivative assets as market conditions stabilised.

The Group s reported tier 1 ratio increased from 8.3 per cent to 10.8 per cent, mainly due to additional equity of US$17.8 billion raised through the rights issue in April 2009, the contribution from profits for the year and a reduction in the underlying level of risk-weighted assets. For more details of capital and risk weighted assets, see pages 285 to 291. The following commentary is on an underlying basis.

Assets

Cash and balances at central banks increased by 12 per cent, consistent with the global liquidity creation by central banks, particularly in Europe and North America.

Trading assets fell by 6 per cent, primarily due to a decrease in the level of reverse repos, particularly in Europe and North America, and a reduction in holdings of short-dated government securities in Hong Kong. There was also a reduction in the collateral required by counterparties to support derivative liabilities as these balances declined. Equity shares held-for-trading grew as activity recovered against a low in the fourth quarter of 2008.

A reduction in the fair values of derivative assets drove an 11 per cent decline in underlying total assets.

Financial assets designated at fair value grew by 19 per cent due to an increase in UK government debt securities in Balance Sheet Management, and an increase in the fair value of equity securities held within the insurance business, particularly in Europe and Hong Kong, as market values recovered.

Table of Contents

Derivative assets declined by 52 per cent with reductions across all classes of asset, notably foreign exchange, interest rate and credit derivatives. Lower volatility within the financial markets, steepening yield curves in major currencies and narrowing credit spreads led to a fall in the fair value of outstanding derivative contracts.

Loans and advances to banks increased by 12 per cent, mainly in Hong Kong and Rest of Asia-Pacific, where surplus funds were placed on a short-term basis with financial institutions and central banks as part of Balance Sheet Management activities.

Loans and advances to customers fell by 9 per cent, driven by a reduction in balances in North America due to the run-off of the consumer finance businesses, the sale of selected portfolios, and a reduction in Treasury reverse repo balances and cash collateral as excess liquidity was placed in other investments. These factors were compounded by declines in balances in other regions, particularly in the first half of the year, due to customer deleveraging and lower credit origination in certain segments as risk appetite reduced and customer demand declined. In the UK, there was also a reduction in customer overdraft balances that are managed on a net basis but reported gross under IFRSs. Mortgage balances increased strongly in the UK and Hong Kong as HSBC targeted growth in these markets, although this was largely offset by the run-off of balances in the US, as noted above.

Financial investments rose by 17 per cent, mainly in Hong Kong driven by purchases of Hong Kong government and other highly-rated securities in the year. This increase was partly offset by a fall in financial investments in Europe, as a result of debt securities that matured and were not replaced.

Other assets grew by 7 per cent compared with 31 December 2008.

Liabilities

Deposits by banks decreased by 10 per cent, largely reflecting a decline in central bank and other interbank deposits in Hong Kong, Rest of Asia-Pacific and North America.

Customer account balances decreased by 2 per cent, despite growth in the Personal Financial Services and Commercial Banking segments. This
was mainly due to an outflow of deposits in Europe as the economic situation improved and investor risk appetite increased. There was also a fall in deposits from customers whose accounts are managed net but reported gross under IFRSs, (see Loans and advances to customers). These factors were partly offset by an increase in deposits in Hong Kong due to an excess of liquidity in the market.

Trading liabilities were 3 per cent higher, driven by increases in hedged net short positions on equity securities in line with a rise in market activity, and in government debt securities as a result of more active market making activities and an expectation of interest rate rises on certain trading desks. Offsetting this was a reduction in repo contracts, and a decrease in structured deposit accounts in Hong Kong as existing deals matured and customers expressed a preference for vanilla cash instruments in the uncertain economic environment.

Financial liabilities designated at fair value grew by 4 per cent due to new HSBC debt issuances in Europe during the year.

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

Debt securities in issue fell by 22 per cent, primarily in North America as the funding requirements reduced in line with the run-off of the consumer finance business.

Liabilities under insurance contracts grew by 18 per cent due to gains recorded on unit-linked products as a result of an improvement in investment market values, and higher insurance sales in Hong Kong following the launch of several new products.

Other liabilities were 4 per cent lower than at 31 December 2008.

Equity

Total shareholders equity increased by 31 per cent, mainly due to the US$17.8 billion of funds raised through the rights issue in April 2009. In addition, the negative balance on the available-for-sale reserve also declined from US$20.6 billion at 31 December 2008 to US$10.0 billion at 31 December 2009, largely reflecting increases in the market value of assets.

43

Table of Contents

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

Financial summary > Balance sheet > Reconciliation of assets and liabilities / Loans and advances and customer accounts
Reconciliation of reported and underlying assets and liabilities

HSBC	31 Dec 08 as reported US$m	Currency translation[31] US$m	31 Dec 08 at 31 Dec 09 exchange rates US$m	Underlying change US$m	31 Dec 09 as reported US$m	Reported change %	Underlying change %
	31 December 2009 compared with 31 December 2008						
Cash and balances at central banks	**52,396**	**1,550**	**53,946**	**6,709**	**60,655**	**16**	**12**
Trading assets	**427,329**	**21,612**	**448,941**	**(27,560)**	**421,381**	**(1)**	**(6)**
Financial assets designated at fair value	**28,533**	**2,636**	**31,169**	**6,012**	**37,181**	**30**	**19**
Derivative assets	**494,876**	**32,379**	**527,255**	**(276,369)**	**250,886**	**(49)**	**(52)**
Loans and advances to banks	**153,766**	**7,406**	**161,172**	**18,609**	**179,781**	**17**	**12**
Loans and advances to customers	**932,868**	**57,163**	**990,031**	**(93,800)**	**896,231**	**(4)**	**(9)**
Financial investments	**300,235**	**14,748**	**314,983**	**54,175**	**369,158**	**23**	**17**
Other assets	**137,462**	**1,807**	**139,269**	**9,910**	**149,179**	**9**	**7**
Total assets	**2,527,465**	**139,301**	**2,666,766**	**(302,314)**	**2,364,452**	**(6)**	**(11)**
Deposits by banks	**130,084**	**8,426**	**138,510**	**(13,638)**	**124,872**	**(4)**	**(10)**
Customer accounts	**1,115,327**	**64,478**	**1,179,805**	**(20,771)**	**1,159,034**	**4**	**(2)**
Trading liabilities	**247,652**	**12,714**	**260,366**	**7,764**	**268,130**	**8**	**3**
Financial liabilities designated at fair value	**74,587**	**2,709**	**77,296**	**2,796**	**80,092**	**7**	**4**
Derivative liabilities	**487,060**	**31,722**	**518,782**	**(271,136)**	**247,646**	**(49)**	**(52)**
Debt securities in issue	**179,693**	**8,005**	**187,698**	**(40,802)**	**146,896**	**(18)**	**(22)**
Liabilities under insurance contracts	**43,683**	**1,763**	**45,446**	**8,261**	**53,707**	**23**	**18**
Other liabilities	**149,150**	**5,144**	**154,294**	**(5,880)**	**148,414**		**(4)**

Total liabilities	**2,427,236**	**134,961**	**2,562,197**	**(333,406)**	**2,228,791**	**(8)**	**(13)**
Total shareholders equity	**93,591**	**4,114**	**97,705**	**30,594**	**128,299**	**37**	**31**
Minority interests	**6,638**	**226**	**6,864**	**498**	**7,362**	**11**	**7**
Total equity	**100,229**	**4,340**	**104,569**	**31,092**	**135,661**	**35**	**30**
Total equity and liabilities	**2,527,465**	**139,301**	**2,666,766**	**(302,314)**	**2,364,452**	**(6)**	**(11)**

For footnote, see page 149.

In 2009, the effect of acquisitions was not material.

Table of Contents

Reconciliation of reported and underlying loans and advances to customers and customer accounts by geographical region

	31 December 2009 compared with 31 December 2008						
	31 Dec 08 as reported US$m	Currency translation31 US$m	31 Dec 08 at 31 Dec 09 exchange rates US$m	Underlying change US$m	31 Dec 09 as reported US$m	Reported change %	Under-lying change %
Loans and advances to customers (net)							
Europe	426,191	37,773	463,964	(24,483)	439,481	3	(5)
Hong Kong	100,220	(54)	100,166	(785)	99,381	(1)	(1)
Rest of Asia-Pacific	80,661	5,320	85,981	(5,938)	80,043	(1)	(7)
Middle East	27,295	(69)	27,226	(4,382)	22,844	(16)	(16)
North America	256,214	7,379	263,593	(56,740)	206,853	(19)	(22)
Latin America	42,287	6,814	49,101	(1,472)	47,629	13	(3)
	932,868	57,163	990,031	(93,800)	896,231	(4)	(9)
Customer accounts							
Europe	502,476	42,883	545,359	(50,340)	495,019	(1)	(9)
Hong Kong	250,517	(119)	250,398	25,043	275,441	10	10
Rest of Asia-Pacific	124,194	5,736	129,930	4,069	133,999	8	3
Middle East	35,165	(76)	35,089	(2,560)	32,529	(7)	(7)
North America	143,532	5,577	149,109	48	149,157	4	
Latin America	59,443	10,477	69,920	2,969	72,889	23	4
	1,115,327	64,478	1,179,805	(20,771)	1,159,034	4	(2)

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

	31 December 2009 compared with 31 December 2008						
	31 Dec 08 as reported US$m	Currency translation31 US$m	31 Dec 08 at 31 Dec 09 exchange rates US$m	Underlying change US$m	31 Dec 09 as reported US$m	Reported change %	Under-lying change %

Loans and advances to customers (net)							
Personal Financial Services	**401,402**	**21,119**	**422,521**	**(23,061)**	**399,460**		**(5)**
Commercial Banking	**203,949**	**14,614**	**218,563**	**(18,889)**	**199,674**	**(2)**	**(9)**
Global Banking and Markets	**287,306**	**19,989**	**307,295**	**(50,339)**	**256,956**	**(11)**	**(16)**
Private Banking	**37,590**	**1,416**	**39,006**	**(1,975)**	**37,031**	**(1)**	**(5)**
Other	**2,621**	**25**	**2,646**	**464**	**3,110**	**19**	**18**
	932,868	**57,163**	**990,031**	**(93,800)**	**896,231**	**(4)**	**(9)**
Customer accounts							
Personal Financial Services	**440,338**	**24,029**	**464,367**	**34,742**	**499,109**	**13**	**7**
Commercial Banking	**235,879**	**13,901**	**249,780**	**17,608**	**267,388**	**13**	**7**
Global Banking and Markets	**320,386**	**24,243**	**344,629**	**(59,902)**	**284,727**	**(11)**	**(17)**
Private Banking	**116,683**	**2,291**	**118,974**	**(12,441)**	**106,533**	**(9)**	**(10)**
Other	**2,041**	**14**	**2,055**	**(778)**	**1,277**	**(37)**	**(38)**
	1,115,327	**64,478**	**1,179,805**	**(20,771)**	**1,159,034**	**4**	**(2)**

For footnote, see page 149.

In 2009, the effect of acquisitions was not material.

Table of Contents

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

Financial summary > Balance sheet / Average balance sheet
Average balance sheet and net interest income
Average balances and related interest are shown for the domestic operations of HSBC s principal commercial banks by geographical region. Other operations comprise the operations of the 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 HSBC s banking activities with monthly or less frequent averages used elsewhere.

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.

Assets

		2009			2008			2007		
		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 %
Summary										
Total interest-earning assets (itemised below)		**1,384,705**	**62,096**	**4.48**	1,466,622	91,301	6.23	1,296,701	92,359	7.12
Trading assets[32]		**357,504**	**7,614**	**2.13**	428,539	16,742	3.91	374,973	17,562	4.68
Financial assets designated at fair value[33]		**62,143**	**1,032**	**1.66**	37,303	1,108	2.97	14,899	813	5.46
Impairment provisions		**(26,308)**			(20,360)			(15,309)		
Non-interest-earning assets		**667,942**			596,885			440,686		
Total assets and interest income		**2,445,986**	**70,742**	**2.89**	2,508,989	109,151	4.35	2,111,950	110,734	5.24
Short-term funds and loans and advances to banks										
Europe	HSBC Bank	**38,455**	**1,379**	**3.59**	46,703	2,187	4.68	49,910	2,592	5.19
	HSBC Private Banking Holdings (Suisse)	**4,451**	**43**	**0.97**	8,040	333	4.14	5,295	229	4.32
		37,239	**440**	**1.18**	35,801	1,495	4.18	31,591	1,294	4.10

	HSBC France									
Hong Kong	Hang Seng Bank	**16,626**	**202**	**1.21**	17,402	587	3.37	13,054	609	4.67
	The Hongkong and Shanghai Banking Corporation	**27,903**	**182**	**0.65**	47,244	1,344	2.84	50,210	2,352	4.68
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**23,107**	**326**	**1.41**	27,907	881	3.16	19,286	810	4.20
	HSBC Bank Malaysia	**3,776**	**81**	**2.15**	4,659	165	3.54	2,861	103	3.60
Middle East[27]	HSBC Bank Middle East	**4,312**	**52**	**1.21**	6,028	188	3.12	6,328	324	5.12
North America	HSBC Bank USA	**2,338**	**94**	**4.02**	9,595	328	3.42	9,393	477	5.08
	HSBC Bank Canada	**2,934**	**10**	**0.34**	3,354	107	3.19	3,810	174	4.57
Latin America	HSBC Mexico	**3,722**	**149**	**4.00**	3,682	247	6.71	3,555	239	6.72
	Brazilian operations[34]	**10,490**	**1,003**	**9.56**	7,959	951	11.95	5,790	645	11.14
	HSBC Bank Panama	**1,187**	**10**	**0.84**	1,133	30	2.65	897	33	3.68
	HSBC Bank Argentina	**256**	**29**	**11.33**	612	43	7.03	304	16	5.26
Other operations		**15,782**	**199**	**1.26**	19,992	760	3.80	19,087	898	4.70
		192,578	**4,199**	**2.18**	240,111	9,646	4.02	221,371	10,795	4.88

For footnotes, see page 149.

Assets (continued)

		2009			2008			2007		
		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	**276,602**	**10,898**	**3.94**	288,214	18,587	6.45	237,231	18,078	7.62
	HSBC Private Banking Holdings (Suisse)	**9,993**	**176**	**1.76**	12,355	494	4.00	9,805	507	5.17
	HSBC France	**71,048**	**1,932**	**2.72**	73,455	3,604	4.91	68,027	3,219	4.73
	HSBC Finance	**3,094**	**319**	**10.31**	4,808	505	10.50	5,492	611	11.13
Hong Kong	Hang Seng Bank	**42,619**	**1,194**	**2.80**	42,304	1,589	3.76	37,827	2,120	5.60
	The Hongkong and Shanghai Banking Corporation	**55,287**	**1,757**	**3.18**	54,628	2,291	4.19	48,134	2,901	6.03
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**66,262**	**3,668**	**5.54**	77,741	5,163	6.64	59,286	4,321	7.29
	HSBC Bank Malaysia	**8,113**	**455**	**5.61**	8,407	553	6.58	7,467	507	6.79
Middle East[27]	HSBC Bank Middle East	**22,612**	**1,593**	**7.04**	23,697	1,549	6.54	15,125	1,200	7.93
North America	HSBC Bank USA	**98,422**	**5,541**	**5.63**	93,088	5,758	6.19	90,091	6,585	7.31
	HSBC Finance	**101,132**	**9,941**	**9.83**	140,957	15,835	11.23	153,658	18,086	11.77
	HSBC Bank Canada	**43,072**	**1,499**	**3.48**	48,331	2,455	5.08	43,570	2,598	5.96
Latin America	HSBC Mexico	**12,185**	**1,708**	**14.02**	17,252	2,565	14.87	16,469	2,187	13.28
	Brazilian operations[34]	**18,704**	**4,494**	**24.03**	19,642	4,879	24.84	13,569	3,895	28.71
	HSBC Bank Panama	**9,302**	**864**	**9.29**	8,620	810	9.40	8,113	778	9.59

	HSBC Bank Argentina	**1,940**	**357**	**18.40**	2,136	378	17.70	1,667	241	14.46
Other operations		**29,670**	**1,905**	**6.42**	28,027	1,707	6.09	21,318	1,790	8.40
		870,057	**48,301**	**5.55**	943,662	68,722	7.28	836,849	69,624	8.32
Financial investments										
Europe	HSBC Bank	**79,763**	**2,321**	**2.91**	83,725	3,840	4.59	45,885	2,431	5.30
	HSBC Private Banking Holdings (Suisse)	**15,602**	**363**	**2.33**	12,018	553	4.60	10,372	511	4.93
	HSBC France	**5,327**	**141**	**2.65**	14,862	795	5.35	10,357	511	4.93
Hong Kong	Hang Seng Bank	**24,594**	**630**	**2.56**	24,031	1,063	4.42	30,791	1,550	5.03
	The Hongkong and Shanghai Banking Corporation	**52,965**	**644**	**1.22**	15,361	563	3.67	20,717	1,017	4.91
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**34,056**	**1,039**	**3.05**	31,992	1,507	4.71	23,739	1,065	4.49
	HSBC Bank Malaysia	**1,218**	**37**	**3.04**	937	36	3.84	1,515	56	3.70
Middle East[27]	HSBC Bank Middle East	**6,996**	**118**	**1.69**	5,671	144	2.54	3,654	174	4.76
North America	HSBC Bank USA	**27,253**	**969**	**3.56**	25,089	1,232	4.91	23,373	1,189	5.09
	HSBC Finance	**2,426**	**120**	**4.95**	2,908	143	4.92	4,072	229	5.62
	HSBC Bank Canada	**10,282**	**205**	**1.99**	7,037	197	2.80	6,068	258	4.25
Latin America	HSBC Mexico	**3,916**	**227**	**5.80**	3,470	244	7.03	3,327	319	9.59
	Brazilian operations[34]	**6,930**	**820**	**11.83**	6,758	853	12.62	5,596	672	12.01
	HSBC Bank Panama	**604**	**39**	**6.46**	618	47	7.61	709	58	8.18
	HSBC Bank Argentina	**181**	**35**	**19.34**	287	47	16.38	563	68	12.08
Other operations		**50,767**	**1,717**	**3.38**	29,632	1,354	4.57	27,252	1,407	5.16
		322,880	**9,425**	**2.92**	264,396	12,618	4.77	217,990	11,515	5.28

For footnotes, see page 149.

Table of Contents

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

Financial summary > Balance sheet > Average balance sheet
Assets (continued)

		2009			2008			2007		
		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	**17,406**	**188**	**1.08**	25,885	630	2.43	11,170	652	5.84
	HSBC Private Banking Holdings (Suisse)	**21,450**	**360**	**1.68**	21,189	875	4.13	16,360	882	5.39
	HSBC France	**11,867**	**172**	**1.45**	23,414	630	2.69	12,158	419	3.45
Hong Kong	Hang Seng Bank	**2,618**	**32**	**1.22**	1,629	48	2.95	832	42	5.05
	The Hongkong and Shanghai Banking Corporation	**26,657**	**214**	**0.80**	33,571	949	2.83	27,057	1,237	4.57
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**19,917**	**106**	**0.53**	24,492	352	1.44	11,137	588	5.28
	HSBC Bank Malaysia	**407**	**6**	**1.47**	212	7	3.30	231	12	5.19
Middle East[27]	HSBC Bank Middle East	**541**	**46**	**8.50**	843	63	7.47	758	52	6.86
North America	HSBC Bank USA	**3,327**	**71**	**2.13**	3,091	188	6.08	3,731	231	6.19
	HSBC Finance	**2,995**	**6**	**0.20**	2,638	63	2.39	1,724	89	5.16
	HSBC Bank Canada	**773**	**9**	**1.16**	1,025	25	2.44	960	31	3.23
Latin America	HSBC Mexico	**138**			193	2	1.04			
		1,074	**46**	**4.28**	1,438	147	10.22	840	75	8.93

	Brazilian operations[34]									
	HSBC Bank Panama	**1,372**	**9**	**0.66**	1,807	23	1.27	1,351	40	2.96
	HSBC Bank Argentina	**51**			58	1	1.72	39	1	2.56
Other operations		**(111,403)**	**(1,094)**		(123,032)	(3,688)		(67,857)	(3,926)	
		(810)	**171**	**(21.11)**	18,453	315	1.71	20,491	425	2.07
Total interest-earning assets										
Europe	HSBC Bank	**412,226**	**14,786**	**3.59**	444,527	25,244	5.68	344,196	23,753	6.90
	HSBC Private Banking Holdings (Suisse)	**51,496**	**942**	**1.83**	53,602	2,255	4.21	41,832	2,129	5.09
	HSBC France	**125,481**	**2,685**	**2.14**	147,532	6,524	4.42	122,133	5,443	4.46
	HSBC Finance	**3,094**	**319**	**10.31**	4,808	505	10.50	5,492	611	11.13
Hong Kong	Hang Seng Bank	**86,457**	**2,058**	**2.38**	85,366	3,287	3.85	82,504	4,321	5.24
	The Hongkong and Shanghai Banking Corporation	**162,812**	**2,797**	**1.72**	150,804	5,147	3.41	146,118	7,507	5.14
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**143,342**	**5,139**	**3.59**	162,132	7,903	4.87	113,448	6,784	5.98
	HSBC Bank Malaysia	**13,514**	**579**	**4.28**	14,215	761	5.35	12,074	678	5.62
Middle East[27]	HSBC Bank Middle East	**34,461**	**1,809**	**5.25**	36,239	1,944	5.36	25,865	1,750	6.77
North America	HSBC Bank USA	**131,340**	**6,675**	**5.08**	130,863	7,506	5.74	126,588	8,482	6.70
	HSBC Finance	**106,553**	**10,067**	**9.45**	146,503	16,041	10.95	159,454	18,404	11.54
	HSBC Bank Canada	**57,061**	**1,723**	**3.02**	59,747	2,784	4.66	54,408	3,061	5.63
Latin America	HSBC Mexico	**19,961**	**2,084**	**10.44**	24,597	3,058	12.43	23,351	2,745	11.76
	Brazilian operations[34]	**37,198**	**6,363**	**17.11**	35,797	6,830	19.08	25,795	5,287	20.50
	HSBC Bank Panama	**12,465**	**922**	**7.40**	12,178	910	7.47	11,070	909	8.21

	HSBC Bank Argentina	**2,428**	**421**	**17.34**	3,093	469	15.16	2,573	326	12.67
Other operations		**(15,184)**	**2,727**		(45,381)	133		(200)	169	
		1,384,705	**62,096**	**4.48**	1,466,622	91,301	6.23	1,296,701	92,359	7.12

For footnotes, see page 149.

Table of Contents

Equity and liabilities

		2009			2008			2007		
		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)		**1,353,283**	**21,366**	**1.58**	1,451,842	48,738	3.36	1,279,460	54,564	4.26
Trading liabilities		**205,670**	**3,987**	**1.94**	277,940	11,029	3.97	250,572	12,186	4.86
Financial liabilities designated at fair value (excluding own debt issued)		**15,688**	**293**	**1.87**	21,266	345	1.62	20,827	224	1.07
Non-interest bearing current accounts		**123,271**			98,193			83,958		
Total equity and other non-interest bearing liabilities		**748,074**			659,747			477,133		
Total equity and liabilities		**2,445,986**	**25,646**	**1.05**	2,508,988	60,112	2.40	2,111,950	66,974	3.17
Deposits by banks[35]										
Europe	HSBC Bank	**35,207**	**553**	**1.57**	48,167	1,875	3.89	44,787	2,148	4.80
	HSBC Private Banking Holdings (Suisse)	**1,063**	**1**	**0.09**	4,493	105	2.34	690	22	3.19
	HSBC France	**43,682**	**536**	**1.23**	37,851	1,672	4.42	30,816	1,358	4.41
Hong Kong	Hang Seng Bank	**1,051**	**5**	**0.48**	1,696	55	3.24	2,993	123	4.11
	The Hongkong and Shanghai Banking Corporation	**6,892**	**9**	**0.13**	3,665	70	1.91	3,634	150	4.13
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**10,710**	**165**	**1.54**	16,232	450	2.77	10,247	445	4.34
	HSBC Bank Malaysia	**110**	**2**	**1.82**	338	10	2.96	375	12	3.20
Middle East[27]	HSBC Bank Middle East	**773**	**9**	**1.16**	1,680	29	1.73	672	32	4.76

North America	HSBC Bank USA	**8,381**	**9**	**0.11**	11,015	220	2.00	6,933	414	5.97
	HSBC Bank Canada	**1,405**	**8**	**0.57**	1,391	41	2.95	1,681	93	5.53
Latin America	HSBC Mexico	**1,462**	**49**	**3.35**	822	32	3.89	983	63	6.41
	Brazilian operations[34]	**3,292**	**241**	**7.32**	2,790	190	6.81	1,549	106	6.84
	HSBC Bank Panama	**908**	**26**	**2.86**	1,016	43	4.23	1,137	66	5.80
	HSBC Bank Argentina	**12**	**1**	**8.33**	27	1	3.70	117	9	7.69
Other operations		**2,899**	**45**	**1.55**	4,564	166	3.64	4,495	291	6.47
		117,847	**1,659**	**1.41**	135,747	4,959	3.65	111,109	5,332	4.80
Financial liabilities designated at fair value own debt issued[36]										
Europe	HSBC Holdings	**17,887**	**369**	**2.06**	18,675	721	3.86	15,142	822	5.43
	HSBC Bank	**7,932**	**196**	**2.47**	8,805	529	6.01	9,907	525	5.30
	HSBC France	**5,108**	**128**	**2.51**	1,515	79	5.21	143	11	7.69
Hong Kong	Hang Seng Bank	**130**	**2**	**1.54**	127	6	4.72	126	6	4.76
North America	HSBC Bank USA	**1,615**	**30**	**1.86**	1,504	67	4.45	1,620	125	7.72
	HSBC Finance	**26,628**	**871**	**3.27**	32,126	1,563	4.87	31,889	2,079	6.52
Other operations		**921**	**(38)**	**(4.13)**	1,083	168	15.51			
		60,221	**1,558**	**2.59**	63,835	3,133	4.91	58,827	3,568	6.07

For footnotes, see page 149.

Table of Contents

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

Financial summary > Balance sheet > Average balance sheet
Equity and liabilities (continued)

		2009			2008			2007		
		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 accounts[37]										
Europe	HSBC Bank	**274,949**	**2,407**	**0.88**	305,702	10,092	3.30	270,965	10,576	3.90
	HSBC Private Banking Holdings (Suisse)	**27,250**	**256**	**0.94**	37,778	1,349	3.57	30,955	1,485	4.80
	HSBC France	**61,465**	**645**	**1.05**	39,428	1,583	4.01	31,845	1,226	3.85
Hong Kong	Hang Seng Bank	**71,140**	**200**	**0.28**	66,142	914	1.38	61,227	1,900	3.10
	The Hongkong and Shanghai Banking Corporation	**150,520**	**211**	**0.14**	139,169	1,365	0.98	125,478	3,499	2.79
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**92,305**	**1,494**	**1.62**	96,476	2,869	2.97	76,052	2,645	3.48
	HSBC Bank Malaysia	**9,658**	**191**	**1.98**	10,266	295	2.87	8,823	260	2.95
Middle East[27]	HSBC Bank Middle East	**18,726**	**432**	**2.31**	19,922	422	2.12	15,685	578	3.69
North America	HSBC Bank USA	**85,007**	**975**	**1.15**	86,701	2,069	2.39	78,138	3,051	3.90
	HSBC Bank Canada	**35,051**	**385**	**1.10**	34,090	967	2.84	30,060	1,090	3.63
Latin America	HSBC Mexico	**11,636**	**391**	**3.36**	14,612	561	3.84	14,230	548	3.85
	Brazilian operations[34]	**28,605**	**2,946**	**10.30**	26,288	3,110	11.83	19,581	2,163	11.05
		8,592	**353**	**4.11**	7,761	296	3.81	7,604	314	4.13

	HSBC Bank Panama									
	HSBC Bank Argentina	**2,151**	**99**	**4.60**	2,266	145	6.40	1,892	85	4.49
Other operations		**63,863**	**361**	**0.57**	64,253	1,952	3.04	55,351	2,297	4.15
		940,918	**11,346**	**1.21**	950,854	27,989	2.94	827,886	31,717	3.83
Debt securities in issue										
Europe	HSBC Bank	**72,955**	**1,305**	**1.79**	86,216	4,001	4.64	64,168	3,753	5.85
	HSBC France	**25,065**	**330**	**1.32**	30,815	1,447	4.70	28,757	1,207	4.20
	HSBC Finance				215	8	3.72	240	18	7.50
Hong Kong	Hang Seng Bank	**1,220**	**21**	**1.72**	1,685	57	3.38	1,734	80	4.61
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**5,409**	**218**	**4.03**	8,995	640	7.12	8,979	559	6.23
	HSBC Bank Malaysia	**403**	**16**	**3.97**	475	20	4.21	318	13	4.09
Middle East[27]	HSBC Bank Middle East	**2,988**	**62**	**2.07**	2,650	90	3.40	2,086	119	5.70
North America	HSBC Bank USA	**20,968**	**590**	**2.81**	21,922	852	3.89	25,724	1,232	4.79
	HSBC Finance	**63,563**	**2,510**	**3.95**	98,096	3,765	3.84	115,520	5,311	4.60
	HSBC Bank Canada	**12,825**	**322**	**2.51**	16,957	604	3.56	14,771	640	4.33
Latin America	HSBC Mexico	**1,460**	**67**	**4.59**	2,693	243	9.02	1,147	110	9.59
	Brazilian operations[34]	**1,568**	**86**	**5.48**	1,859	156	8.39	1,417	115	8.12
	HSBC Bank Panama	**487**	**34**	**6.98**	556	33	5.94	607	45	7.41
	HSBC Bank Argentina	**1**			2			12		
Other operations		**16,745**	**340**	**2.03**	13,691	66	0.48	6,446	(13)	(0.20)
		225,657	**5,901**	**2.62**	286,827	11,982	4.18	271,926	13,189	4.85

For footnotes, see page 149.

		2009 Average balance US$m	2009 Interest expense US$m	2009 Cost %	2008 Average balance US$m	2008 Interest expense US$m	2008 Cost %	2007 Average balance US$m	2007 Interest expense US$m	2007 Cost %
Other interest-bearing liabilities										
Europe	HSBC Bank	**50,247**	**655**	**1.30**	38,906	1,134	2.91	22,035	1,302	5.91
	HSBC Private Banking Holdings (Suisse)	**3,892**	**18**	**0.46**	4,203	135	3.21	3,427	163	4.76
	HSBC France	**24,699**	**187**	**0.76**	33,920	1,361	4.01	27,830	979	3.52
	HSBC Finance	**2,363**	**59**	**2.50**	3,712	191	5.15	4,557	227	4.98
Hong Kong	Hang Seng Bank	**789**	**5**	**0.63**	1,258	41	3.26	2,278	114	5.00
	The Hongkong and Shanghai Banking Corporation	**12,815**	**105**	**0.82**	10,557	288	2.73	9,866	535	5.42
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**19,447**	**177**	**0.91**	23,685	466	1.97	12,631	580	4.59
	HSBC Bank Malaysia	**266**	**2**	**0.75**	338	7	2.07	232	6	2.59
Middle East[27]	HSBC Bank Middle East	**1,748**	**68**	**3.89**	1,918	89	4.64	1,168	81	6.93
North America	HSBC Bank USA	**9,754**	**368**	**3.77**	10,490	468	4.46	13,602	587	4.32
	HSBC Finance	**4,051**	**102**	**2.52**	4,670	141	3.02	1,941	113	5.82
	HSBC Bank Canada	**1,149**	**6**	**0.52**	1,306	19	1.45	1,151	27	2.35
		1,716	**36**	**2.10**	10,349	78	0.75	8,889	255	2.87

	HSBC Markets Inc									
Latin America	HSBC Mexico	**301**	**11**	**3.65**	187	20	10.70	207	16	7.73
	Brazilian operations[34]	**1,496**	**130**	**8.69**	2,340	207	8.85	1,103	182	16.50
	HSBC Bank Panama	**192**	**2**	**1.04**	917	3	0.33	574	9	1.57
	HSBC Bank Argentina	**36**	**1**	**2.78**	92	6	6.52	95	4	4.21
Other operations		**(126,321)**	**(1,030)**		(134,269)	(3,979)		(101,874)	(4,422)	
		8,640	**902**	**10.44**	14,579	675	4.63	9,712	758	7.80
Total interest-bearing liabilities										
Europe	HSBC Bank	**441,290**	**5,116**	**1.16**	487,796	17,631	3.61	411,862	18,304	4.44
	HSBC Private Banking Holdings (Suisse)	**32,205**	**275**	**0.85**	46,474	1,589	3.42	35,072	1,670	4.76
	HSBC France	**160,019**	**1,826**	**1.14**	143,529	6,142	4.28	119,391	4,781	4.00
	HSBC Finance	**2,363**	**59**	**2.50**	3,927	199	5.07	4,797	245	5.11
Hong Kong	Hang Seng Bank	**74,330**	**233**	**0.31**	70,908	1,073	1.51	68,358	2,223	3.25
	The Hongkong and Shanghai Banking Corporation	**170,227**	**325**	**0.19**	153,391	1,723	1.12	138,978	4,184	3.01
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**127,871**	**2,054**	**1.61**	145,388	4,425	3.04	107,909	4,229	3.92
	HSBC Bank Malaysia	**10,437**	**211**	**2.02**	11,417	332	2.91	9,748	291	2.99
Middle East[27]		**24,235**	**571**	**2.36**	26,170	630	2.41	19,611	810	4.13

	HSBC Bank Middle East									
North America	HSBC Bank USA	**125,725**	**1,972**	**1.57**	131,632	3,676	2.79	126,017	5,409	4.29
	HSBC Finance	**94,242**	**3,483**	**3.70**	134,892	5,469	4.05	149,350	7,503	5.02
	HSBC Bank Canada	**50,430**	**721**	**1.43**	53,744	1,631	3.03	47,663	1,850	3.88
	HSBC Markets Inc	**1,716**	**36**	**2.10**	10,349	78	0.75	8,889	255	2.87
Latin America	HSBC Mexico	**14,859**	**518**	**3.49**	18,314	856	4.67	16,567	737	4.45
	Brazilian operations[34]	**34,961**	**3,403**	**9.73**	33,277	3,663	11.01	23,650	2,566	10.85
	HSBC Bank Panama	**10,179**	**415**	**4.08**	10,250	375	3.66	9,922	434	4.37
	HSBC Bank Argentina	**2,200**	**101**	**4.59**	2,387	152	6.37	2,116	98	4.63
Other operations		**(24,006)**	**47**		(32,003)	(906)		(20,440)	(1,025)	
		1,353,283	**21,366**	**1.58**	1,451,842	48,738	3.36	1,279,460	54,564	4.26

For footnotes, see page 149.

Table of Contents

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

Financial summary > Balance sheet > Net interest margin / Average asset distribution / Changes in net interest income and expense

Net interest margin[39]

		2009 %	2008 %	2007 %
Europe	HSBC Bank	**2.35**	1.71	1.58
	HSBC Private Banking Holdings (Suisse)	**1.30**	1.24	1.10
	HSBC France	**0.68**	0.26	0.54
	HSBC Finance	**8.40**	6.36	6.66
Hong Kong	Hang Seng Bank	**2.11**	2.59	2.54
	The Hongkong and Shanghai Banking Corporation	**1.52**	2.27	2.27
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**2.15**	2.15	2.25
	HSBC Bank Malaysia	**2.72**	3.02	3.21
Middle East[27]	HSBC Bank Middle East	**3.59**	3.63	3.63
North America	HSBC Bank USA	**3.58**	2.93	2.43
	HSBC Finance	**6.18**	7.22	6.84
	HSBC Bank Canada	**1.76**	1.93	2.23
Latin America	HSBC Mexico	**7.85**	8.95	8.60
	Brazilian operations[34]	**7.96**	8.85	10.55
	HSBC Bank Panama	**4.07**	4.39	4.29
	HSBC Bank Argentina	**13.18**	10.25	8.86
		2.94	2.90	2.91

Distribution of average total assets

		2009 %	2008 %	2007 %
Europe	HSBC Bank	**36.7**	36.7	34.6
	HSBC Private Banking Holdings (Suisse)	**2.3**	2.3	2.2
	HSBC France	**15.0**	13.8	12.0
	HSBC Finance	**0.0**	0.2	0.3

Hong Kong	Hang Seng Bank	**4.2**	3.9	4.4
	The Hongkong and Shanghai Banking Corporation	**10.5**	9.5	10.1
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**8.5**	8.8	6.9
	HSBC Bank Malaysia	**0.6**	0.6	0.7
Middle East[27]	HSBC Bank Middle East	**1.6**	1.8	1.4
North America	HSBC Bank USA	**11.0**	11.2	10.1
	HSBC Finance	**4.5**	6.2	8.3
	HSBC Bank Canada	**2.7**	2.9	3.3
Latin America	HSBC Mexico	**1.4**	1.5	2.5
	Brazilian operations[34]	**2.1**	2.1	1.6
	HSBC Bank Panama	**0.6**	0.6	0.7
	HSBC Bank Argentina	**0.2**	0.2	0.2
Other operations (including consolidation adjustments)		**(1.9)**	(2.3)	0.7
		100.0	100.0	100.0

For footnotes, see page 149.

Table of Contents

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 2009 compared with 2008, and for 2008 compared with 2007.

Interest income

			Increase/(decrease) in 2009 compared with 2008			Increase/(decrease) in 2008 compared with 2007		
		2009 US$m	**Volume US$m**	**Rate US$m**	2008 US$m	Volume US$m	Rate US$m	2007 US$m
Short-term funds and loans and advances to banks								
Europe	HSBC Bank	**1,379**	**(386)**	**(422)**	2,187	(166)	(239)	2,592
	HSBC Private Banking Holdings (Suisse)	**43**	**(149)**	**(141)**	333	119	(15)	229
	HSBC France	**440**	**60**	**(1,115)**	1,495	173	28	1,294
Hong Kong	Hang Seng Bank	**202**	**(26)**	**(359)**	587	203	(225)	609
	The Hongkong and Shanghai Banking Corporation	**182**	**(549)**	**(613)**	1,344	(139)	(869)	2,352
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**326**	**(152)**	**(403)**	881	362	(291)	810
	HSBC Bank Malaysia	**81**	**(31)**	**(53)**	165	65	(3)	103
Middle East[27]	HSBC Bank Middle East	**52**	**(54)**	**(82)**	188	(15)	(121)	324
North America	HSBC Bank USA	**94**	**(248)**	**14**	328	10	(159)	477
	HSBC Bank Canada	**10**	**(13)**	**(84)**	107	(21)	(46)	174
Latin America	HSBC Mexico	**149**	**3**	**(101)**	247	9	(1)	239
	Brazilian operations[34]	**1,003**	**302**	**(250)**	951	242	64	645
	HSBC Bank Panama	**10**	**1**	**(21)**	30	9	(12)	33
	HSBC Bank Argentina	**29**	**(25)**	**11**	43	16	11	16
Other operations		**199**	**(160)**	**(401)**	760	43	(181)	898
		4,199	**(1,911)**	**(3,536)**	9,646	915	(2,064)	10,795

Loans and advances to customers

Europe	HSBC Bank	**10,898**	**(749)**	**(6,940)**	18,587	3,885	(3,376)	18,078
	HSBC Private Banking Holdings (Suisse)	**176**	**(94)**	**(224)**	494	132	(145)	507
	HSBC France	**1,932**	**(118)**	**(1,554)**	3,604	257	128	3,219
	HSBC Finance	**319**	**(180)**	**(6)**	505	(76)	(30)	611
Hong Kong	Hang Seng Bank	**1,194**	**12**	**(407)**	1,589	251	(782)	2,120
	The Hongkong and Shanghai Banking Corporation	**1,757**	**28**	**(562)**	2,291	392	(1,002)	2,901
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**3,668**	**(762)**	**(733)**	5,163	1,345	(503)	4,321
	HSBC Bank Malaysia	**455**	**(19)**	**(79)**	553	64	(18)	507
Middle East[27]	HSBC Bank Middle East	**1,593**	**(71)**	**115**	1,549	680	(331)	1,200
North America	HSBC Bank USA	**5,541**	**330**	**(547)**	5,758	219	(1,046)	6,585
	HSBC Finance	**9,941**	**(4,472)**	**(1,422)**	15,835	(1,495)	(756)	18,086
	HSBC Bank Canada	**1,499**	**(267)**	**(689)**	2,455	284	(427)	2,598
Latin America	HSBC Mexico	**1,708**	**(753)**	**(104)**	2,565	104	274	2,187
	Brazilian operations[34]	**4,494**	**(233)**	**(152)**	4,879	1,744	(760)	3,895
	HSBC Bank Panama	**864**	**64**	**(10)**	810	49	(17)	778
	HSBC Bank Argentina	**357**	**(35)**	**14**	378	68	69	241
Other operations		**1,905**	**100**	**98**	1,707	564	(647)	1,790
		48,301	**(5,358)**	**(15,063)**	68,722	8,887	(9,789)	69,624

For footnotes, see page 149.

Table of Contents

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

Financial summary > Balance sheet > Changes in net interest income / net interest expense

Interest income (continued)

			Increase/(decrease) in 2009 compared with 2008			Increase/(decrease) in 2008 compared with 2007		
		2009 US$m	**Volume US$m**	**Rate US$m**	2008 US$m	Volume US$m	Rate US$m	2007 US$m
Financial investments								
Europe	HSBC Bank	**2,321**	**(182)**	**(1,337)**	3,840	2,006	(597)	2,431
	HSBC Private Banking Holdings (Suisse)	**363**	**165**	**(355)**	553	81	(39)	511
	HSBC France	**141**	**(510)**	**(144)**	795	222	62	511
Hong Kong	Hang Seng Bank	**630**	**25**	**(458)**	1,063	(340)	(147)	1,550
	The Hongkong and Shanghai Banking Corporation	**644**	**1,380**	**(1,299)**	563	(263)	(191)	1,017
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**1,039**	**97**	**(565)**	1,507	371	71	1,065
	HSBC Bank Malaysia	**37**	**11**	**(10)**	36	(21)	1	56
Middle East[27]	HSBC Bank Middle East	**118**	**34**	**(60)**	144	96	(126)	174
North America	HSBC Bank USA	**969**	**106**	**(369)**	1,232	87	(44)	1,189
	HSBC Finance	**120**	**(24)**	**1**	143	(65)	(21)	229
	HSBC Bank Canada	**205**	**91**	**(83)**	197	41	(102)	258
Latin America	HSBC Mexico	**227**	**31**	**(48)**	244	14	(89)	319
	Brazilian operations[34]	**820**	**22**	**(55)**	853	140	41	672
	HSBC Bank Panama	**39**	**(1)**	**(7)**	47	(7)	(4)	58
	HSBC Bank Argentina	**35**	**(17)**	**5**	47	(33)	12	68
Other operations		**1,717**	**966**	**(603)**	1,354	123	(176)	1,407
		9,425	**2,790**	**(5,983)**	12,618	2,450	(1,347)	11,515

Interest expense

Deposits by banks

Europe	HSBC Bank	**553**	**(504)**	**(818)**	1,875	162	(435)	2,148
	HSBC Private Banking Holdings (Suisse)	**1**	**(80)**	**(24)**	105	121	(38)	22
	HSBC France	**536**	**258**	**(1,394)**	1,672	310	4	1,358
Hong Kong	Hang Seng Bank	**5**	**(21)**	**(29)**	55	(53)	(15)	123
	The Hongkong and Shanghai Banking Corporation	**9**	**62**	**(123)**	70	1	(81)	150
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**165**	**(153)**	**(132)**	450	260	(255)	445
	HSBC Bank Malaysia	**2**	**(7)**	**(1)**	10	(1)	(1)	12
Middle East[27]	HSBC Bank Middle East	**9**	**(16)**	**(4)**	29	48	(51)	32
North America	HSBC Bank USA	**9**	**(53)**	**(158)**	220	244	(438)	414
	HSBC Bank Canada	**8**		**(33)**	41	(16)	(36)	93
Latin America	HSBC Mexico	**49**	**25**	**(8)**	32	(10)	(21)	63
	Brazilian operations[34]	**241**	**34**	**17**	190	85	(1)	106
	HSBC Bank Panama	**26**	**(5)**	**(12)**	43	(7)	(16)	66
	HSBC Bank Argentina	**1**	**(1)**	**1**	1	(7)	(1)	9
Other operations		**45**	**(61)**	**(60)**	166	4	(129)	291
		1,659	**(653)**	**(2,647)**	4,959	1,183	(1,556)	5,332

For footnotes, see page 149.

Table of Contents

Interest expense (continued)

			Increase/(decrease) in 2009 compared with 2008			Increase/(decrease) in 2008 compared with 2007		
		2009 US$m	**Volume US$m**	**Rate US$m**	2008 US$m	Volume US$m	Rate US$m	2007 US$m
Customer accounts								
Europe	HSBC Bank	**2,407**	**(1,015)**	**(6,670)**	10,092	1,355	(1,839)	10,576
	HSBC Private Banking Holdings (Suisse)	**256**	**(376)**	**(717)**	1,349	328	(464)	1,485
	HSBC France	**645**	**884**	**(1,822)**	1,583	292	65	1,226
Hong Kong	Hang Seng Bank	**200**	**69**	**(783)**	914	152	(1,138)	1,900
	The Hongkong and Shanghai Banking Corporation	**211**	**111**	**(1,265)**	1,365	382	(2,516)	3,499
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**1,494**	**(124)**	**(1,251)**	2,869	711	(487)	2,645
	HSBC Bank Malaysia	**191**	**(17)**	**(87)**	295	43	(8)	260
Middle East[27]	HSBC Bank Middle East	**432**	**(25)**	**35**	422	156	(312)	578
North America	HSBC Bank USA	**975**	**(40)**	**(1,054)**	2,069	334	(1,316)	3,051
	HSBC Bank Canada	**385**	**27**	**(609)**	967	146	(269)	1,090
Latin America	HSBC Mexico	**391**	**(114)**	**(56)**	561	15	(2)	548
	Brazilian operations[34]	**2,946**	**274**	**(438)**	3,110	741	206	2,163
	HSBC Bank Panama	**353**	**32**	**25**	296	6	(24)	314
	HSBC Bank Argentina	**99**	**(7)**	**(39)**	145	17	43	85
Other operations		**361**	**(12)**	**(1,579)**	1,952	369	(714)	2,297
		11,346	**(292)**	**(16,351)**	27,989	4,710	(8,438)	31,717
		1,558	**(177)**	**(1,398)**	3,133	304	(739)	3,568

Financial liabilities designated at fair value own debt issued

Debt securities in issue

Europe	HSBC Bank	**1,305**	**(615)**	**(2,081)**	4,001	1,290	(1,042)	3,753
	HSBC France	**330**	**(270)**	**(847)**	1,447	86	154	1,207
	HSBC Finance		**(8)**		8	(2)	(8)	18
Hong Kong	Hang Seng Bank	**21**	**(16)**	**(20)**	57	(2)	(21)	80
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**218**	**(255)**	**(167)**	640	1	80	559
	HSBC Bank Malaysia	**16**	**(3)**	**(1)**	20	6	1	13
Middle East[27]	HSBC Bank Middle East	**62**	**11**	**(39)**	90	32	(61)	119
North America	HSBC Bank USA	**590**	**(37)**	**(225)**	852	(182)	(198)	1,232
	HSBC Finance	**2,510**	**(1,326)**	**71**	3,765	(802)	(744)	5,311
	HSBC Bank Canada	**322**	**(147)**	**(135)**	604	95	(131)	640
Latin America	HSBC Mexico	**67**	**(111)**	**(65)**	243	148	(15)	110
	Brazilian operations[34]	**86**	**(24)**	**(46)**	156	36	5	115
	HSBC Bank Panama	**34**	**(4)**	**5**	33	(4)	(8)	45
Other operations		**340**	**15**	**259**	66	(14)	93	(13)
		5,901	**(2,557)**	**(3,524)**	11,982	(723)	(1,930)	13,189

For footnotes, see page 149.

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

Financial summary > Balance sheet > Short-term borrowings / Contractual obligations / Ratios / Loan maturities

Short-term borrowings
HSBC includes short-term borrowings within customer accounts, deposits by banks and debt securities in issue and does not show short-term borrowings separately on the balance sheet. Short-term borrowings are defined by the US Securities and Exchange Commission (SEC) as
Repos and short-term bonds
Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings. HSBC s 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.

	2009	2008	2007
	US$m	US$m	US$m
Securities sold under agreements to repurchase			
Outstanding at 31 December	**152,218**	145,180	140,001
Average amount outstanding during the year	**170,671**	177,256	129,779
Maximum quarter-end balance outstanding during the year.	**157,778**	190,651	148,601
Weighted average interest rate during the year	**0.8%**	3.8%	5.4%
Weighted average interest rate at the year-end	**0.4%**	2.9%	4.8%
Short-term bonds			
Outstanding at 31 December	**38,776**	40,279	51,792
Average amount outstanding during the year	**33,010**	45,330	39,153
Maximum quarter-end balance outstanding during the year.	**38,776**	55,842	51,792
Weighted average interest rate during the year	**3.2%**	5.0%	7.0%
Weighted average interest rate at the year-end	**0.6%**	3.1%	6.5%

Contractual obligations
The table below provides details of HSBC s material contractual obligations as at 31 December 2009.

		Payments due by period		
	Total	**Less than 1 year**	**1 5 years**	**More than 5 years**
	US$m	**US$m**	**US$m**	**US$m**
Long-term debt obligations	**234,297**	**71,482**	**93,778**	**69,037**
Term deposits and certificates of deposit	**211,434**	**198,081**	**13,353**	
Capital (finance) lease obligations	**971**	**103**	**249**	**619**
Operating lease obligations	**5,655**	**857**	**2,264**	**2,534**
Purchase obligations	**1,359**	**1,045**	**314**	

Short positions in debt securities and equity shares.	**90,067**	**73,437**	**5,332**	**11,298**
Current tax liability	**2,141**	**2,141**		
Pension/healthcare obligation	**15,979**	**1,188**	**5,548**	**9,243**
	561,903	**348,334**	**120,838**	**92,731**

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

	2009	2008	2007	2006	2005
	%	%	%	%	%
Ratios of earnings to combined fixed charges and preference share dividends:[38]					
excluding interest on deposits	**2.64**	2.97	6.96	7.22	9.16
including interest on deposits	**1.20**	1.13	1.34	1.40	1.59
Ratios of earnings to combined fixed charges:[38]					
excluding interest on deposits	**2.99**	3.17	7.52	7.93	9.60
including interest on deposits	**1.22**	1.14	1.34	1.41	1.59

For footnote, see page 149.

Table of Contents

Loan maturity and interest sensitivity analysis

At 31 December 2009, 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[27] US$m**	**Middle East[27] US$m**	**North America US$m**	**Latin America US$m**	**Total US$m**
Maturity of 1 year or less							
Loans and advances to banks	62,840	**35,817**	**35,535**	**8,212**	**15,093**	**15,525**	**173,022**
Commercial loans to customers							
Commercial, industrial and international trade	80,451	12,563	22,085	7,248	4,327	9,576	136,250
Real estate and other property related	18,951	5,678	4,221	1,624	8,690	1,545	40,709
Non-bank financial institutions	67,934	1,201	1,751	959	9,680	1,181	82,706
Governments	1,155	110	172	1,212	161	442	3,252
Other commercial	26,238	2,026	4,173	1,432	6,944	2,665	43,478
	194,729	21,578	32,402	12,475	29,802	15,409	306,395
Hong Kong Government Home Ownership Scheme		385					385
Residential mortgages and other personal loans	29,732	13,083	10,811	2,959	35,352	8,793	100,730
Loans and advances to customers	224,461	35,046	43,213	15,434	65,154	24,202	407,510
	287,301	70,863	78,748	23,646	80,247	39,727	580,532
Maturity after 1 year but within 5 years							
Loans and advances to banks	2,452	380	105	168	221	374	3,700
Commercial loans to customers							
Commercial, industrial and international trade	21,101	4,708	5,427	1,591	6,183	4,591	43,601
Real estate and other property related	13,937	13,125	5,354	957	8,551	988	42,912
Non-bank financial institutions	4,622	535	472	239	1,993	519	8,380
Governments	461	263	257	125	46	731	1,883
Other commercial	13,638	4,375	2,536	1,076	3,029	2,508	27,162

	53,759	23,006	14,046	3,988	19,802	9,337	123,938
Hong Kong Government Home Ownership Scheme		1,276					1,276
Residential mortgages and other personal loans	35,063	9,642	6,782	2,635	47,021	6,364	107,507
Loans and advances to customers	88,822	33,924	20,828	6,623	66,823	15,701	232,721
	91,274	34,304	20,933	6,791	67,044	16,075	236,421
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							
Fixed interest rate	12,159	302	789	925	3,831	2,684	20,690
Variable interest rate	44,052	23,084	13,362	3,231	16,192	7,027	106,948
	56,211	23,386	14,151	4,156	20,023	9,711	127,638
Maturity after 5 years							
Loans and advances to banks	322		8	55	72	2,709	3,166
Commercial loans to customers							
Commercial, industrial and international trade	10,822	457	716	497	1,018	2,767	16,277
Real estate and other property related	7,196	5,041	763	85	2,738	465	16,288
Non-bank financial institutions	669	726	23	8	2,290	435	4,151
Governments	600	68	166	19	1	700	1,554
Other commercial	15,279	1,363	409	745	944	224	18,964
	34,566	7,655	2,077	1,354	6,991	4,591	57,234
Hong Kong Government Home Ownership Scheme		1,795					1,795
Residential mortgages and other personal loans	97,767	21,765	14,921	811	81,561	5,688	222,513
Loans and advances to customers	132,333	31,215	16,998	2,165	88,552	10,279	281,542
	132,655	31,215	17,006	2,220	88,624	12,988	284,708
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							
Fixed interest rate	7,742		150	749	1,436	2,337	12,414

Variable interest rate	27,146	7,655	1,935	660	5,627	4,963	47,986
	34,888	7,655	2,085	1,409	7,063	7,300	60,400

For footnote, see page 149.

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

Financial summary > Balance sheet > Deposits

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

	2009		2008		2007	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**87,677**		99,228		84,635	
Demand and other non-interest bearing	**6,415**		5,231		6,359	
Demand interest bearing	**14,259**	**1.0**	19,204	3.2	11,036	3.8
Time	**30,367**	**1.6**	43,695	3.9	38,470	4.7
Other	**36,636**	**1.3**	31,098	4.4	28,770	4.8
Hong Kong	**10,725**		5,916		7,269	
Demand and other non-interest bearing	**2,975**		1,375		1,331	
Demand interest bearing	**5,526**	**0.1**	2,780	2.0	2,420	4.3
Time	**1,637**	**0.3**	1,583	2.7	3,267	4.5
Other	**587**	**0.5**	178	3.4	251	0.4
Rest of Asia-Pacific[27]	**12,467**		18,203		12,748	
Demand and other non-interest bearing	**1,605**		1,546		1,356	
Demand interest bearing	**4,097**	**1.2**	4,317	2.3	3,164	2.4
Time	**4,682**	**1.9**	9,103	3.5	5,464	5.2
Other	**2,083**	**1.4**	3,237	3.8	2,764	4.8
Middle East[27]	**1,317**		2,151		1,517	

Demand and other non-interest bearing	**539**		365		541	
Demand interest bearing	**18**		15		3	
Time	**691**	**1.2**	1,239	2.7	969	4.5
Other	**69**	**1.4**	532	0.2	4	
North America	**13,203**		14,835		11,501	
Demand and other non-interest bearing	**1,755**		761		827	
Demand interest bearing	**4,770**	**0.1**	5,684	1.7	3,759	4.8
Time	**5,422**	**0.2**	7,941	2.3	6,746	6.0
Other	**1,256**	**0.7**	449	1.6	169	7.1
Latin America	**5,959**		5,058		4,661	
Demand and other non-interest bearing	**212**		366		808	
Demand interest bearing	**219**	**0.9**	81	2.5	153	5.9
Time	**4,171**	**5.0**	3,357	5.6	2,690	6.5
Other	**1,357**	**8.1**	1,254	7.8	1,010	8.0
Total	**131,348**		145,391		122,331	
Demand and other non-interest bearing	**13,501**		9,644		11,222	
Demand interest bearing	**28,889**	**0.7**	32,081	2.7	20,535	3.8
Time	**46,970**	**1.7**	66,918	3.7	57,606	4.9
Other	**41,988**	**1.6**	36,748	4.5	32,968	5.0

For footnote, see page 149.

Customer accounts

	2009		2008		2007	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**440,450**		447,982		391,496	
Demand and other non-interest bearing	**55,751**		39,610		34,585	
Demand interest bearing	**212,178**	**0.4**	225,034	2.9	210,692	3.5
Savings	**57,344**	**2.2**	73,479	4.3	62,002	4.6
Time	**67,045**	**1.4**	83,208	3.8	69,476	4.9
Other	**48,132**	**0.8**	26,651	3.9	14,741	4.5
Hong Kong	**261,703**		236,109		212,792	
Demand and other non-interest bearing	**22,056**		15,620		14,214	
Demand interest bearing	**171,846**	**0.1**	126,199	0.4	107,053	2.2
Savings	**45,537**	**0.6**	65,068	2.4	63,649	3.9
Time	**20,901**	**0.6**	27,659	2.3	26,712	3.9
Other	**1,363**	**0.1**	1,563	1.2	1,164	4.3
Rest of Asia-Pacific[27]	**126,144**		128,381		103,235	
Demand and other non-interest bearing	**13,425**		11,872		10,225	
Demand interest bearing	**53,108**	**0.8**	49,329	2.0	37,340	2.5
Savings	**46,137**	**2.5**	52,849	3.8	44,004	4.1
Time	**12,542**	**1.2**	13,342	3.3	10,114	4.7
Other	**932**	**1.8**	989	3.6	1,552	5.2
Middle East[27]	**33,211**		35,546		25,615	
Demand and other non-interest bearing	**9,865**		10,849		6,213	
Demand interest bearing	**6,364**	**1.4**	6,324	1.6	3,749	2.0
Savings	**15,005**	**3.4**	16,119	3.1	13,946	4.6
Time	**1,424**	**2.7**	1,884	2.9	1,424	4.1
Other	**553**	**0.2**	370	0.5	283	1.1

North America	**145,820**		144,982		130,982	
Demand and other non-interest bearing	**18,350**		16,759		15,175	
Demand interest bearing	**25,870**	**0.2**	18,261	1.6	15,389	3.3
Savings	**69,296**	**1.4**	87,001	2.5	79,529	3.3
Time	**25,164**	**1.3**	17,838	3.2	17,655	5.9
Other	**7,140**	**0.8**	5,123	2.4	3,234	3.7
Latin America	**63,635**		65,071		54,708	
Demand and other non-interest bearing	**10,598**		12,507		10,530	
Demand interest bearing	**4,734**	**1.1**	4,994	1.9	5,662	2.1
Savings	**33,091**	**8.5**	31,442	10.3	24,861	8.8
Time	**14,244**	**4.8**	15,179	5.2	12,443	5.9
Other	**968**	**6.4**	949	8.2	1,212	9.5
Total	**1,070,963**		1,058,071		918,828	
Demand and other non-interest bearing	**130,045**		107,217		90,942	
Demand interest bearing	**474,100**	**0.3**	430,141	1.9	379,885	3.0
Savings	**266,410**	**2.6**	325,958	3.9	287,991	4.4
Time	**141,320**	**1.6**	159,110	3.6	137,824	4.9
Other	**59,088**	**0.9**	35,645	3.6	22,186	4.7

For footnote, see page 149.

Table of Contents

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

Financial summary > Balance sheet > CDs // Critical accounting policies

Certificates of deposit and other money market instruments

	2009		2008		2007	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**65,151**	**0.9**	74,007	4.5	66,164	5.0
Hong Kong	**278**	**3.6**	745	3.0	941	3.9
Rest of Asia-Pacific[27]	**3,536**	**3.7**	6,966	6.6	7,094	6.0
Middle East[27]	**265**	**6.4**	648	4.6	136	3.7
North America	**14,218**	**1.1**	22,278	3.3	23,735	5.4
Latin America	**1,227**	**3.6**	3,036	7.8	1,526	6.8
	84,675	**1.2**	107,680	4.5	99,596	5.2

For footnote, see page 149.

Certificates of deposit and other time deposits

The maturity analysis of CDs 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 2009				
	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	**97,874**	**11,310**	**19,664**	**7,131**	**135,979**
Certificates of deposit	**18,009**	**3,810**	**3,755**	**1**	**25,575**
Time deposits:					
banks	**25,194**	**2,048**	**9,455**	**3,965**	**40,662**
customers	**54,671**	**5,452**	**6,454**	**3,165**	**69,742**
Hong Kong	**12,031**	**873**	**484**	**500**	**13,888**
Certificates of deposit	**75**	**24**	**151**	**265**	**515**

Time deposits:					
banks	**619**	**1**		**89**	**709**
customers	**11,337**	**848**	**333**	**146**	**12,664**
Rest of Asia-Pacific[27]	**13,890**	**1,784**	**651**	**1,108**	**17,433**
Certificates of deposit	**1,498**	**1,001**	**366**	**183**	**3,048**
Time deposits:					
banks	**2,231**	**252**	**19**	**108**	**2,610**
customers	**10,161**	**531**	**266**	**817**	**11,775**
Middle East[27]	**902**	**486**	**43**	**319**	**1,750**
Certificates of deposit		**136**			**136**
Time deposits:					
banks	**448**	**186**		**24**	**658**
customers	**454**	**164**	**43**	**295**	**956**
North America	**14,235**	**4,221**	**3,314**	**1,293**	**23,063**
Time deposits:					
banks	**2,798**		**7**	**238**	**3,043**
customers	**11,437**	**4,221**	**3,307**	**1,055**	**20,020**
Latin America	**11,980**	**2,626**	**1,713**	**3,002**	**19,321**
Certificates of deposit	**88**			**322**	**410**
Time deposits:					
banks	**1,036**	**1,421**	**747**	**236**	**3,440**
customers	**10,856**	**1,205**	**966**	**2,444**	**15,471**
Total	**150,912**	**21,300**	**25,869**	**13,353**	**211,434**
Certificates of deposit	**19,670**	**4,971**	**4,272**	**771**	**29,684**
Time deposits:					
banks	**32,326**	**3,908**	**10,228**	**4,660**	**51,122**
customers	**98,916**	**12,421**	**11,369**	**7,922**	**130,628**

For footnote, see page 149.

Table of Contents

Critical accounting policies

(Audited)

Introduction

The results of HSBC are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its consolidated financial statements. The significant accounting policies used in the preparation of the consolidated financial statements 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 HSBC s results and financial position, in terms of the materiality of the items to which the policy is applied, and which involve a high degree of judgement including the use of assumptions and estimation, are discussed below.

Impairment of loans and advances

HSBC s 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$922 billion (2008: US$957 billion), US$14.8 billion or 2 per cent (2008: US$7.9 billion; 1 per cent) were individually assessed for impairment, and US$907 billion or 98 per cent (2008: US$949 billion; 99 per cent) were collectively assessed for impairment.

The most significant judgemental area is the calculation of collective impairment allowances. HSBC s most significant geographical area of exposure to collectively assessed loans and advances is North America, which comprised US$219 billion or 24 per cent (2008: US$271 billion; 29 per cent) of HSBC s total collectively assessed loans and advances. Collective impairment allowances in North America were US$13.0 billion, representing 68 per cent (2008: US$15.9 billion; 77 per cent) of the total collectively assessed loan impairment allowance.

HSBC uses two alternative methods to calculate collective impairment allowances on homogeneous groups of loans that are not considered individually significant:

- when appropriate empirical information is available, HSBC utilises roll-rate methodology. This methodology employs statistical analysis of historical data and experience of delinquency and default to estimate the likelihood that loans will progress through the various stages of delinquency and ultimately prove irrecoverable. 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; and

- 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.

Both methodologies 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.

In addition, the use of statistically assessed historical information 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. In certain circumstances, historical loss experience provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, where there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in the portfolio risk factors being not fully reflected in the statistical models. In these circumstances, such risk factors are taken into account when calculating the appropriate levels of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

This key area of judgement is subject to uncertainty and is highly sensitive to factors such as 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 factors that can affect customer payment patterns. Different factors are applied in different regions and countries to reflect the variation in economic conditions, laws and regulations. The assumptions underlying this judgement are highly subjective. 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.

The total amount of the Group s impairment allowances on homogeneous groups of loans is inherently uncertain because it is highly sensitive to changes in economic and credit conditions across a large number of geographical areas. Economic and credit conditions within geographical areas are influenced by many factors with a high degree of interdependency so that there is no single factor to which the Group s loan impairment allowances as a whole are sensitive. However, HSBC s loan impairment allowances are particularly sensitive to general economic and credit conditions in North America. For example, a 10 per cent increase in impairment allowances on collectively assessed loans and advances in North America would increase loan impairment allowances by US$1.3 billion at 31 December 2009 (2008: US$1.6 billion). It is possible that the outcomes within the next financial year could be different from the assumptions built into the models, resulting in a material adjustment to the carrying amount of loans and advances.

Goodwill impairment

HSBC s accounting policy for goodwill is described in Note 2p on the Financial Statements. Note 22 on the Financial Statements lists the Group s cash generating units (CGU s) by geographical region and global business. Total goodwill for the Group amounted to US$23 billion as at 31 December 2009 (2008: US$22 billion).

The process of identifying and evaluating goodwill impairment is inherently uncertain because it requires significant management judgement in making a series of estimations, the results of which are highly sensitive to the assumptions used. The review of goodwill impairment represents management s best estimate of the factors below:

- 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 in future years; however, the cash flow forecasts necessarily and appropriately reflect management s view of future business prospects at the time of the assessment; and

- the rate used to discount the future expected cash flows is based on the cost of capital assigned to an individual CGU, and can have a significant effect on the CGU s 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 to reflect the inherent risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic conditions outside management s control and are therefore established on the basis of significant management judgement and are subject to uncertainty.

When this exercise demonstrates that the expected cash flows of a CGU have declined and/or that its cost of capital has increased, the effect is to reduce the CGU s estimated recoverable amount. If this is lower than the carrying value of the CGU, a charge for impairment of goodwill will be recognised in HSBC s 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 2009, no impairment of goodwill was identified (2008: US$10.6 billion). In addition to the annual impairment test which was performed as at 1 July 2009, HSBC reviewed the current and expected performance of the CGUs as at 31 December 2009 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 22 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

HSBC s 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 include comparisons with similar financial instruments for which market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Valuation techniques incorporate assumptions that other market participants would use in their valuations, including assumptions about interest rate yield curves, exchange rates, volatilities, and prepayment and default rates. When valuing instruments by reference to comparable instruments, management takes into account the maturity, structure and rating of the instrument with which the position held is being compared.

The main assumptions and estimates which management considers 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 management 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;
- selecting an appropriate discount rate for the instrument. Management bases the determination of this rate on its 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 will be based on some market observable inputs even where the unobservable inputs are significant.

The value of financial assets and liabilities measured at fair value that use a valuation technique was US$599 billion (2008: US$876 billion) and US$447 billion (2008: US$671 billion) or 56 per cent (2008: 71 per cent) and 75 per cent (2008: 83 per cent) of total financial assets and total financial liabilities measured at fair value, respectively.

Disclosures of types and amounts of fair value adjustments made in determining the fair value of financial instruments measured at fair value using valuation techniques is provided on page 168. In addition, a sensitivity analysis of fair values for financial instruments with significant unobservable inputs to reasonably possible alternative assumptions and a range of assumptions can be found on page 175. 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.

Critical accounting policies

Impairment of available-for-sale financial assets

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

Available-for-sale financial assets are measured at fair value, and changes in fair value 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. An impairment loss is recognised if there is objective evidence of impairment as a result of loss events which have an impact on the estimated future cash flows of the financial asset that can be reliably estimated. If an available-for-sale financial asset becomes impaired, the cumulative balance previously recognised in other comprehensive income is removed and recognised in the income statement as an impairment loss. A further decline in the fair value of an available-for-sale debt security subsequent to the initial impairment is recognised in the income statement when there is further objective evidence of impairment.

At 31 December 2009, the Group s total available-for-sale financial assets amounted to US$352 billion (2008: US$286 billion), of which US$342 billion or 97 per cent (2008: US$279 billion; 98 per cent) were debt securities. The available-for-sale fair value reserve relating to debt securities amounted to a deficit of US$11.4 billion (2008: deficit of US$21.4 billion). A deficit in the available-for-sale fair value reserve occurs on debt securities when the fair value of a security so categorised is less than the security s acquisition cost (net of any principal repayments and amortisation) less 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 .

The objective evidence required to determine whether an available-for-sale debt security is impaired comprises evidence of the occurrence of a loss event and evidence that the loss event results in a decrease in estimated future cash flows. When cash flows are readily determinable, less judgement is required. When determination of estimated future cash flows requires consideration of a number of variables, some of which may be unobservable in current market conditions, more judgement is required.

The most significant judgements concern more complex instruments, such as asset-backed securities (ABS s), 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 representative of current economic and credit 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 range of different types of securities held, 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.

Management s current assessment of the holdings of available-for-sale ABSs with the most sensitivity to possible future impairment is focused on sub-prime and Alt-A residential mortgage-backed securities. Excluding holdings in certain special purpose entities where significant first loss risks are borne by external investors, the available-for-sale holdings in these categories amounted to US$4.9 billion at 31 December 2009 (2008: US$6.1 billion). The deficit in the available-for-sale fair value reserve at 31 December 2009 in relation to these securities was US$4.3 billion (2008: US$6.0 billion).

Further details of the nature and extent of HSBC s exposures to ABSs classified as available-for-sale are provided in Impact of market turmoil under Nature and extent of HSBC s exposures on page 157 and a more detailed description of the assumptions and estimates used in assessing these securities for impairment is disclosed in Assessing available-for-sale assets for impairment on page 178.

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

HSBC s accounting policy for the recognition of deferred tax assets is described in Note 2s on the Financial Statements. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. The recognition of a deferred tax asset relies on management s judgements about the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

HSBC s most significant judgements are around the US deferred tax assets, given the recent history of losses in HSBC s US operations. Net US deferred tax assets amounted to US$5.1 billion or 59 per cent (2008: US$5.1 billion; 73 per cent) 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 by management regarding projections of loan impairment charges and the timing of recovery in the US economy. Management s judgement takes into consideration the impact 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.

The tax losses incurred in HSBC s US operations in 2009 were primarily caused by the high level of loan impairment charges which were due to the current housing and credit market conditions and continued weakness in the general economy, resulting in high unemployment levels. Management has evaluated the factors contributing to the losses to determine whether the factors leading to the losses are temporary or indicative of a permanent decline in earnings.

Management s 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 the depth and severity of house price depreciation, assumptions about the US economic downturn, including unemployment levels and their impact on loan impairment charges, and assumptions about capital support from HSBC.

Management s 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 over the last three years, 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 asset 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, including tax planning strategies implemented in relation to such support. The most significant tax planning strategy is HSBC s investment of capital in its US operations to ensure the realisation of the deferred tax assets. Further to the implementation of this strategy, an internal reorganisation on 31 January 2010 resulted in a capital injection that provided substantial support for the recoverability of the US deferred tax assets. HSBC expects that, with support, its US operations will continue to execute their business strategies and plans until they return to profitability. If HSBC 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 write-off of the deferred tax asset which would be recognised as a charge in the income statement.

Disclosure controls / Management s assessment of internal controls

Disclosure controls

The Group Chief Executive and Chief Financial Officer, Executive Director, Risk and Regulation, 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 2009. Based upon that evaluation, the Group Chief Executive and Chief Financial Officer, Executive Director, Risk and Regulation concluded that HSBC s disclosure controls and procedures as of 31 December 2009 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 2009 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 2009. In making the assessment, management used the framework for Directors 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 2009, the Group s internal control over financial reporting was effective.

KPMG Audit Plc, which has audited the consolidated financial statements of the Group for the year ended 31 December 2009, 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 350 and 351.

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

Customer groups > Personal Financial Services

Customer groups and global businesses

Summary

HSBC s senior management reviews operating activity on a number of bases, including by geographical region and by customer group and global business. Although information is reviewed on a number of bases, capital resources are allocated and performance is assessed primarily by geographical region, as presented on page 85.

In addition to utilising information by geographical region, management assesses performance through two customer groups, Personal Financial Services and Commercial Banking, and two global businesses, Global Banking and Markets and Private Banking. Personal Financial Services incorporates the Group s consumer finance businesses, the largest of which is HSBC Finance.

The commentaries below present customer groups and global businesses followed by geographical regions. Performance is discussed in this order because certain strategic themes, business initiatives and trends affect more than one geographical region. All commentaries are on an underlying basis (see page 21) unless stated otherwise.

Profit/(loss) before tax

	2009		2008		2007	
	US$m	**%**	US$m	%	US$m	%
Personal Financial Services.	**(2,065)**	**(29.2)**	(10,974)	(117.9)	5,900	24.4
Commercial Banking	**4,275**	**60.4**	7,194	77.3	7,145	29.5
Global Banking and Markets	**10,481**	**148.1**	3,483	37.4	6,121	25.3
Private Banking	**1,108**	**15.6**	1,447	15.6	1,511	6.2
Other[40]	**(6,720)**	**(94.9)**	8,157	87.6	3,535	14.6

	7,079	**100.0**	9,307	100.0	24,212	100.0

Total assets[41]

	At 31 December			
	2009		2008	
	US$m	**%**	US$m	%
Personal Financial Services.	**554,074**	**23.4**	527,901	20.9
Commercial Banking	**251,143**	**10.6**	249,218	9.9
Global Banking and Markets	**1,683,672**	**71.2**	1,991,852	78.8
Private Banking	**116,148**	**4.9**	133,216	5.2
Other	**150,983**	**6.4**	145,581	5.8
Intra-HSBC items	**(391,568)**	**(16.5)**	(520,303)	(20.6)
	2,364,452	**100.0**	2,527,465	100.0

For footnotes, see page 149.

Basis of preparation

The results are presented in accordance with the accounting policies used in the preparation of HSBC s consolidated financial statements. HSBC s operations are closely integrated and, accordingly, the presentation of customer group data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and Group Management Office (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.

Table of Contents

Personal Financial Services

Profit/(loss) before tax

	2009	2008	2007
	US$m	US$m	US$m
Net interest income	**25,107**	29,419	29,069
Net fee income	**8,238**	10,107	11,742
Trading income excluding net interest income	**637**	175	38
Net interest income on trading activities	**65**	79	140
Net trading income[42]	**702**	254	178
Net income/(expense) from financial instruments designated at fair value.	**2,339**	(2,912)	1,333
Gains less losses from financial investments	**224**	663	351
Dividend income	**33**	90	55
Net earned insurance premiums	**9,534**	10,083	8,271
Other operating income	**809**	259	387
Total operating income	**46,986**	47,963	51,386
Net insurance claims[43]	**(11,571)**	(6,474)	(8,147)
Net operating income[16]	**35,415**	41,489	43,239
Loan impairment charges and other credit risk provisions	**(19,902)**	(21,220)	(16,172)
Net operating income	**15,513**	20,269	27,067
Employee expenses	**(7,323)**	(9,243)	(9,401)
Goodwill impairment		(10,564)	
Other operating expenses	**(10,969)**	(11,897)	(12,356)
Total operating expenses	**(18,292)**	(31,704)	(21,757)

Operating profit/(loss)	**(2,779)**	(11,435)	5,310
Share of profit in associates and joint ventures	**714**	461	590
Profit/(loss) before tax	**(2,065)**	(10,974)	5,900
By geographical region			
Europe	**312**	1,658	1,581
Hong Kong	**2,728**	3,428	4,212
Rest of Asia-Pacific[27]	**463**	211	515
Middle East[27]	**(126)**	289	245
North America	**(5,226)**	(17,228)	(1,546)
Latin America	**(216)**	668	893
	(2,065)	(10,974)	5,900
	%	*%*	*%*
Share of HSBC s profit before tax	**(29.2)**	(117.9)	24.4
Cost efficiency ratio	**51.7**	76.4	50.3

Balance sheet data [41]

	US$m	US$m	US$m
Loans and advances to customers (net)	**399,460**	401,402	464,726
Total assets	**554,074**	527,901	636,185
Customer accounts	**499,109**	440,338	450,071

For footnotes, see page 149.

Strategic direction

HSBC s strategy for Personal Financial Services is to use its global reach and scale to grow profitably in selected markets by providing relationship banking and wealth management services.

In markets where HSBC already has scale, such as Hong Kong and Mexico, or in emerging markets where scale can be built over time, HSBC provides services to all customer segments. In other markets, HSBC participates more selectively, targeting mass affluent customer segments which have strong international connectivity or where HSBC s global scale is crucial.

HSBC employs two globally consistent propositions, HSBC Premier (Premier) and HSBC Advance (Advance), to serve customers who value international connectivity, who are confident using direct channels to access financial services and who are likely to require wealth management services.

HSBC s continued strategic focus on increasing penetration of wealth management services, through deepening customer relationships and offering innovative solutions, positions the Personal Financial Services business for growth as confidence and demand for equity market and insurance products improves.

Financial performance in 2009

The reported loss before tax of US$2.1 billion compared with a loss before tax of US$11.0 billion in 2008. On an underlying basis and excluding the impairment charge of US$10.6 billion in 2008 to fully write off goodwill in respect of North America Personal Financial Services, the pre-tax loss grew by US$1.1 billion. This was driven by a decline in profits due to a significant fall in deposit spreads, reflecting the very low levels of major currency interest rates throughout 2009, and a rise in loan impairment charges outside North America as global economic conditions deteriorated. Within North America, loan impairment charges and operating expenses fell, reflecting the continuing run-off of the exit portfolios, some stabilisation in the credit environment and the closure of the US Consumer Lending branch network at the beginning of 2009.

Net interest income decreased by 10 per cent. This was due to significant deposit spread compression experienced in the Group s major deposit-taking entities as a result of lower base rates and lower asset balances as customer loans

Table of Contents

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

Customer groups > Personal Financial Services

in the US declined and consumer finance and unsecured lending activities in other countries were scaled back. These factors were partially mitigated by the benefit of lower funding costs on lending spreads and growth in average liability balances as customers responded to the strength of HSBC s brand following the market turmoil in 2008.

Net fee income was 13 per cent lower, reflecting lower card fees from reduced volumes of new lending and changes in customer behaviour, particularly in North America. Weak equity market sentiment in the first half of 2009 further affected revenues from retail securities and investments, notably in Hong Kong, although relatively more buoyant markets led to some recovery in the second half of the year.

A net gain of US$2.3 billion was recorded on financial instruments designated at fair value, compared with an expense of US$2.9 billion in 2008. This was largely due to an increase in the value of assets held to meet liabilities under insurance and investment contracts.

Loan impairment charges fell by 3 per cent, with the significant decline in North America driven by the continuing reduction in balances and some stabilisation of loss experience in certain segments of the consumer finance portfolios. This was partly offset by credit deterioration elsewhere, primarily in the unsecured portfolios of various lending products in the Middle East, the UK and Brazil. The Group further strengthened collection systems and practices, reduced credit lines and tightened lending criteria in 2009.

Costs declined by US$1.4 billion excluding the goodwill impairment charge in North America in 2008. This reduction resulted primarily from the decision to discontinue originations and close the branch network in the Consumer Lending business in the US, and from the exercise of tight control of discretionary expenditure in most regions, notably in Asia. Costs also benefited from a US$0.2 billion accounting gain on staff benefits in 2009 in the UK.

Income from associates and joint ventures rose by 51 per cent, largely driven by the Group s share of profits from Ping An Insurance which increased in 2009 following the non-recurrence of an impairment on its investment in Fortis in 2008.
Customer accounts increased by 7 per cent, largely on the back of strong deposit growth in Asia. Loans and advances to customers were 5 per cent lower as the US consumer finance portfolio continued to decline and, globally, customers reduced their use of credit. At 31 December 2009, the aggregate ratio of customer advances to deposits in Personal Financial Services was 80 per cent, compared with 91 per cent at the end of 2008.

Business highlights in 2009

Premier, the Group s flagship global customer proposition, grew to 3.4 million customers in 2009, attracting 724,000 net new customers of which nearly 50 per cent were new to the Group. Premier was launched in Russia and Colombia during the year, extending the total number of markets where the service is offered to 43.

Premier was expanded in 2009 with the launch of HSBC Amanah Premier, the world s first Islamic premium banking service, in six markets (UAE, Saudi Arabia, Malaysia, Indonesia, Qatar and Bahrain), offering customers a suite of shariah compliant products and Islamic wealth management services.

A second globally consistent proposition, Advance, was developed in 2009 for launch in early 2010. Building on the success of Premier, Advance will target emerging mass affluent customers who are not yet Premier but have the potential to be so. Advance is currently available in seven markets, including Hong Kong and the UK, and will be offered in over 30 markets by the end of 2010.

As part of its wealth management strategy, HSBC successfully launched the World Selection global investment offering in seven markets. This fund, which will be available in over 20 markets by the end of 2010, is designed to meet the different needs and risk appetites of HSBC customers by offering a range of globally diversified and multi-asset portfolios. The fund had assets of US$2.7 billion at the end of the year.

HSBC s growth in personal lending in 2009 was largely in mortgage products in the UK and Hong Kong. In the UK, HSBC launched various marketing campaigns including a new Rate Matcher mortgage promotion. As a result of market share gains in 2009, the UK bank more than met its commitment to make £15 billion (US$24.7 billion) of new mortgage lending available to borrowers. In Hong Kong, HSBC maintained its market leading position with gross mortgage balance growth of 7 per cent during the year.

As part of its strategy to deliver a globally consistent customer experience, Personal Financial Services commenced a global retail store update and refresh programme including the introduction of a set of minimum service standards across customer touch points. The standardised range of design principles helps address the diverse needs of customers and enables them to recognise and be confident in their dealings with HSBC wherever they are. The customer recommendation score for Personal Financial Services increased in 2009 (see page 20).

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

	2009 compared with 2008								
Personal Financial Services	**2008 as reported US$m**	**2008 acquisitions and disposals[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 acquisitions and disposals[10] US$m**	**Underlying change US$m**	**2009 as reported US$m**	**Reported change[13] %**	**Underlying change[13] %**
Net interest income	**29,419**	**(36)**	**(1,534)**	**27,849**	**3**	**(2,745)**	**25,107**	**(15)**	**(10)**
Net fee income	**10,107**	**(32)**	**(645)**	**9,430**		**(1,192)**	**8,238**	**(18)**	**(13)**
Other income[15]	**1,963**	**(121)**	**(258)**	**1,584**	**1**	**485**	**2,070**	**5**	**31**
Net operating income[16]	**41,489**	**(189)**	**(2,437)**	**38,863**	**4**	**(3,452)**	**35,415**	**(15)**	**(9)**
Loan impairment charges and other credit risk provisions	**(21,220)**	**3**	**595**	**(20,622)**		**720**	**(19,902)**	**6**	**3**
Net operating income	**20,269**	**(186)**	**(1,842)**	**18,241**	**4**	**(2,732)**	**15,513**	**(23)**	**(15)**
Operating expenses (excluding goodwill impairment)	**(21,140)**	**38**	**1,372**	**(19,730)**	**(1)**	**1,439**	**(18,292)**	**13**	**7**
Goodwill impairment	**(10,564)**			**(10,564)**		**10,564**		**100**	**100**
Operating loss	**(11,435)**	**(148)**	**(470)**	**(12,053)**	**3**	**9,271**	**(2,779)**	**76**	**77**
Income from associates	**461**		**13**	**474**		**240**	**714**	**55**	**51**

Loss before tax	**(10,974)**	**(148)**	**(457)**	**(11,579)**	**3**	**9,511**	**(2,065)**	**81**	**82**

	2008 compared with 2007								
Personal Financial Services	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	29,069	(224)	(126)	28,719	215	485	29,419	1	2
Net fee income	11,742	(21)	(105)	11,616	(9)	(1,500)	10,107	(14)	(13)
Other income[15]	2,428	(91)	(10)	2,327	83	(447)	1,963	(19)	(19)
Net operating income[16]	43,239	(336)	(241)	42,662	289	(1,462)	41,489	(4)	(3)
Loan impairment charges and other credit risk provisions	(16,172)	4	75	(16,093)	(3)	(5,124)	(21,220)	(31)	(32)
Net operating income	27,067	(332)	(166)	26,569	286	(6,586)	20,269	(25)	(25)
Operating expenses (excluding goodwill impairment)	(21,757)	236	117	(21,404)	(98)	362	(21,140)	3	2
Goodwill impairment						(10,564)	(10,564)		
Operating profit/(loss)	5,310	(96)	(49)	5,165	188	(16,788)	(11,435)	(315)	(325)
Income from associates	590		52	642		(181)	461	(22)	(28)
Profit/(loss) before tax	5,900	(96)	3	5,807	188	(16,969)	(10,974)	(286)	(292)

For footnotes, see page 149.

Commercial Banking

Profit before tax

	2009 US$m	2008 US$m	2007 US$m
Net interest income	**7,883**	9,494	9,055
Net fee income	**3,702**	4,097	3,972
Trading income excluding net interest income	**332**	369	265
Net interest income on trading activities	**22**	17	31
Net trading income[42]	**354**	386	296
Net income/(expense) from financial instruments designated at fair value.	**100**	(224)	22
Gains less losses from financial investments	**23**	193	90
Dividend income	**8**	88	8
Net earned insurance premiums	**886**	679	733
Other operating income	**739**	939	165
Total operating income	**13,695**	15,652	14,341
Net insurance claims[43]	**(842)**	(335)	(391)
Net operating income[16]	**12,853**	15,317	13,950
Loan impairment charges and other credit risk provisions	**(3,282)**	(2,173)	(1,007)
Net operating income	**9,571**	13,144	12,943
Employee expenses	**(2,606)**	(3,056)	(3,094)
Other operating expenses	**(3,357)**	(3,525)	(3,158)
Total operating expenses	**(5,963)**	(6,581)	(6,252)
Operating profit	**3,608**	6,563	6,691
Share of profit in associates and joint ventures	**667**	631	454
Profit before tax	**4,275**	7,194	7,145
By geographical region			
Europe	**1,292**	2,722	2,516
Hong Kong	**956**	1,315	1,619
Rest of Asia-Pacific[27]	**1,064**	1,235	868
Middle East[27]	**21**	558	482

North America	**543**	658	920
Latin America	**399**	706	740
	4,275	7,194	7,145
	%	%	%
Share of HSBC s profit before tax	**60.4**	77.3	29.5
Cost efficiency ratio	**46.4**	43.0	44.8

Balance sheet data[41]

	US$m	US$m	US$m
Loans and advances to customers (net)	**199,674**	203,949	220,068
Total assets	**251,143**	249,218	307,944
Customer accounts	**267,388**	235,879	237,987

For footnotes, see page 149.

Strategic direction

HSBC s Commercial Banking strategy is focused on two key initiatives:

- to be the leading international business bank, using HSBC s extensive geographical network together with product expertise in payments, trade, receivables finance and foreign exchange to actively support customers who are trading and investing across borders; and

- to be the best bank for small and medium-sized enterprises (SME s) in target markets, building global scale and creating efficiencies by sharing systems and best practice, including customer experience, training and product offerings, and selectively rolling out the direct banking model.

Financial performance in 2009

Commercial Banking remained profitable in all regions in 2009, although profit before tax of US$4.3 billion was 41 per cent lower than in 2008. The results included a US$280 million gain from the disposal of the remaining stake in HSBC s UK card merchant acquiring business, compared with a US$425 million gain in 2008 from the sale of the first tranche. On an underlying basis, pre-tax profit declined by 35 per cent, driven by the effects of lower interest rates on deposit margins and higher loan impairment charges resulting from deterioration in the global economy.

Deposit balances increased by 7 per cent to US$267 billion, largely in Hong Kong and the UK, as HSBC s brand strength continued to attract new customers. Loans and advances were 9 per cent lower, largely as customer demand for new lending declined. This decline was partly offset by targeted growth in key markets such as mainland China. The relative movement in deposits and loans strengthened HSBC s liquidity position, with an aggregate customer advances to deposits ratio in Commercial Banking of 75 per cent compared with 86 per cent reported at 31 December 2008.

Net interest income fell by 11 per cent despite higher deposit balances, driven by deposit spread compression and reduced lending balances. This was partly offset by wider spreads on lending due to improved pricing.

Net fee income was broadly unchanged, as repricing initiatives drove higher fee income from credit facilities in North America which was offset by a reduction in fee income following the part disposal of the card merchant acquiring business to a joint venture in 2008.

Loan impairment charges and other credit risk provisions increased by 56 per cent to US$3.3 billion, representing less than 2 per cent of average reported assets. Loan impairment charges in 2009 remained at broadly the same rate as experienced in the second half of 2008, with the charge concentrated in manufacturing, general trading and real estate. The increase in loan impairment charges was mainly in the Middle East, the UK, Brazil, and India, partly offset by an improving credit environment in Hong Kong.

Operating expenses remained broadly unchanged, including the benefit in the UK of an accounting gain on staff benefits; however, the cost efficiency ratio deteriorated slightly driven by the effect of deposit spread compression on revenues.

Income from associates and joint ventures rose by 5 per cent.

Business highlights in 2009

HSBC s leading international business strategy continued to deliver customer-led and product-driven growth across all segments.

Product revenues from foreign exchange were unchanged at US$0.5 billion, and revenues from trade and supply chain also remained flat at US$1.4 billion despite the overall decline in global trade levels. While volumes of trade activity were depressed in line with world trade volumes, signs of recovery were apparent towards the end of the year.

Foreign exchange services were enhanced with the launch of GetRate on Business Internet Banking in Malaysia, India and the UK.

The number of cross-border intra-Group referrals increased by 48 per cent, notably in Asia which accounted for over half of all successful referrals. The aggregate transaction value of successful referrals was US$9.0 billion.

HSBC further strengthened its international offerings for customers, with particular focus on business flows to and from mainland China. In conjunction with Bank of Communications, HSBC launched a renminbi trade settlement service in seven ASEAN countries and a same-day credit pledge service on outward remittances into mainland China from Hong Kong.

Services for mainland China companies looking to expand overseas were also a focus of attention, with innovative solutions including a video conference account opening service for SMEs. Investment flows into mainland China were targeted by increasing the number of foreign national relationship managers in HSBC s international business teams there.

HSBC s best bank for business strategy also progressed strongly with its transaction banking and liabilities-led approach, particularly relevant in a period of low credit demand:

Business banking customer numbers increased by 12 per cent to 3 million with over 61 per cent of new customers in emerging markets.

Deposit balances in business banking were US$146 billion, providing a significant surplus of funds for deployment. Total revenue from Business Banking of US$5.8 billion, despite the effects of deposit spread compression, represented 45 per cent of total revenue, highlighting the importance of this segment to the Commercial Banking business.

Customer loans and advances in business banking were US$53 billion, and HSBC continued to support businesses in the global downturn. The US$5 billion International SME Fund was launched in December 2008 in five key markets. The fund was fully allocated by the end of 2009 and 80 per cent of it was utilised.

In 2009, the global roll-out of internationally consistent offerings continued. Business Direct, the direct channel proposition, was launched in a further three countries and is now live in ten, while the roll-out of a credit scoring platform and deployment of globally consistent training programmes illustrated HSBC s ability to leverage best practice and drive efficiencies across its worldwide network.

In the corporate segment (see page 145 for details), HSBC s ability to provide or arrange debt finance combined with its international reach for payments and trade activity across developed and emerging markets was evident in the number of new multi-country banking relationships won in 2009, despite the more cautious sentiment within the global economy.

The number of customers using HSBCnet continued to grow strongly, and full regional connectivity was rolled out in Latin America. The receivables finance capability was extended to deliver supplier funding programmes for large buyers, and new pan-European deals were written.

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

Customer groups > Commercial Banking / Global Banking and Markets

Total revenue in the corporate segment was US$6.3 billion. Deposits from corporate customers were US$121 billion, while loans and advances were US$147 billion. Signs of returning confidence in the second half of 2009 were accompanied by higher levels of new lending, particularly in Asia and other emerging markets.

Commercial Banking continued to seek opportunities to deliver intra-Group referrals:

A new global referral programme between Commercial Banking and Personal Financial Services was launched, resulting in over 15,000 successful referrals to HSBC Premier.

The number of referrals to Private Banking was 1,057, generating over US$2.5 billion in assets under management.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Commercial Banking	2008 as reported US$m	2008 acquisitions and disposals[10] US$m	Currency translation[11] US$m	2008 at 2009 exchange rates[12] US$m	2009 acquisitions and disposals[10] US$m	Under-lying change US$m	2009 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	**9,494**	**(29)**	**(697)**	**8,768**	**45**	**(930)**	**7,883**	**(17)**	**(11)**
Net fee income	**4,097**	**(26)**	**(367)**	**3,704**	**5**	**(7)**	**3,702**	**(10)**	
Other income[15]	**1,726**	**(464)**	**(213)**	**1,049**	**295**	**(76)**	**1,268**	**(27)**	**(7)**
Net operating income[16]	**15,317**	**(519)**	**(1,277)**	**13,521**	**345**	**(1,013)**	**12,853**	**(16)**	**(7)**
Loan impairment charges and other credit risk provisions	**(2,173)**	**3**	**68**	**(2,102)**		**(1,180)**	**(3,282)**	**(51)**	**(56)**
Net operating income	**13,144**	**(516)**	**(1,209)**	**11,419**	**345**	**(2,193)**	**9,571**	**(27)**	**(19)**
Operating expenses	**(6,581)**	**30**	**537**	**(6,014)**	**(27)**	**78**	**(5,963)**	**9**	**1**
Operating profit	**6,563**	**(486)**	**(672)**	**5,405**	**318**	**(2,115)**	**3,608**	**(45)**	**(39)**
Income from associates	**631**		**7**	**638**		**29**	**667**	**6**	**5**
Profit before tax	**7,194**	**(486)**	**(665)**	**6,043**	**318**	**(2,086)**	**4,275**	**(41)**	**(35)**

2008 compared with 2007

2007

Commercial Banking	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[12] US$m	2008 acquisitions and disposals[10] US$m	Under- lying change US$m	2008 as reported US$m	Re- ported change[13] %	Under- lying change[13] %
Net interest income	9,055	(166)	(77)	8,812	41	641	9,494	5	7
Net fee income	3,972	(113)	(76)	3,783	27	287	4,097	3	8
Other income[15]	923	(7)	(28)	888	525	313	1,726	87	35
Net operating income[16]	13,950	(286)	(181)	13,483	593	1,241	15,317	10	9
Loan impairment charges and other credit risk provisions	(1,007)	3	36	(968)	(3)	(1,202)	(2,173)	(116)	(124)
Net operating income	12,943	(283)	(145)	12,515	590	39	13,144	2	
Operating expenses	(6,252)	180	47	(6,025)	(106)	(450)	(6,581)	(5)	(7)
Operating profit	6,691	(103)	(98)	6,490	484	(411)	6,563	(2)	(6)
Income from associates	454		26	480		151	631	39	31
Profit before tax	7,145	(103)	(72)	6,970	484	(260)	7,194	1	(4)

For footnotes, see page 149.

Table of Contents

Global Banking and Markets

Profit before tax

	2009 US$m	2008 US$m	2007 US$m
Net interest income	**8,610**	8,541	4,430
Net fee income	**4,363**	4,291	4,901
Trading income excluding net interest income	**4,701**	157	3,503
Net interest income/ (expense) on trading activities	**2,174**	324	(236)
Net trading income[42]	**6,875**	481	3,267
Net income/(expense) from financial instruments designated at fair value	**473**	(438)	(164)
Gains less losses from financial investments	**265**	(327)	1,313
Dividend income	**68**	76	222
Net earned insurance premiums	**54**	105	93
Other operating income	**1,146**	868	1,218
Total operating income	**21,854**	13,597	15,280
Net insurance claims[43]	**(34)**	(79)	(70)
Net operating income[16]	**21,820**	13,518	15,210
Loan impairment charges and other credit risk provisions.	**(3,168)**	(1,471)	(38)
Net operating income	**18,652**	12,047	15,172
Employee expenses	**(4,703)**	(4,928)	(5,572)
Other operating expenses	**(3,834)**	(4,164)	(3,786)
Total operating expenses	**(8,537)**	(9,092)	(9,358)
Operating profit	**10,115**	2,955	5,814
Share of profit in associates and joint ventures	**366**	528	307
Profit before tax	**10,481**	3,483	6,121
By geographical region			
Europe	**4,545**	195	2,527
Hong Kong	**1,507**	1,436	1,578
Rest of Asia-Pacific[27]	**2,319**	2,970	1,969
Middle East[27]	**467**	816	495
North America	**712**	(2,575)	(965)
Latin America	**931**	641	517
	10,481	3,483	6,121

	%	%	%
Share of HSBC s profit before tax	**148.1**	37.4	25.3
Cost efficiency ratio	**39.1**	67.3	61.5

For footnotes, see page 149.

Strategic direction

In 2009, Global Banking and Markets 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 Global Banking and Markets hub-and-spoke business model; and
- continuing to build capabilities in major hubs to support the delivery of an advanced suite of services to corporate, institutional and government clients across the HSBC network.

Ensuring that this combination of product depth and distribution strength meets the needs of existing and new clients will allow Global Banking and Markets to achieve its strategic goals.

Financial performance in 2009

- Global Banking and Markets delivered a considerably improved performance with reported pre-tax profits of US$10.5 billion, an increase of US$7.0 billion or 201 per cent compared with 2008. On an underlying basis, profit before tax increased by 249 per cent with strong performances in both developed and emerging markets. Robust revenues across core businesses were driven by higher margins and an increase in market share, with particularly strong performances in Rates and Balance Sheet Management. Revenues grew faster than operating expenses with continued emphasis on active cost management limiting the latter to a relatively modest rise. The cost efficiency ratio improved by 29.1 percentage points to 39.1 per cent.
- Write-downs on legacy positions in credit trading, leveraged and acquisition financing and monoline credit exposures, which totalled US$331 million, were significantly lower than those recorded in 2008, primarily driven by the stabilisation of asset prices. This was partly offset by a fair value loss of US$444 million resulting from tightening credit spreads on structured liabilities; a gain of US$529 million was reported in 2008.
- Loan impairment charges and other credit risk provisions increased by US$1.7 billion. Loan impairment charges were US$1.7 billion compared with US$0.8 billion in 2008, reflecting a deterioration in the credit position of

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

Customer groups > Global Banking and Markets
Management view of total operating income

	2009 US$m	2008 US$m	2007 US$m
Global Markets[44]	**10,364**	2,676	5,720
Credit	**2,330**	(5,502)	(1,319)
Rates	**2,648**	2,033	1,291
Foreign exchange	**2,979**	3,842	2,178
Equities	**641**	(64)	1,177
Securities services[45]	**1,420**	2,116	1,926
Asset and structured finance	**346**	251	467
Global Banking	**4,630**	5,718	4,190
Financing and equity capital markets	**3,070**	3,572	2,186
Payments and cash management[46]	**1,053**	1,665	1,632
Other transaction services[47]	**507**	481	372
Balance Sheet Management	**5,390**	3,618	1,226
Global Asset Management	**939**	934	1,336
Principal Investments	**42**	(415)	1,253
Other[48]	**489**	1,066	1,555
Total operating income	**21,854**	13,597	15,280

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

For footnotes, see page 149.

a small number of clients. This was in line with market trends of a rise in the number and severity of defaults on loans, despite a return of liquidity to the market. Impairment charges on the available-for-sale portfolio at US$1.4 billion were US$0.8 billion higher than in 2008; however, they remained within the range of the stress tests described on page 156 of the *Annual Report and Accounts 2008*.

Within the Group s available-for-sale portfolio, the negative reserves in respect of asset-backed securities (ABS s) reduced significantly from US$18.7 billion to US$12.2 billion, reflecting the impact of amortisation and recent increases in ABS prices. Impairment charges of US$1.4 billion were identified on ABSs with a nominal value of

US$2.6 billion and were taken to the income statement in 2009. However, due to the underlying credit quality and seniority of the tranches held by HSBC, the expected cash flow impairment on these securities was a more modest US$378 million. A further US$666 million of impairments was absorbed by income noteholders who take the first loss on positions within the securities investment conduits (SIC s) now consolidated in HSBC s accounts. Further details on the SICs are provided on page 182.

Business highlights in 2009

HSBC was recognised for the continuing success of its emerging markets-led and financing-focused strategy with numerous key industry awards, including *Euromoney* s Best Debt House in the following emerging market countries and regions: Mexico, Turkey, Asia, Latin America and the Middle East, along with Best Global Bank , and Best Global Debt House . Other awards included European DCM House of the Year , European Corporate Bond House of the Year and European Financial Institutions Bond House of the Year in *Financial News*.

Global Markets revenues grew significantly as volatile markets and increased customer activity gave impetus to client-facing businesses. Exceptional revenues in Rates and improved revenues in Credit were boosted by greater market share in both primary and secondary client business. Credit revenues were also assisted by a general tightening of credit spreads and an increase in asset prices following a return of liquidity in financial markets. Foreign exchange revenues normalised following unprecedented levels of market volatility in 2008, as the business established deeper institutional client relationships. Equities took advantage of a changed competitive landscape to capture a greater share of business in strategic markets from key institutional clients, particularly in Europe, the Middle East and Asia.

Securities Services revenues declined as lower interest rates drove down overall margins, although this was partially offset by recent improvements in Asian equity markets which stimulated increases in volumes and assets under custody in the second half of 2009.

In Global Banking, certain credit default swap transactions which hedge risk within the portfolio, recorded fair value losses of US$429 million as credit spreads tightened, compared with gains of US$912 million reported in 2008. Excluding this, higher spreads drove an increase in credit and lending revenues, reflecting the strength of HSBC s franchise and the quality of the client portfolio. Revenues in the equity capital markets business doubled following increased market share in key strategic regions. Payments and cash management activities continued to be adversely affected by the low interest rate environment, partly countered by an increase in liability balances.

Table of Contents

Balance Sheet Management continued to benefit from early positioning against the backdrop of a low interest rate environment although, as expected, revenues slowed in the second half of 2009 as certain higher yield positions matured.

In Global Asset Management, positive fee income growth was recorded in each consecutive quarter, with an improving contribution from emerging markets. Funds under management at 31 December 2009 were US$423 billion, 14 per cent higher than at the start of the year, assisted by positive net inflows of US$11 billion and strengthening market performance. Fund launches during the year included HSBC World Selection in conjunction with Personal Financial Services, which had assets of US$2.7 billion at year end. In August 2009, Global Asset Management entered the European Exchange Traded Funds (ETF) market, working closely with Global Markets and HSBC Securities Services, and launched three ETF funds.

In Principal Investments, opportunities for private equity realisations were limited and impairment charges were made against a small number of equity investments.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Global Banking and Markets	**2008 as reported US$m**	**2008 acquisitions and disposals[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 acquisitions and disposals[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**8,541**		**(451)**	**8,090**	**5**	**515**	**8,610**	**1**	**6**
Net fee income	**4,291**		**(267)**	**4,024**	**1**	**338**	**4,363**	**2**	**8**
Other income[15]	**686**		**(555)**	**131**	**2**	**8,714**	**8,847**	**1,190**	**6,652**
Net operating income[16]	**13,518**		**(1,273)**	**12,245**	**8**	**9,567**	**21,820**	**61**	**78**
Loan impairment charges and other credit risk provisions	**(1,471)**		**45**	**(1,426)**		**(1,742)**	**(3,168)**	**(115)**	**(122)**
Net operating income	**12,047**		**(1,228)**	**10,819**	**8**	**7,825**	**18,652**	**55**	**72**
Operating expenses	**(9,092)**		**743**	**(8,349)**	**(3)**	**(185)**	**(8,537)**	**6**	**(2)**
Operating profit	**2,955**		**(485)**	**2,470**	**5**	**7,640**	**10,115**	**242**	**309**
Income from associates	**528**		**6**	**534**		**(168)**	**366**	**(31)**	**(31)**
Profit before tax	**3,483**		**(479)**	**3,004**	**5**	**7,472**	**10,481**	**201**	**249**

2008 compared with 2007

2007

Global Banking and Markets	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[12] US$m	2008 acquisitions and disposals[10] US$m	Underlying change US$m	2008 as reported US$m	Reported change[13] %	Underlying change[13] %
Net interest income	4,430		(32)	4,398		4,143	8,541	93	94
Net fee income	4,901		(46)	4,855		(564)	4,291	(12)	(12)
Other income[15]	5,879		(57)	5,822		(5,136)	686	(88)	(88)
Net operating income[16]	15,210		(135)	15,075		(1,557)	13,518	(11)	(10)
Loan impairment charges and other credit risk provisions	(38)		1	(37)		(1,434)	(1,471)	(3,771)	(3,876)
Net operating income	15,172		(134)	15,038		(2,991)	12,047	(21)	(20)
Operating expenses	(9,358)		175	(9,183)		91	(9,092)	3	1
Operating profit	5,814		41	5,855		(2,900)	2,955	(49)	(50)
Income from associates	307		18	325		203	528	72	62
Profit before tax	6,121		59	6,180		(2,697)	3,483	(43)	(44)

For footnotes, see page 149.

75

Table of Contents

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

Customer groups > Global Banking and Markets / Private Banking

Balance sheet data significant to Global Banking and Markets

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[27] US$m	Middle East[27] US$m	North America US$m	Latin America US$m	Total US$m
At 31 December 2009							
Trading assets[49]	**294,951**	**25,742**	**15,960**	**511**	**67,466**	**6,283**	**410,913**
Derivative assets	**190,900**	**16,937**	**15,660**	**668**	**61,192**	**2,820**	**288,177**
Loans and advances to:							
customers (net)	**176,123**	**21,991**	**23,989**	**6,554**	**18,654**	**9,645**	**256,956**
banks (net)	**59,171**	**27,789**	**29,388**	**6,385**	**14,403**	**16,638**	**153,774**
Financial investments[49]	**83,715**	**92,181**	**36,355**	**9,688**	**49,386**	**14,659**	**285,984**
Total assets[41]	**981,831**	**217,146**	**138,884**	**28,189**	**260,131**	**57,491**	**1,683,672**
Deposits by banks	**88,043**	**5,824**	**7,874**	**1,357**	**13,229**	**3,948**	**120,275**
Customer accounts	**169,390**	**26,650**	**43,698**	**5,752**	**19,095**	**20,142**	**284,727**
Trading liabilities	**169,814**	**10,720**	**3,040**	**13**	**69,302**	**2,875**	**255,764**
Derivative liabilities	**191,480**	**16,619**	**15,500**	**651**	**60,178**	**3,270**	**287,698**
At 31 December 2008							
Trading assets[49]	281,089	45,398	19,192	414	74,498	5,004	425,595
Derivative assets	303,265	26,989	25,492	1,014	125,848	5,145	487,753
Loans and advances to:							
customers (net)	185,818	23,042	27,941	6,649	35,583	8,273	287,306
banks (net)	49,508	20,970	21,309	5,401	9,238	12,574	119,000
Financial investments[49]	105,546	46,964	29,772	7,574	39,841	8,179	237,876
Total assets[41]	1,180,759	233,187	147,714	27,975	348,347	53,870	1,991,852
Deposits by banks	79,509	11,509	12,261	944	16,244	3,871	124,338
Customer accounts	199,687	30,866	42,977	7,628	23,844	15,384	320,386
Trading liabilities	144,759	13,056	3,633	54	72,325	2,546	236,373
Derivative liabilities	300,200	28,536	25,465	1,016	122,699	4,615	482,531

At 31 December 2007

Trading assets[49]	294,078	26,877	18,119	1,613	93,395	8,570	442,652
Derivative assets	102,409	11,492	9,795	439	56,531	1,814	182,480
Loans and advances to:							
customers (net)	163,066	19,171	26,476	5,630	26,186	9,935	250,464
banks (net)	89,651	53,725	24,733	6,120	14,938	10,339	199,506
Financial investments[49]	94,416	46,765	31,301	8,147	33,273	10,155	224,057
Total assets[41]	912,299	218,293	130,096	26,548	263,008	46,606	1,596,850
Deposits by banks	85,315	6,251	14,737	2,437	14,825	2,830	126,395
Customer accounts	163,713	37,364	45,773	8,347	30,732	13,950	299,879
Trading liabilities	201,010	15,939	8,517	84	73,081	4,998	303,629
Derivative liabilities	104,687	10,865	9,204	452	53,058	1,986	180,252

For footnotes, see page 149.

Private Banking
Profit before tax

	2009 US$m	2008 US$m	2007 US$m
Net interest income	**1,474**	1,612	1,216
Net fee income	**1,236**	1,476	1,615
Trading income excluding net interest income	**322**	408	525
Net interest income on trading activities	**22**	14	9
Net trading income[42]	**344**	422	534
Net expense from financial instruments designated at fair value			(1)
Gains less losses from financial investments	**5**	64	119
Dividend income	**5**	8	7
Other operating income	**48**	49	58
Total operating income	**3,112**	3,631	3,548
Net insurance claims[43]			
Net operating income[16]	**3,112**	3,631	3,548
Loan impairment charges and other credit risk provisions	**(128)**	(68)	(14)
Net operating income	**2,984**	3,563	3,534
Employee expenses	**(1,234)**	(1,367)	(1,250)
Other operating expenses	**(650)**	(749)	(775)
Total operating expenses	**(1,884)**	(2,116)	(2,025)
Operating profit	**1,100**	1,447	1,509
Share of profit in associates and joint ventures	**8**		2

Profit before tax	**1,108**	1,447	1,511
By geographical region			
Europe	**854**	998	915
Hong Kong	**197**	237	305
Rest of Asia-Pacific[27]	**90**	109	89
Middle East[27]	**6**	4	3
North America	**(50)**	83	174
Latin America	**11**	16	25
	1,108	1,447	1,511
	%	%	%
Share of HSBC s profit before tax	**15.6**	15.6	6.2
Cost efficiency ratio	**60.5**	58.3	57.1

Balance sheet data[41]

	US$m	US$m	US$m
Loans and advances to customers (net)	**37,031**	37,590	43,612
Total assets	**116,148**	133,216	130,893
Customer accounts	**106,533**	116,683	106,197

For footnotes, see page 149.

Strategic direction

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

The strength of HSBC s brand, capital position, and extensive global network provides a foundation from which Private Banking continues to attract and retain clients. Product and service leadership in areas such as credit, estate planning, hedge funds, and investment advice helps Private Banking meet the complex international financial needs of individuals and families.

Through continuing investment in its people, integrated IT solutions and emerging markets-focused domestic operations, Private Banking is well-positioned for sustainable long-term growth.

Financial performance in 2009

Reported pre-tax profit was 23 per cent lower at US$1.1 billion, a fall of 21 per cent on an underlying basis, primarily from a decline in fee income. This was due to a change in the risk tolerance of private banking customers and consequent reduction in client activity, lower fiduciary fees and the effect of weak markets on the value of funds under management. Strong cost control including reduced performance-related costs partially offset the lower revenues.

Net interest income fell by 6 per cent as lower interest rates in the major economies, combined with aggressive competition for deposits from weaker competitors, particularly in Europe and North America, led to tighter spreads and a decline in balances. Lending volumes declined due to client deleveraging and a lower appetite for credit, although this was partly mitigated by re-pricing historically low margin business to reflect the changed conditions. Favourable interest rate and yield curve movements at the beginning of 2009 generated higher treasury income in Asia and Europe, benefiting net interest income.

Net fee income decreased by 14 per cent, affected by the fall in the value of equity markets in the second half of 2008 and the first quarter of 2009. This resulted in a lower average value of funds under management and the redemption of investments, particularly hedge funds, in early 2009. Commission income on fiduciary deposits decreased as low interest rates resulted in a decline in volumes, and annual fund performance fees earned in January 2008 were not repeated in 2009.

Table of Contents

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

Customer groups > Private Banking

Trading income fell by 18 per cent, also reflecting lower client trading activity, mainly in foreign exchange and structured products.

Gains less losses from financial investments decreased by 90 per cent due to gains made on the disposal of HSBC s residual interest in the Hermitage Fund in the first half of 2008 which did not recur in 2009.

Other operating income was in line with 2008, and included gains on the sale of two office buildings in Switzerland and Luxembourg.

Loan impairment charges and other credit risk provisions increased by US$62 million, largely due to a single specific charge in the US in 2009.

Operating expenses decreased by 9 per cent as performance-related costs were cut, staff numbers were reduced and discretionary costs such as travel and marketing were tightly managed. These steps were taken in response to the lower revenues earned in the weaker economic environment. Costs included US$19 million of integration costs relating to the merger of HSBC s two Swiss private banks, US$17 million of redundancy costs worldwide and the up-front cost of establishing Private Banking in new developing markets, including investments in mainland China, India and Russia.

The cost efficiency ratio increased by 2.1 percentage points to 60.5 per cent.

Client assets

	2009	2008
	US$bn	US$bn
At 1 January	**352**	421
Net new money	**(7)**	24
Value change	**27**	(71)
Exchange and other	**(5)**	(22)
At 31 December	**367**	352

Client assets by investment class

	2009	2008
	US$bn	US$bn
Equities	**73**	53
Bonds	**69**	57
Structured products	**10**	7
Funds	**82**	87
Cash, fiduciary deposits and other	**133**	148

367	352

Reported client assets increased by 4 per cent to US$367 billion due to portfolio appreciation and foreign exchange movements, partly offset by a net outflow of funds due to hedge fund redemptions, client deleveraging and the decision not to match aggressive deposit prices offered by weaker competitors, particularly in Europe and North America. Private Banking continued to experience net client inflows in emerging markets, namely Asia, the Middle East and Latin America, with net new money of US$6.6 billion generated in these markets in the year.

Reported total client assets increased by 6 per cent to US$460 billion, largely due to an increase in the market value of assets. Total client assets is a measure equivalent to many industry definitions of assets under management which include some non-financial assets held in client trusts.

Business highlights in 2009

Intragroup referrals continued to result in good inflows with US$5.8 billion raised during 2009.

The legal merger of HSBC s two Swiss private banks was achieved as planned in April 2009 and technical integration was completed in early January 2010. The combined bank is expected to achieve significant operational and cost efficiencies.

HSBC Alternative Investments Limited continued to achieve strong returns on hedge fund products in the second half of 2009, including its flagship fund of hedge funds, the GH fund, which achieved a return of 12.3 per cent during the year. A series of new products were launched including one of the first UCITS III hedge funds of hedge funds and as a result, the business saw net inflows in the second half of 2009.

Major awards included Outstanding Global Private Bank by *Private Banker International*, and Best Global Private Bank , Best Private Bank in Asia and Best Private Bank in the Middle East by *The Banker* and *The Financial Times*. The *Euromoney* 2010 Private Banking Survey placed HSBC second in the Global Private Banking category for the second consecutive year.

Investment in emerging markets and domestic businesses continued, including the launch of Private Banking in Russia and further investments in Private Banking operations in Asia, Latin America and the Middle East.

Table of Contents

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Private Banking	**2008 as reported US$m**	**2008 acquisitions and disposals[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 acquisitions and disposals[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**1,612**		**(52)**	**1,560**		**(86)**	**1,474**	**(9)**	**(6)**
Net fee income	**1,476**		**(33)**	**1,443**		**(207)**	**1,236**	**(16)**	**(14)**
Other income[15]	**543**		**(19)**	**524**		**(122)**	**402**	**(26)**	**(23)**
Net operating income[16]	**3,631**		**(104)**	**3,527**		**(415)**	**3,112**	**(14)**	**(12)**
Loan impairment charges and other credit risk provisions	**(68)**		**2**	**(66)**		**(62)**	**(128)**	**(88)**	**(94)**
Net operating income	**3,563**		**(102)**	**3,461**		**(477)**	**2,984**	**(16)**	**(14)**
Operating expenses	**(2,116)**		**54**	**(2,062)**		**178**	**(1,884)**	**11**	**9**
Operating profit	**1,447**		**(48)**	**1,399**		**(299)**	**1,100**	**(24)**	**(21)**
Income from associates						**8**	**8**		
Profit before tax	**1,447**		**(48)**	**1,399**		**(291)**	**1,108**	**(23)**	**(21)**

	2008 compared with 2007								
Private Banking	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	1,216	1	(12)	1,205		407	1,612	33	34

Net fee income	1,615	(105)	26	1,536	(60)	1,476	(9)	(4)
Other income[15]	717	(18)	5	704	(161)	543	(24)	(23)
Net operating income[16]	3,548	(122)	19	3,445	186	3,631	2	5
Loan impairment charges and other credit risk provisions	(14)			(14)	(54)	(68)	(386)	(386)
Net operating income	3,534	(122)	19	3,431	132	3,563	1	4
Operating expenses	(2,025)	98	(17)	(1,944)	(172)	(2,116)	(4)	(9)
Operating profit	1,509	(24)	2	1,487	(40)	1,447	(4)	(3)
Income from associates	2			2	(2)		(100)	(100)
Profit before tax	1,511	(24)	2	1,489	(42)	1,447	(4)	(3)

For footnotes, see page 149.

Table of Contents

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

Customer groups > Other

Other

Profit/(loss) before tax

	2009 US$m	2008 US$m	2007 US$m
Net interest expense	**(1,035)**	(956)	(542)
Net fee income/(expense)	**125**	53	(228)
Trading income/(expense) excluding net interest income	**244**	(262)	127
Net interest income/(expense) on trading activities	**35**	(268)	(1)
Net trading income/(expense)[42]	**279**	(530)	126
Changes in fair value of long-term debt issued and related derivatives	**(6,247)**	6,679	2,812
Net income/(expense) from other financial instruments designated at fair value	**(196)**	747	81
Net income/(expense) from financial instruments designated at fair value	**(6,443)**	7,426	2,893
Gains less losses from financial investments	**3**	(396)	83
Gains arising from dilution of interests in associates			1,092
Dividend income	**12**	10	32
Net earned insurance premiums	**(3)**	(17)	(21)
Gains on disposal of French regional banks		2,445	
Other operating income	**5,042**	4,261	3,523
Total operating income/(expense)	**(2,020)**	12,296	6,958
Net insurance claims[43]	**(3)**	(1)	
Net operating income/(expense)[16]	**(2,023)**	12,295	6,958
Loan impairment charges and other credit risk provisions	**(8)**	(5)	(11)
Net operating income/(expense)	**(2,031)**	12,290	6,947
Employee expenses	**(2,602)**	(2,198)	(2,017)

Other operating expenses	**(2,113)**	(1,976)	(1,545)
Total operating expenses	**(4,715)**	(4,174)	(3,562)
Operating profit/(loss)	**(6,746)**	8,116	3,385
Share of profit in joint ventures and associates	**26**	41	150
Profit/(loss) before tax	**(6,720)**	8,157	3,535
By geographical region			
Europe	**(2,994)**	5,296	1,056
Hong Kong	**(359)**	(955)	(375)
Rest of Asia-Pacific[27]	**264**	197	1,261
Middle East[27]	**87**	79	82
North America	**(3,717)**	3,534	1,508
Latin America	**(1)**	6	3
	(6,720)	8,157	3,535
	%	%	%
Share of HSBC s profit before tax	**(94.9)**	87.6	14.6
Cost efficiency ratio	**(233.1)**	33.9	51.2

Balance sheet data[41]

	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**3,110**	2,621	2,678
Total assets	**150,983**	145,581	164,806
Customer accounts	**1,277**	2,041	2,006

For footnotes, see page 149.

Notes

Reported loss before tax in Other was US$6.7 billion, compared with a profit of US$8.2 billion in 2008. For a description of the main items reported under Other , see footnote 40 on page 150.

Net interest expense substantially comprises the interest paid on third-party debt issues at the holding company level.

Net trading income was US$279 million, compared with a net trading expense in 2008; this reflected fair value gains on certain non-qualifying hedges, compared with fair value losses in 2008. This caption also included a one-off hedging loss of US$344 million relating to forward foreign exchange contracts entered into to hedge the proceeds of the Group s rights issue, and a US$121 million loss arising from the mark-to-market of the implied contingent forward contract entered into with the underwriters of the Group s rights issue. Both of these items were part of the net proceeds of the rights issue but for technical accounting reasons were reflected through the income statement.

Net expense from financial instruments designated at fair value declined by 90 per cent to US$90 million due to reduced income from non-qualifying interest and exchange rate hedges related to long-term debt issued by HSBC Holdings and its North American and European subsidiaries.

HSBC recognised a gain of US$576 million in respect of the sale and leaseback of 8 Canada Square, its global headquarters in London, which was effected through the disposal of its entire shareholding in PMII. In 2008, a gain of US$416 million was reported in respect of the purchase of PMII from Metrovacesa. See Note 23 on the Financial Statements.

Operating expenses increased by 15 per cent to US$4.7 billion, mainly due to further centralisation of certain operational functions in the US to HSBC Technology Services USA resulting in cost savings across the other customer groups in North America. These expenses were previously incurred directly by customer groups, and are now substantially recovered from them through a recharge mechanism with the revenue reported in other operating income. Costs at HSBC s Group Service Centres rose by 10 per cent as the number of migrated activities increased in line with the Group s Global Resourcing model.

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

	2009 compared with 2008								
Other	**2008 as reported US\$m**	**2008 adjust-ments[10] US\$m**	**Currency translation[11] US\$m**	**2008 at 2009 exchange rates[12] US\$m**	**2009 adjust-ments[10] US\$m**	**Under-lying change US\$m**	**2009 as reported US\$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest expense	(956)		12	(944)		(91)	(1,035)	(8)	(10)
Net fee income	53		(3)	50		75	125	136	150
Changes in fair value	6,570	(6,570)			(6,533)		(6,533)	(199)	
Gains on disposal of French regional banks	2,445	(2,445)						(100)	
Other income[15]	4,183	(95)	(13)	4,075		1,345	5,420	30	33
Net operating income/ (expense)[16]	12,295	(9,110)	(4)	3,181	(6,533)	1,329	(2,023)	(116)	42
Loan impairment charges and other credit risk provisions	(5)		(1)	(6)		(2)	(8)	(60)	(33)
Net operating income/ (expense)	12,290	(9,110)	(5)	3,175	(6,533)	1,327	(2,031)	(117)	42
Operating expenses	(4,174)		70	(4,104)		(611)	(4,715)	(13)	(15)
Operating profit/(loss)	8,116	(9,110)	65	(929)	(6,533)	716	(6,746)	(183)	77
Income from associates	41		(1)	40		(14)	26	(37)	(35)

Profit/(loss) before tax	**8,157**	**(9,110)**	**64**	**(889)**	**(6,533)**	**702**	**(6,720)**	**(182)**	**79**

	2008 compared with 2007								
Other	2007 as reported US$m	2007 adjustments and dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 at 2008 exchange rates[17] US$m	2008 adjustments[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest expense	(542)		(38)	(580)	(6)	(370)	(956)	(76)	(64)
Net fee income/ (expense)	(228)		49	(179)		232	53	123	130
Changes in fair value	3,055	(3,055)			6,570		6,570	115	
Gains on disposal of French regional banks					2,445		2,445		
Other income[15]	4,673	(1,116)	36	3,593	95	495	4,183	(10)	14
Net operating income[16]	6,958	(4,171)	47	2,834	9,104	357	12,295	77	13
Loan impairment charges and other credit risk provisions	(11)	24	1	14		(19)	(5)	55	(136)
Net operating income	6,947	(4,147)	48	2,848	9,104	338	12,290	77	12
Operating expenses	(3,562)		(15)	(3,577)	6	(603)	(4,174)	(17)	(17)
Operating profit	3,385	(4,147)	33	(729)	9,110	(265)	8,116	140	(36)
Income from associates	150	(12)	11	149		(108)	41	(73)	(72)
Profit before tax	3,535	(4,159)	44	(580)	9,110	(373)	8,157	131	(64)

For footnotes, see page 149.

Table of Contents

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

Customer groups > Profit/(loss) before tax

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

	2009						
Total	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other[40] US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
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[42]	**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)**
	224	**23**	**265**	**5**	**3**		**520**

Gains less losses from financial investments							
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[43]	**(11,571)**	**(842)**	**(34)**		**(3)**		**(12,450)**
Net operating income/ (expense)[16]	**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**
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**
Balance sheet data[41]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
	399,460	**199,674**	**256,956**	**37,031**	**3,110**		**896,231**

Loans and advances to customers (net)							
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 149.

	2008						
Total	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other[40] US$m	Inter-segment elimination[50] US$m	Total US$m
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)[42]	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[43]	(6,474)	(335)	(79)		(1)		(6,889)
Net operating income[16]	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
Operating expenses (excluding goodwill impairment)	(21,140)	(6,581)	(9,092)	(2,116)	(4,174)	4,568	(38,535)
Goodwill impairment	(10,564)						(10,564)
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
Balance sheet data[41]							
	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 149.

Table of Contents

HSBC HOLDINGS PLC

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

Customer groups > Profit/(loss) before tax // Geographical regions > Summary

Profit/(loss) before tax (continued)

	2007						
Total	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other[40] US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income/(expense)	29,069	9,055	4,430	1,216	(542)	(5,433)	37,795
Net fee income/(expense)	11,742	3,972	4,901	1,615	(228)		22,002
Trading income excluding net interest income	38	265	3,503	525	127		4,458
Net interest income/(expense) on trading activities	140	31	(236)	9	(1)	5,433	5,376
Net trading income[42]	178	296	3,267	534	126	5,433	9,834
Changes in fair value of long-term debt issued and related derivatives					2,812		2,812
Net income/(expense) from other financial instruments designated at fair value	1,333	22	(164)	(1)	81		1,271
Net income/(expense) from financial instruments	1,333	22	(164)	(1)	2,893		4,083

designated at fair value							
Gains less losses from financial investments	351	90	1,313	119	83		1,956
Gains arising from dilution of interests in associates					1,092		1,092
Dividend income	55	8	222	7	32		324
Net earned insurance premiums	8,271	733	93		(21)		9,076
Other operating income	387	165	1,218	58	3,523	(3,912)	1,439
Total operating income	51,386	14,341	15,280	3,548	6,958	(3,912)	87,601
Net insurance claims[43]	(8,147)	(391)	(70)				(8,608)
Net operating income[16]	43,239	13,950	15,210	3,548	6,958	(3,912)	78,993
Loan impairment charges and other credit risk provisions	(16,172)	(1,007)	(38)	(14)	(11)		(17,242)
Net operating income	27,067	12,943	15,172	3,534	6,947	(3,912)	61,751
Total operating expenses	(21,757)	(6,252)	(9,358)	(2,025)	(3,562)	3,912	(39,042)
Operating profit	5,310	6,691	5,814	1,509	3,385		22,709
Share of profit in associates and joint ventures	590	454	307	2	150		1,503
Profit before tax	5,900	7,145	6,121	1,511	3,535		24,212
	%	%	%	%	%		%
Share of HSBC s profit before tax	24.4	29.5	25.3	6.2	14.6		100.0

Cost efficiency ratio	50.3	44.8	61.5	57.1	51.2		49.4
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	464,726	220,068	250,464	43,612	2,678		981,548
Total assets	636,185	307,944	1,596,850	130,893	164,806	(482,412)	2,354,266
Customer accounts	450,071	237,987	299,879	106,197	2,006		1,096,140

For footnotes, see page 149.

Geographical regions

Additional information on results in 2009 may be found in the Financial Summary on pages 23 to 60.

Summary

Europe

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

Hong Kong

HSBC s principal banking subsidiaries in Hong Kong are The Hongkong and Shanghai Banking Corporation Limited (The Hongkong and Shanghai Banking Corporation) and Hang Seng Bank Limited (Hang Seng Bank). The former is the largest bank incorporated in Hong Kong and is HSBC s flagship bank in the Asia-Pacific region. It is one of Hong Kong s three note-issuing banks, accounting for more than 67.2 per cent by value of banknotes in circulation in 2008.

Rest of Asia-Pacific

HSBC offers personal, commercial, global banking and markets services in mainland China, mainly through its local subsidiary, HSBC Bank (China) Company Limited (HSBC Bank China). HSBC also participates indirectly in mainland China through its four associates, Bank of Communications (19.01 per cent owned), Ping An Insurance (16.78 per cent), Industrial Bank (12.78 per cent) and Yantai City Commercial Bank (20 per cent) and has a further interest of 8 per cent in Bank of Shanghai.

Outside Hong Kong and mainland China, HSBC conducts business in 20 countries in the Asia-Pacific region, primarily through branches and subsidiaries of The Hongkong and Shanghai Banking Corporation, with particularly strong coverage in Australia, India, Indonesia, Malaysia, South Korea, Singapore and Taiwan. HSBC s presence in Australia is led by HSBC Bank Australia Limited and in Malaysia by HSBC Bank Malaysia Berhad (HSBC Bank Malaysia), which has the largest foreign bank-owned branch network in the country.

Middle East

In the Middle East, the network of branches of HSBC Bank Middle East Limited (HSBC Bank Middle East), together with HSBC s subsidiaries and associates, gives it the widest coverage in the region. HSBC s associate in Saudi Arabia, The Saudi British Bank (40 per cent owned), is the Kingdom s fifth largest bank by total assets.

North America

HSBC s North American businesses are located in the US, Canada and Bermuda. Operations in the US are primarily conducted through HSBC Bank USA, N.A. (HSBC Bank USA) which is concentrated in New York State, and HSBC Finance, a national consumer finance company based in the Chicago metropolitan area. HSBC Markets (USA) Inc. is the intermediate holding company of, *inter alia*, HSBC Securities (USA) Inc., a registered broker and dealer of securities and a registered futures commission merchant. HSBC Bank Canada and The Bank of Bermuda Limited

(Bank of Bermuda) operate in their respective countries.

Latin America

HSBC s operations in Latin America principally comprise HSBC México, S.A. (HSBC Mexico), HSBC Bank Brasil S.A.-Banco Múltiplo (HSBC Bank Brazil), HSBC Bank Argentina S.A. (HSBC Bank Argentina) and HSBC Bank (Panama) S.A. (HSBC Bank Panama), which owns subsidiaries in Costa Rica, Honduras, Colombia and El Salvador. HSBC is also represented by subsidiaries in Chile, the Bahamas, Peru, Paraguay and Uruguay. In addition to banking services, HSBC operates insurance businesses in Mexico, Argentina, Brazil, Panama, Honduras and El Salvador. In Brazil, HSBC offers consumer finance products through its subsidiary, Losango Promoções e Vendas Ltda.

Table of Contents

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

Geographical regions > Summary / Europe

In the analysis of profit by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US$2,756 million (2008: US$2,492 million; 2007: US$1,985 million).

Profit/(loss) before tax

	2009		2008		2007	
	US$m	**%**	US$m	%	US$m	%
Europe	**4,009**	**56.7**	10,869	116.7	8,595	35.5
Hong Kong	**5,029**	**71.0**	5,461	58.7	7,339	30.3
Rest of Asia-Pacific[27]	**4,200**	**59.3**	4,722	50.7	4,702	19.4
Middle East[27]	**455**	**6.4**	1,746	18.8	1,307	5.4
North America	**(7,738)**	**(109.3)**	(15,528)	(166.8)	91	0.4
Latin America	**1,124**	**15.9**	2,037	21.9	2,178	9.0
	7,079	**100.0**	9,307	100.0	24,212	100.0

Total assets[41]

	At 31 December			
	2009		2008	
	US$m	**%**	US$m	%
Europe	**1,268,600**	**53.7**	1,392,049	55.1
Hong Kong	**399,243**	**16.9**	414,484	16.4
Rest of Asia-Pacific[27]	**222,139**	**9.4**	225,573	8.9
Middle East[27]	**48,107**	**2.0**	50,952	2.0
North America	**475,014**	**20.1**	596,302	23.6
Latin America	**115,967**	**4.9**	102,946	4.1
Intra-HSBC items	**(164,618)**	**(7.0)**	(254,841)	(10.1)
	2,364,452	**100.0**	2,527,465	100.0

For footnotes, see page 149.

Europe

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$m	Private Banking US$m	Other US$m	Total US$m
2009						
UK	**364**	**1,026**	**3,045**	**252**	**(2,561)**	**2,126**
France[51]	**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[51]	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
2007						
UK	1,221	2,064	1,214	317	976	5,792
France[51]	173	192	692	25	(49)	1,033
Germany		36	195	45	19	295
Malta	45	67	45			157
Switzerland				475		475
Turkey	144	75	118	(1)		336
Other	(2)	82	263	54	110	507
	1,581	2,516	2,527	915	1,056	8,595

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
UK	**329,182**	313,065	326,927
France[51]	**71,567**	70,896	81,473
Germany	**4,131**	5,756	6,411
Malta	**4,649**	4,343	4,157
Switzerland	**12,072**	12,708	13,789
Turkey	**5,758**	6,125	7,974
Other	**12,122**	13,298	11,544
	439,481	426,191	452,275

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
UK	**349,162**	351,253	367,363
France[51]	**70,899**	74,826	64,905
Germany	**8,134**	11,611	10,282
Malta	**5,888**	5,604	5,947
Switzerland	**45,148**	44,643	41,015
Turkey	**5,830**	5,845	6,473
Other	**9,958**	8,694	8,969
	495,019	502,476	504,954

For footnote, see page 149.

Table of Contents

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

Geographical regions > Europe > 2009

Profit before tax

Europe	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**12,268**	9,696	7,746
Net fee income	**6,267**	7,492	8,431
Net trading income	**5,459**	5,357	6,943
Changes in fair value of long-term debt issued and related derivatives	**(2,746)**	2,939	1,059
Net income/(expense) from other financial instruments designated at fair value	**1,321**	(1,826)	167
Net income/(expense) from financial instruments designated at fair value	**(1,425)**	1,113	1,226
Gains less losses from financial investments	**50**	418	1,326
Dividend income	**29**	130	171
Net earned insurance premiums	**4,223**	5,299	4,010
Gains on disposal of French regional banks		2,445	
Other operating income	**2,262**	2,096	1,193
Total operating income	**29,133**	34,046	31,046
Net insurance claims incurred and movement in liabilities to policyholders	**(5,589)**	(3,367)	(3,479)
Net operating income before loan impairment charges and other credit risk provisions	**23,544**	30,679	27,567
Loan impairment charges and other credit risk provisions	**(5,568)**	(3,754)	(2,542)
Net operating income	**17,976**	26,925	25,025
Total operating expenses	**(13,988)**	(16,072)	(16,525)
Operating profit	**3,988**	10,853	8,500
Share of profit in associates and joint ventures	**21**	16	95

Profit before tax	**4,009**	10,869	8,595
	%	%	%
Share of HSBC s profit before tax	**56.7**	116.7	35.5
Cost efficiency ratio	**59.4**	52.4	59.9
Year-end staff numbers (full-time equivalent)	**76,703**	82,093	82,166

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**439,481**	426,191	452,275
Loans and advances to banks (net)	**65,521**	61,949	104,527
Trading assets, financial assets designated at fair value and financial investments[49]	**450,727**	433,885	445,258
Total assets	**1,268,600**	1,392,049	1,256,220
Deposits by banks	**89,893**	80,847	87,491
Customer accounts	**495,019**	502,476	504,954

For footnotes, see page 149.

All commentaries on Europe are on an underlying basis unless stated otherwise.

2009 compared with 2008

Economic briefing

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 per cent in 2009 the sharpest contraction in over 60 years after a 0.5 per cent increase in 2008. Weakness affected most sectors of the economy, and the unemployment rate hit a 13-year high of 7.9 per cent 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 per cent in September 2009 before moving towards the Bank of England s 2 per cent target by the end of the year. Nominal house prices

Table of Contents

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 per cent 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 per cent following a 0.5 per cent 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 per cent 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 per cent.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Europe	**2008 as reported US$m**	**2008 adjust-ments[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjust-ments[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**9,696**	**(65)**	**(1,049)**	**8,582**		**3,686**	**12,268**	**27**	**43**
Net fee income	**7,492**	**(58)**	**(917)**	**6,517**		**(250)**	**6,267**	**(16)**	**(4)**
Changes in fair value[14]	**3,118**	**(3,118)**			**(2,841)**		**(2,841)**	**(191)**	
Gains on disposal of French regional banks	**2,445**	**(2,445)**						**(100)**	
Other income[15]	**7,928**	**(609)**	**(1,206)**	**6,113**	**280**	**1,457**	**7,850**	**(1)**	**24**
Net operating income[16]	**30,679**	**(6,295)**	**(3,172)**	**21,212**	**(2,561)**	**4,893**	**23,544**	**(23)**	**23**
Loan impairment charges and other credit risk provisions	**(3,754)**	**6**	**395**	**(3,353)**		**(2,215)**	**(5,568)**	**(48)**	**(66)**
Net operating income	**26,925**	**(6,289)**	**(2,777)**	**17,859**	**(2,561)**	**2,678**	**17,976**	**(33)**	**15**

Operating expenses	**(16,072)**	**68**	**1,723**	**(14,281)**		**293**	**(13,988)**	**13**	**2**
Operating profit	**10,853**	**(6,221)**	**(1,054)**	**3,578**	**(2,561)**	**2,971**	**3,988**	**(63)**	**83**
Income from associates	**16**			**16**		**5**	**21**	**31**	**31**
Profit before tax	**10,869**	**(6,221)**	**(1,054)**	**3,594**	**(2,561)**	**2,976**	**4,009**	**(63)**	**83**

For footnotes, see page 149.

Review of business performance

HSBC s European operations reported a pre-tax profit of US$4.0 billion, compared with US$10.9 billion in 2008. This decline was largely caused by movement in the fair value attributable to credit spread on the Group s own debt. A US$2.8 billion expense in 2009 following stabilisation in financial markets and a narrowing of credit spreads largely reversed the US$3.1 billion income recognised in 2008, giving a US$5.9 billion 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$280 million in June 2009. This followed a US$425 million 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$3.0 billion or 83 per cent. This was driven by robust performances in the European Global Banking and Markets 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 the Personal Financial Services and Commercial Banking businesses. HSBC Bank continued to provide lending services to its customers while maintaining effective credit control and strengthening collection practices and systems.

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

Geographical regions > Europe > 2009

Net interest income increased by 43 per cent, with Balance Sheet Management revenues in Global Banking and Markets rising robustly. This resulted from the early positioning of the 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 Personal Financial Services and Commercial Banking businesses and payments and cash management were adversely affected by continued margin compression following interest rate reductions in late 2008 and early 2009.

Excluding one-off gains and movements in fair value of own debt, underlying profit grew by US$3.0 billion or 83 per cent.

Mortgage balances increased as HSBC gained market share in the UK through the success of a new Rate Matcher mortgage promotion and other campaigns launched in line with its secured lending growth strategy. In 2009, the UK bank more than met its commitment to make £15 billion (US$24.7 billion) of new mortgage lending available to borrowers. In Commercial Banking, 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 per cent 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 HSBC s 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, HSBC 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.

Net fee income fell by 4 per cent. 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 the consumer finance branch network in the UK and reduced sales of discontinued products. In Private Banking, 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.

HSBC 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 its wealth management strategy, HSBC continued to grow the Premier customer base and successfully launched the World Selection fund in the UK which raised US$1.5 billion. In France, the Premier customer base grew by over 10 per cent as HSBC brand awareness increased.

Trading income increased by 23 per cent to US$5.5 billion 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.

In 2009, the UK bank more than met its commitment to make £15 billion (US$24.7 billion) of new mortgage lending available to borrowers.

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$854 million 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.

A net expense of US$1.4 billion was incurred 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$192 million 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 per cent. In the UK demand for the insurance-linked Guaranteed Income Bond fell as HSBC offered more favourable rates on an alternative non-insurance deposit product, giving rise to a US$1.1 billion 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 per cent, mainly due to a US$576 million gain on the sale and leaseback of 8 Canada Square in London which was effected through the disposal of HSBC s entire shareholding in the company which was the legal owner of the building and long leasehold interest in 8 Canada Square. In 2008, HSBC reported a gain of US$416 million 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 HSBC s introduction of enhanced benefits to 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$2.5 billion. The majority of the movement was due to the change 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$310 million 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.

Utilisation of committed overdraft facilities to commercial customers in the UK only 40 per cent.

Loan impairment charges and other credit risk provisions rose by 66 per cent to US$5.6 billion as the impact of weaker economic conditions across the region fed through to higher delinquency and default. In Global Banking and Markets, 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$1.1 billion to the charge. Impairment booked on these exposures reflects mark-to-market losses which HSBC judges to be significantly in excess of the likely ultimate cash losses.

In Commercial Banking, loan impairment charges rose by US$471 million, again reflecting the economic downturn. The commercial property portfolio in the UK declined during 2009, reflecting HSBC s 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 HSBC s 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 per cent.

Operating expenses were held broadly in line with 2008. Excluding an accounting gain of US$499 million 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 Global Banking and

Markets exceptional revenue and profit growth in selective businesses.

In Personal Financial Services and Commercial Banking businesses, operational cost savings reflected HSBC s leverage of its 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.

2008 compared with 2007

Economic briefing

In the **UK**, growth in GDP decelerated markedly in 2008 to 0.7 per cent from 3 per cent in 2007, with a technical recession of two successive quarterly contractions in GDP confirmed during the second half of the year. Weakness proved widespread across most of the economy, prompting a sharp deterioration in labour market conditions as unemployment hit a nine-year high of 6.1 per cent in November 2008. CPI inflation reached a decade-long high of 5.2 per cent in September 2008 before falling back to 3.1 per cent by the year-end, still some way above the Bank of England s 2 per cent target. House prices continued to fall throughout the year and housing activity decreased sharply. The Bank of England reduced interest rates by 350 basis points during 2008, to finish the year at 2 per cent, as policymakers sought to mitigate the worst effects of the economic slowdown.

The expansion of the **eurozone** economy slowed sharply in 2008, with GDP growth of 0.7 per cent following a 2.6 per cent expansion in 2007. As in the UK, conditions deteriorated markedly as the year progressed and three successive quarterly declines in GDP were recorded during 2008, confirming that the economy had entered a period of recession. Consumer spending growth proved subdued following the sharp rise in oil prices during the first of half of 2008 and a progressive increase in the unemployment rate towards the year-end. Inflation remained a concern for much of 2008, hitting a peak of 4 per cent in July before falling rapidly to 1.6 per cent in December. The European Central Bank, having initially raised interest rates by 25 basis points in July, cut them by 175 basis points to finish the year at 2.5 per cent.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Europe	2007 as reported US$m	2007 adjustments & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjust-ments[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	7,746	(390)	(224)	7,132	219	2,345	9,696	25	33
Net fee income	8,431	(134)	(244)	8,053	15	(576)	7,492	(11)	(7)
	1,294	(1,294)			3,118		3,118	141	

Changes in fair value[14]									
Gains on disposal of French regional banks					2,445		2,445		
Other income[15]	10,096	(121)	(321)	9,654	562	(2,288)	7,928	(21)	(24)
Net operating income[16]	27,567	(1,939)	(789)	24,839	6,359	(519)	30,679	11	(2)
Loan impairment charges and other credit risk provisions	(2,542)	30	152	(2,360)	(6)	(1,388)	(3,754)	(48)	(59)
Net operating income	25,025	(1,909)	(637)	22,479	6,353	(1,907)	26,925	8	(8)
Operating expenses	(16,525)	416	531	(15,578)	(88)	(406)	(16,072)	3	(3)
Operating profit	8,500	(1,493)	(106)	6,901	6,265	(2,313)	10,853	28	(34)
Income from associates	95	(12)	14	97		(81)	16	(83)	(84)
Profit before tax	8,595	(1,505)	(92)	6,998	6,265	(2,394)	10,869	26	(34)

For footnotes, see page 149.

Review of business performance

HSBC s European operations reported a pre-tax profit of US$10.9 billion, compared with US$8.6 billion in 2007, an increase of 26 per cent.

These results included gains of US$2.4 billion on the disposal of seven regional banks in France in July 2008, and of US$425 million on the sale of the card acquiring business in the UK to a joint venture with Global Payments, Inc. in June 2008. Excluding these disposals and, in 2007, the acquisition of HSBC Assurances and the disposal of Hamilton Insurance Company Limited and Hamilton Life Assurance Company Limited and substantial fair value gains on own debt, underlying pre-tax profits fell by 34 per cent. This primarily reflected a sharp decline in Global Banking and Markets revenues, which was mainly attributable to the deterioration in credit markets, the continuing illiquidity in asset-backed securities markets which led to further write-downs, and a US$854 million charge within the equities business following the alleged fraud at Madoff Securities. Personal Financial Services and Private Banking delivered underlying growth.

Net interest income increased by 33 per cent. There was significant growth in Balance Sheet Management revenues, which reflected favourable interest rate risk positioning in expectation of interest rate cuts by central banks. Net interest income also benefited from necessarily selective incremental lending as credit availability generally contracted. In Global Banking, net interest income was boosted by improved spreads.

Falling confidence in the UK banking sector necessitated government intervention in a number of competitor banks. HSBC experienced a strong increase in customer numbers, with corresponding growth in liability balances as the market turmoil intensified. The volume benefit was partially offset by narrowing deposit spreads, as base rates were cut in the UK, and increased funding costs, principally for trading activities, in France. Higher net interest income from the expansion of credit card lending and commercial loan portfolio growth in the small and mid-market customer segments in Turkey was partially offset by narrower spreads following credit card interest rate cap reductions by the central bank.

Net fee income fell by 7 per cent, with lower fees from mergers and acquisitions and equity capital markets due to origination and execution difficulties, coupled with a rise in brokerage expenses in line with increased trading activity in France. Lower performance and management fees in the UK and France, as the value of funds under management reduced, reflected the decline in global equity markets. Increased customer acquisition partly offset this, with higher fees derived from growth in packaged accounts and transaction volumes in France and credit card fees in Turkey.

Trading income was 20 per cent lower than in 2007, falling significantly in Global Banking and Markets due to further write-downs on legacy exposures in credit, structured credit derivatives and leveraged and acquisition finance caused by the ongoing turmoil in the credit markets. In addition, a US$854 million charge was taken in equities in respect of the alleged fraud at Madoff Securities. US$11.4 billion and US$2.4 billion of held-for-trading financial assets were reclassified under revised IFRS rules as loans and receivables and available for sale, respectively, preventing any further mark-to-market trading losses on these assets. If these reclassifications had not been made, the profit before tax would have been US$2.6 billion lower.

Excluding the write-downs on legacy exposures and the charge relating to Madoff Securities, trading income grew by 11 per cent, driven by a significant increase in foreign exchange revenues against the backdrop of greater market volatility, and robust revenues in the Rates business, which was positioned to take advantage of falling interest rates. The widening of credit spreads, particularly in the second half of 2008, contributed to fair value gains on structured liabilities and on credit protection bought in the form of credit default swaps.

A rise in the *Net expense from financial instruments designated at fair value* was recorded as a result of a reduction in the value of assets held to meet liabilities under insurance and investment contracts. The reduction in fair value of assets held to meet liabilities under unit-linked insurance contracts is offset by a corresponding reduction in Net insurance claims and liabilities to policyholders .

Gains less losses from financial investments of US$418 million were US$915 million lower than in 2007 as there were fewer disposal opportunities in 2008 and the significant realisations from equity investments in the UK and

France in 2007 did not recur. Gains mainly reflected the sale of MasterCard shares in 2008.

Net earned insurance premiums increased by 22 per cent, largely due to growth in the Guaranteed Income Bond launched in June 2007 and the introduction of enhanced death benefits to certain pension products in the UK. In France, HSBC Assurances performed well in a declining market, as the launch of new guaranteed rate products contributed to 3 per cent growth in gross earned premiums. However, net earned insurance premiums fell following a significant reinsurance transaction undertaken in the first half of 2008.

Other operating income increased by 33 per cent. This was primarily due to recognition of the gain in respect of the purchase of the subsidiary of Metrovacesa which owned the property and long leasehold land comprising 8 Canada Square, London. See Note 23 on the Financial Statements for further details. The growth in revenue also reflected the non-recurrence of a decrease in the value of PVIF business in 2007 following regulatory changes to the rules governing the calculation of insurance liabilities. In addition, there was a favourable embedded value adjustment following HSBC s introduction of enhanced benefits to existing commercial pension products in the first half of 2008. These benefits were partially offset by costs associated with the support of money market funds in the global asset management business.

Net insurance claims incurred and movement in liabilities to policyholders decreased by 5 per cent as a reduction in insurance liabilities reflected the fall in value of market-linked funds. This was partially offset by an increase in liabilities following increased sales of the Guaranteed Income Bond and the implementation of FSA rule changes in 2007 which lowered the liability valuation on life policies.

Loan impairment charges and credit risk provisions rose by 59 per cent to US$3.8 billion; in the UK, primarily in Global Banking and Markets. The deteriorating credit environment resulted in a rise in loan impairment charges, largely reflecting an exposure to a single European property company, and additional credit risk provisions on debt securities held within the Group s available-for-sale portfolio, mainly in Solitaire Funding Limited (Solitaire), a special purpose entity managed by HSBC. A modest improvement in the UK personal finance sector reflected the non-recurrence of a change in the methodology in the consumer finance business which resulted in a higher charge in 2007. Excluding this factor, delinquency rates in cards were marginally higher and there was a rise in impairments in the consumer finance business driven by worsening economic conditions and credit quality deterioration, partly offset by action taken to mitigate risk through the continued application of strict lending criteria and the sale of non-core credit card portfolios.

Credit conditions weakened in the commercial business and specific loan impairment charges increased in the UK and France due to the deteriorating credit environment in the second half of 2008. In Turkey, credit card and personal loan delinquency rates were significantly higher, resulting in the implementation of tighter underwriting criteria, reduced credit limits and revised account management policies throughout 2008.

Operating costs increased by 3 per cent to US$16.1 billion. Costs in the UK were in line with 2007, which included ex-gratia payments expensed in respect of overdraft fees applied in previous years and a provision for reimbursement of certain charges on historic will trusts and other related services. Excluding these items, costs rose as a result of an increase in the Financial Services Compensation Scheme levy, restructuring costs and increased rental charges following the sale and leaseback of branch properties, partially offset by lower performance-related pay and a reduction in defined benefit pension scheme costs due to a change in actuarial assumptions.

Operating costs in France decreased slightly with lower performance-related pay and a reduction in pension and retirement healthcare costs following the transfer of certain obligations to a third-party offsetting the higher costs of a voluntary retirement programme.

There was investment in premises and new staff to support business expansion in Turkey, Russia and central and eastern Europe. In 2008, 112 new branches opened and staff numbers increased by 30 per cent in these markets.

Share of profit in associates and joint ventures declined by 84 per cent to US$16 million with 2007 benefiting from an adjustment to the embedded value of HSBC Assurances. The absence of this gain was partially offset by increased joint venture profits following the sale of the card acquiring business in the UK.

Table of Contents

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

	2009						
Europe	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
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[42]	**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**
	3,975	**253**	**(2)**		**(3)**		**4,223**

Net earned insurance premiums							
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[43]	**(5,221)**	**(365)**			**(3)**		**(5,589)**
Net operating income/ (expense)[16]	**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**
Balance sheet data[41]							
	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**

For footnotes, see page 149.

Table of Contents

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

Geographical regions > Europe > Profit/(loss) before tax by customer group

Profit/(loss) before tax (continued)

	2008						
Europe	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
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)[42]	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[43]	(3,224)	(143)					(3,367)
Net operating income[16]	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
Balance sheet data[41]							
	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 149.

Europe	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
				2007			
Net interest income	6,604	3,419	1,361	793	86	(4,517)	7,746
Net fee income/(expense)	3,060	2,194	2,316	1,032	(171)		8,431
Trading income excluding net interest income	60	36	2,657	161	89		3,003
Net interest income/(expense) on trading activities	(7)	30	(610)	9	1	4,517	3,940
Net trading income[42]	53	66	2,047	170	90	4,517	6,943
Changes in fair value of long-term debt issued and related derivatives					1,059		1,059
Net income/(expense) from other financial instruments designated at fair value	126	31	(185)		195		167
Net income/(expense) from financial instruments designated at fair value	126	31	(185)		1,254		1,226
Gains less losses from financial investments	50	36	1,100	115	25		1,326
Dividend income	1	4	155	7	4		171
Net earned insurance premiums	3,511	521			(22)		4,010

Other operating income/(expense)	54	(35)	853	8	301	12	1,193
Total operating income	13,459	6,236	7,647	2,125	1,567	12	31,046
Net insurance claims[43]	(3,214)	(265)					(3,479)
Net operating income[16]	10,245	5,971	7,647	2,125	1,567	12	27,567
Loan impairment (charges)/recoveries and other credit risk provisions	(2,044)	(515)	26	(4)	(5)		(2,542)
Net operating income	8,201	5,456	7,673	2,121	1,562	12	25,025
Total operating expenses	(6,635)	(2,941)	(5,150)	(1,208)	(579)	(12)	(16,525)
Operating profit	1,566	2,515	2,523	913	983		8,500
Share of profit in associates and joint ventures	15	1	4	2	73		95
Profit before tax	1,581	2,516	2,527	915	1,056		8,595
	%	%	%	%	%		%
Share of HSBC s profit before tax	6.5	10.4	10.4	3.8	4.4		35.5
Cost efficiency ratio	64.8	49.3	67.3	56.8	36.9		59.9
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	151,687	106,846	163,066	30,195	481		452,275
Total assets	240,361	168,846	912,299	83,740	96,346	(245,372)	1,256,220
Customer accounts	178,757	99,704	163,713	62,055	725		504,954

For footnotes, see page 149.

Table of Contents

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

Geographical regions > Hong Kong > 2009

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

	2009	2008	2007
	US$m	US$m	US$m
Personal Financial Services	**2,728**	3,428	4,212
Commercial Banking	**956**	1,315	1,619
Global Banking and Markets	**1,507**	1,436	1,578
Private Banking	**197**	237	305
Other	**(359)**	(955)	(375)
	5,029	5,461	7,339

Profit before tax

	2009	2008	2007
	US$m	US$m	US$m
Net interest income	**4,195**	5,698	5,483
Net fee income	**2,669**	2,580	3,362
Net trading income	**1,225**	1,193	1,242
Changes in fair value of long-term debt issued and related derivatives	**(3)**	3	2
Net income/(expense) from other financial instruments designated at fair value	**788**	(1,194)	674
Net income/(expense) from financial instruments designated at fair value	**785**	(1,191)	676
Gains less losses from financial investments	**9**	(309)	94
Dividend income	**28**	41	31
Net earned insurance premiums	**3,674**	3,247	2,797
Other operating income	**1,274**	817	845
Total operating income	**13,859**	12,076	14,530
	(4,392)	(1,922)	(3,208)

Net insurance claims incurred and movement in liabilities to policyholders			
Net operating income before loan impairment charges and other credit risk provisions	**9,467**	10,154	11,322
Loan impairment charges and other credit risk provisions	**(500)**	(765)	(231)
Net operating income	**8,967**	9,389	11,091
Total operating expenses	**(3,946)**	(3,943)	(3,780)
Operating profit	**5,021**	5,446	7,311
Share of profit in associates and joint ventures	**8**	15	28
Profit before tax	**5,029**	5,461	7,339
	%	%	%
Share of HSBC s profit before tax	**71.0**	58.7	30.3
Cost efficiency ratio	**41.7**	38.8	33.4
Year-end staff numbers (full-time equivalent)	**27,614**	29,330	27,655

Balance sheet data[41]

		At 31 December	
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**99,381**	100,220	89,638
Loans and advances to banks (net)	**36,197**	29,646	63,737
Trading assets, financial assets designated at fair value, and financial investments	**154,418**	122,602	102,180
Total assets	**399,243**	414,484	359,386
Deposits by banks	**6,023**	11,769	6,420
Customer accounts	**275,441**	250,517	234,488

For footnote, see page 149.

All commentaries on Hong Kong are on an underlying basis unless stated otherwise.

98

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:

Name:	Douglas J Flint
Title:	Chief Financial Officer, Executive Director, Risk and Regulation

Dated: 15 March 2009

Table of Contents

2009 compared with 2008

Economic briefing

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 per cent after growth of 2.1 per cent in 2008. Unemployment rose during the first half of 2009, before falling slightly to end the year at 4.9 per cent, 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 per cent 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 per cent 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 per cent increase during the year.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Hong Kong	**2008 as reported US$m**	**2008 adjust-ments[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjust-ments[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**5,698**		**21**	**5,719**		**(1,524)**	**4,195**	**(26)**	**(27)**
Net fee income	**2,580**		**10**	**2,590**		**79**	**2,669**	**3**	**3**
Changes in fair value[14]	**5**	**(5)**			**(1)**		**(1)**	**(120)**	
Other income[15]	**1,871**		**7**	**1,878**		**726**	**2,604**	**39**	**39**
Net operating income[16]	**10,154**	**(5)**	**38**	**10,187**	**(1)**	**(719)**	**9,467**	**(7)**	**(7)**
Loan impairment charges and other credit risk provisions	**(765)**		**(2)**	**(767)**		**267**	**(500)**	**35**	**35**
Net operating income	**9,389**	**(5)**	**36**	**9,420**	**(1)**	**(452)**	**8,967**	**(4)**	**(5)**
Operating expenses	**(3,943)**		**(16)**	**(3,959)**		**13**	**(3,946)**		

Operating profit	**5,446**	**(5)**	**20**	**5,461**	**(1)**	**(439)**	**5,021**	**(8)**	**(8)**
Income from associates	**15**			**15**		**(7)**	**8**	**(47)**	**(47)**
Profit before tax	**5,461**	**(5)**	**20**	**5,476**	**(1)**	**(446)**	**5,029**	**(8)**	**(8)**

For footnotes, see page 149.

Review of business performance

HSBC s operations in Hong Kong reported pre-tax profits of US$5.0 billion compared with US$5.5 billion in 2008, an 8 per cent 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 HSBC s market-leading share in deposits, residential mortgages, cards and insurance. In particular, HSBC consolidated its position as Hong Kong s leading bancassurer, growing the value of
new life insurance business by 38 per cent. In residential mortgages, business growth was combined with conservative loan-to-value ratios on new business.

Net interest income declined by 27 per cent to US$4.2 billion, 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 HSBC to benefit from economic recovery and a resulting widening of deposit spreads.

Average customer lending balances remained broadly in line with 2008, as lower Commercial Banking balances, which reflected the reduction in exports in the first half of 2009, were broadly offset by higher lending in Personal Financial Services and Global Banking and Markets. As the regional economy rebounded, trade volumes and Commercial

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

Geographical regions > Hong Kong > 2009 / 2008

Banking lending activity increased in the second half of the year. Throughout this challenging period for trade, HSBC continued to support local business through its HK$20 billion (US$2.6 billion) 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 HSBC consolidated its mortgage market share by originating significant volumes of new mortgages. HSBC led this market with a 38 per cent share of new loan drawdowns with an average loan-to-value ratio of 58 per cent 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. Pre-tax profit declined by 8 per cent to US$5.0 billion as deposit spreads compressed in the near-zero interest rate environment.

HSBC continued to increase market share in savings and deposit accounts, and balances grew following a series of deposit acquisition campaigns. In Personal Financial Services, customer account balances rose by 15 per cent and Premier customer numbers grew to over 380,000. Strong growth in Commercial Banking 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 per cent. Liability spreads remained under severe pressure throughout 2009, however.

Net fee income increased by 3 per cent 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. Personal Financial Services 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 Commercial Banking.

Trading income increased by 2 per cent, primarily due to increased volumes of bond trading and wider margins on market making activities. The non-recurrence of US$0.2 billion 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 volumes. Interest on trading assets declined due to a reduced holding of trading debt securities.

Income of US$0.8 billion was generated from *financial instruments designated at fair value*, compared with an expense of US$1.2 billion 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 per cent to US$3.7 billion 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. HSBC retained its market leadership position in the regular-premium individual-life new business. The growth in 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$310 million to a net gain of US$9 million, mainly due to the non-recurrence of impairments against 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$1.3 billion was 55 per cent higher than in 2008, reflecting a positive movement in PVIF driven largely by an increase in insurance sales to new customers. A gain of US$110 million was recognised in respect of the disposal of a property in Hong Kong.

Loan impairment charges and other credit risk provisions fell by 35 per cent to US$0.5 billion, 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 Personal Financial Services, 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 the increased use of direct channels.

2008 compared with 2007

Economic briefing

Hong Kong s GDP growth slowed to 2.5 per cent in 2008 from 6.4 per cent in 2007. After performing strongly during the early months of the year, the economy slowed sharply and a technical recession was confirmed with the release of the third quarter GDP statistics. External demand proved especially weak during the second half of 2008 and the growth in private consumption also slowed sharply. The unemployment rate rose from a ten-year low of 3.2 per cent in August 2008 to 4.1 per cent by the year-end. Consumer price inflation proved volatile during the year, rising to a ten-year high of 6.3 per cent in July before slowing to 2.1 per cent by December 2008, although this movement largely reflected the trends in food and energy prices. In response to interest rate cuts in the US, Hong Kong cut its base interest rate on seven occasions during 2008, finishing the year at 0.5 per cent compared with 5.75 per cent at the end of 2007. The Hang Seng Index fell by 48 per cent during 2008.

Review of business performance

Hong Kong reported pre-tax profits of US$5.5 billion, a 26 per cent decline compared with record profits of US$7.3 billion in 2007. Lower revenues largely reflected a decline in wealth management and insurance income as economic conditions deteriorated. Revenue decline was compounded by impairment charges recognised on certain investments, which arose as a consequence of significant falls in equity market prices. Offsetting this, in part, was considerably stronger Balance Sheet Management income from treasury positions which correctly anticipated the decline in interest rates.

Net interest income rose by 4 per cent, driven by the strong Balance Sheet Management performance in Global Banking and Markets mainly driven by liquidity generated by retail banking in the environment of falling short-term interest rates.

Savings and deposit balances grew strongly, particularly in Personal Financial Services, as customers revealed a preference for security and liquidity following declines in equity markets. Deposit growth was augmented by the launch of campaigns offering both preferential time deposit rates and an enhanced HSBC online platform. The significant decline in interest rates during 2008 led to a narrowing of deposit spreads.

Customer lending volumes were 11 per cent higher, due in part to an 11 per cent rise in mortgage balances. Lending margins narrowed, however, due to interest rate cuts, particularly affecting mortgage lending and other loans linked to HIBOR. Balances outstanding on credit cards rose, driven by increased cardholder spending, and spreads on this business increased due to lower funding costs. Nearly one million new cards were issued in the year, bringing the total cards in circulation to 5.3 million. Volumes of trade finance grew strongly, driven by demand from corporates with international trade requirements, and commercial lending balances rose, particularly during the first half of the year.

Fee income declined by 23 per cent, driven by lower equity market-related revenues. Weak market sentiment led to lower volumes of retail brokerage and a decrease in income from wealth management activity. This was partly offset by a rise in fees from cards following increases in both cards in circulation and cardholder spending. Fees from account services rose due to greater customer activity and there were higher fees generated from bundled products.

Trading income was 4 per cent lower, driven by further write-downs of US$0.2 billion in Global Banking and Markets on a legacy monoline exposure. Excluding these write-downs, trading income grew due to a rise in foreign exchange and rates income as continuing market volatility generated increased trading opportunities and demand for active hedging products.

The net loss of US$1.2 billion on *financial instruments designated at fair value* compared with income of US$676 million in 2007. The loss reflected a decline in the value of assets linked to the insurance business. To a large extent, these losses are attributable to policyholders, with an equivalent reduction in *net insurance claims and movement in liabilities to policyholders*. While the decline in the value of assets which relate to unit-linked products is

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

Geographical regions > Hong Kong > 2008 / Profit(loss) before tax by customer group

allocated to policyholders in full, the portion of decline in the value passed on to clients who have products with discretionary participation features and guarantees may be restricted.

Losses from financial investments of US$309 million reflected impairments required on investments which have experienced significant falls in equity market prices. These equity investments are classified as available for sale, are not held for trading, and remain part of the strategic positioning of HSBC s businesses in Asia. These losses were partly offset by an aggregate gain of US$203 million from the redemption of shares in the Visa initial public offering (IPO) and the disposal of MasterCard shares.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Hong Kong	2007 as reported US$m	2007 adjustments and dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjust-ments[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	5,483		15	5,498		200	5,698	4	4
Net fee income	3,362		9	3,371		(791)	2,580	(23)	(23)
Changes in fair value[14]	1	(1)			5		5	400	
Other income[15]	2,476	(1)	3	2,478		(607)	1,871	(24)	(24)
Net operating income[16]	11,322	(2)	27	11,347	5	(1,198)	10,154	(10)	(11)
Loan impairment charges and other credit risk provisions	(231)	1	(1)	(231)		(534)	(765)	(231)	(231)
Net operating income	11,091	(1)	26	11,116	5	(1,732)	9,389	(15)	(16)
Operating expenses	(3,780)		(9)	(3,789)		(154)	(3,943)	(4)	(4)

Operating profit	7,311	(1)	17	7,327	5	(1,886)	5,446	(26)	(26)
Income from associates	28			28		(13)	15	(46)	(46)
Profit before tax	7,339	(1)	17	7,355	5	(1,899)	5,461	(26)	(26)

For footnotes, see page 149.

Net earned insurance premiums increased by 16 per cent to US$3.2 billion, largely due to growth in the life insurance business, in particular for policies with discretionary participation features.

Net insurance claims and movement in liabilities to policyholders fell by 40 per cent, reflecting the decline in asset values noted above partly offset by increases due to growth in premiums.

Loan impairment charges and other credit risk provisions rose markedly from the previously low level to US$765 million as economic conditions deteriorated. Within these charges were exposures to financial institutions held within Global Banking and Markets, which resulted in other credit risk provisions. In Commercial Banking, the combination of an absence of significant recoveries recorded in 2007 and weakness among certain exporters in Hong Kong, who were affected by reduced demand from the US and other developed countries, raised loan impairment charges. As local businesses responded to the economic environment, unemployment rose in the second half of 2008. Credit policies were consequently adjusted across certain products as delinquency and bankruptcy increased in Hong Kong. Although property market declines reduced equity levels for residential mortgage customers, the impact on loan impairment charges was limited as this lending was well-secured and regulatory restrictions constrained origination loan-to-value ratios to below 70 per cent.

Operating expenses rose by 4 per cent. Staff costs declined by 3 per cent despite wage increases and a rise in the number of customer-facing staff, largely due to lower performance-related costs in Global Banking and Markets. Staff numbers were higher than in 2007 notwithstanding reductions within the branch network for lower business volumes in the latter part of 2008. IT costs rose as investment in systems continued. Marketing costs were lower following active management of costs while property rental costs increased due to higher market rental rates. Overall, cost growth was curtailed in response to the more difficult economic climate.

Table of Contents

Analysis by customer group and global business

Profit/(loss) before tax

	2009						
Hong Kong	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
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)[42]	**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[43]	**(3,979)**	**(404)**	**(9)**				**(4,392)**

Net operating income[16]	**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**
Balance sheet data[41]							
	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	**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**

For footnotes, see page 149.

Table of Contents

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

Hong Kong > Profit/(loss) before tax by customer group

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

	2008						
Hong Kong	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
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 income/(expense) on trading activities	11	1	244		(168)	250	338
Net trading income/(expense)[42]	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[43]	(1,773)	(136)	(11)		(2)		(1,922)
Net operating income[16]	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
Balance sheet data[41]							
	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 149.

	2007						
	Personal Financial Services	Commercial Banking	Global Banking & Markets	Private Banking	Other	Inter-segment elimination[50]	Total
Hong Kong	US$m	US$m	US$m	US$m	US$m	US$m	US$m
Net interest income/(expense)	3,342	1,540	986	70	(767)	312	5,483
Net fee income	1,973	526	682	179	2		3,362
Trading income excluding net interest income	188	63	553	280	186		1,270
Net interest income on trading activities	5		241		38	(312)	(28)
Net trading income[42]	193	63	794	280	224	(312)	1,242
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	820	(13)	7		(140)		674
Net income/(expense) from financial instruments designated at fair value	820	(13)	7		(138)		676
Gains less losses from financial investments			38	1	55		94
Dividend income	2	1	6		22		31
Net earned insurance premiums	2,654	130	13				2,797
Other operating income	153	28	114	6	881	(337)	845
Total operating income	9,137	2,275	2,640	536	279	(337)	14,530
Net insurance claims[43]	(3,116)	(82)	(10)				(3,208)
Net operating income[16]	6,021	2,193	2,630	536	279	(337)	11,322

Loan impairment charges and other credit risk provisions	(175)	(28)	(28)				(231)
Net operating income	5,846	2,165	2,602	536	279	(337)	11,091
Total operating expenses	(1,639)	(547)	(1,025)	(231)	(675)	337	(3,780)
Operating profit/(loss)	4,207	1,618	1,577	305	(396)		7,311
Share of profit in associates and joint ventures	5	1	1		21		28
Profit/(loss) before tax	4,212	1,619	1,578	305	(375)		7,339
	%	%	%	%	%		%
Share of HSBC s profit before tax	17.4	6.7	6.5	1.3	(1.6)		30.3
Cost efficiency ratio	27.2	24.9	39.0	43.1	241.9		33.4
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	38,197	25,890	19,171	4,329	2,051		89,638
Total assets	66,002	32,059	218,293	17,484	53,227	(27,679)	359,386
Customer accounts	129,159	51,562	37,364	15,649	754		234,488

For footnotes, see page 149.

Table of Contents

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

Geographical regions > Rest of Asia-Pacific > 2009

Rest of Asia-Pacific[27]
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$m	Private Banking US$m	Other US$m	Total US$m
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**
Other	**50**	**207**	**288**	**2**	**(35)**	**512**
	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
Other	32	200	397	1	66	696
	211	1,235	2,970	109	197	4,722
2007						
Australia	41	37	42		4	124
India	(70)	88	429	(1)	83	529
Indonesia	(7)	29	86		(4)	104
Japan	(34)	(3)	75		5	43
Mainland China	494	397	369		1,101	2,361
Associates	516	351	220		1,093	2,180
Other mainland China	(22)	46	149		8	181
Malaysia	81	90	146		13	330
Singapore	101	112	240	90	7	550
South Korea	(44)	(20)	159		28	123
Taiwan	(52)	27	144		4	123
Other	5	111	279		20	415
	515	868	1,969	89	1,261	4,702

For footnote see page 149.

Table of Contents

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Australia	**12,112**	9,321	11,339
India	**4,893**	6,244	7,220
Indonesia	**2,721**	1,904	1,642
Japan	**2,496**	5,839	4,258
Mainland China	**13,294**	11,440	11,647
Malaysia	**9,132**	9,404	8,856
Singapore	**14,817**	13,441	11,505
South Korea	**4,438**	5,336	7,124
Taiwan	**4,280**	4,329	3,658
Other	**11,860**	13,403	12,996
	80,043	80,661	80,245

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Australia	**12,093**	9,201	11,418
India	**11,676**	9,767	12,021
Indonesia	**5,014**	2,896	2,574
Japan	**4,914**	6,204	4,657
Mainland China	**21,867**	19,171	14,537
Malaysia	**12,809**	11,963	11,701
Singapore	**33,211**	32,748	28,962
South Korea	**4,162**	4,383	5,760
Taiwan	**9,891**	9,689	9,426
Other	**18,362**	18,172	18,240
	133,999	124,194	119,296

2009 compared with 2008

Economic briefing

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 per cent in 2009, down from 9.6 per cent in 2008, although on a quarterly basis the annual rate of growth rose to a very high 10.7 per cent 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 per cent 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 per cent 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 per cent on a quarter-on-quarter basis, before gains of 1.3 per cent, zero and 1.1 per cent were recorded in the next three quarters, respectively. The unemployment rate rose from 4.3 per cent in December 2008 to a record high of 5.7 per cent in July 2009, before declining to finish the year at 5.1 per cent. 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 per cent in the first three

Table of Contents

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

Geographical regions > Rest of Asia-Pacific > 2009

Profit before tax

Rest of Asia-Pacific[27]	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**3,539**	3,937	3,049
Net fee income	**1,557**	1,867	1,775
Net trading income	**1,606**	2,042	1,346
Changes in fair value of long-term debt issued and related derivatives	**(1)**	1	1
Net income/(expense) from other financial instruments designated at fair value	**111**	(172)	110
Net income/(expense) from financial instruments designated at fair value	**110**	(171)	111
Gains less losses from financial investments	**(19)**	24	36
Gains arising from dilution of interests in associates			1,081
Dividend income	**2**	2	6
Net earned insurance premiums	**365**	197	226
Other operating income	**1,238**	1,055	781
Total operating income	**8,398**	8,953	8,411
Net insurance claims incurred and movement in liabilities to policyholders	**(395)**	28	(253)
Net operating income before loan impairment charges and other credit risk provisions	**8,003**	8,981	8,158
Loan impairment charges and other credit risk provisions	**(896)**	(852)	(561)
Net operating income	**7,107**	8,129	7,597
Total operating expenses	**(4,450)**	(4,704)	(3,991)
Operating profit	**2,657**	3,425	3,606
Share of profit in associates and joint ventures	**1,543**	1,297	1,096

Profit before tax	**4,200**	4,722	4,702
	%	%	%
Share of HSBC s profit before tax	**59.3**	50.7	19.4
Cost efficiency ratio	**55.6**	52.4	48.9
Year-end staff numbers (full-time equivalent)	**87,141**	89,706	80,523

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**80,043**	80,661	80,245
Loans and advances to banks (net)	**35,648**	28,665	32,373
Trading assets, financial assets designated at fair value, and financial investments	**58,941**	53,167	54,541
Total assets	**222,139**	225,573	208,195
Deposits by banks	**8,075**	12,688	15,100
Customer accounts	**133,999**	124,194	119,296

For footnotes, see page 149.

All commentaries on Rest of Asia-Pacific are on an underlying basis unless stated otherwise.

quarters of the fiscal year 2009/10 following a 5.7 per cent 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 per cent 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 per cent 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 per cent 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 per cent for the full year, following a 2.2 per cent increase during 2008. Increased public

Table of Contents

expenditure helped the **Philippines** economy to return to growth following a weak start to 2009, with full year growth of 0.9 per cent being recorded, down from 3.8 per cent 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 per cent from 6.2 per cent in 2008.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Rest of Asia-Pacific[27]	**2008 as reported US$m**	**2008 adjust-ments**[10] **US$m**	**Currency translation**[11] **US$m**	**2008 at 2009 exchange rates**[12] **US$m**	**2009 adjust-ments**[10] **US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change**[13] **%**	**Under-lying change**[13] **%**
Net interest income	**3,937**		**(165)**	**3,772**	**53**	**(286)**	**3,539**	**(10)**	**(8)**
Net fee income	**1,867**		**(80)**	**1,787**	**6**	**(236)**	**1,557**	**(17)**	**(13)**
Changes in fair value[14]	**3**	**(3)**			**(3)**		**(3)**	**(200)**	
Other income[15]	**3,174**		**(205)**	**2,969**	**18**	**(77)**	**2,910**	**(8)**	**(3)**
Net operating income[16]	**8,981**	**(3)**	**(450)**	**8,528**	**74**	**(599)**	**8,003**	**(11)**	**(7)**
Loan impairment charges and other credit risk provisions	**(852)**		**31**	**(821)**		**(75)**	**(896)**	**(5)**	**(9)**
Net operating income	**8,129**	**(3)**	**(419)**	**7,707**	**74**	**(674)**	**7,107**	**(13)**	**(9)**
Operating expenses	**(4,704)**		**208**	**(4,496)**	**(31)**	**77**	**(4,450)**	**5**	**2**
Operating profit	**3,425**	**(3)**	**(211)**	**3,211**	**43**	**(597)**	**2,657**	**(22)**	**(19)**
Income from associates	**1,297**		**27**	**1,324**		**219**	**1,543**	**19**	**17**
Profit before tax	**4,722**	**(3)**	**(184)**	**4,535**	**43**	**(378)**	**4,200**	**(11)**	**(8)**

For footnotes, see page 149.

Review of business performance

HSBC s operations in the Rest of Asia-Pacific region reported a pre-tax profit of US$4.2 billion compared with US$4.7 billion in 2008, a decline of 11 per cent or 8 per cent 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, HSBC continued to build its presence in the region through organic growth, the acquisition of Bank Ekonomi, and strategic investments. The purchase of Bank Ekonomi nearly doubled HSBC s presence in Indonesia to over 200 outlets in 27 cities. HSBC 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 HSBC s network in India, allowing it to offer wealth management products through over
200 additional outlets. Building the Group s mainland China business and renminbi capabilities continued to be a key focus, as 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 HSBC s position as the leading foreign bank in the country. HSBC 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 11 million cards in force will be transferred. In insurance, HSBC expanded its regional coverage and increased its stake in Bao Viet in January 2010, allowing it to extend its position in the Vietnamese market.

Net interest income declined by 8 per cent to US$3.5 billion, 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 Commercial Banking.

Average lending balances fell in Global Banking and Markets and Commercial Banking 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. Personal Financial Services continued to successfully attract deposits and the acquisition of Premier customers was strong with the region growing customer numbers by 35 per cent to over 580,000. Payments and cash management was adversely affected by the low interest rate environment.

Net fee income was 13 per cent 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 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 the Group took various steps to capture cross-border business and continued to benefit from its 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 per cent, 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$110 million was recorded compared with a net expense of US$171 million 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 per cent to US$365 million. 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*.

Deposit spread compression, lower fees and a rise in loan impairment charges reduced underlying profit before tax by 8 per cent.

Loan impairment charges and other credit risk provisions rose by 9 per cent compared with 2008 as credit quality deteriorated in India.

In Personal Financial Services, loan impairment charges rose by 9 per cent to US$649 million, primarily due to rising delinquencies in the 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 implemented by HSBC 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 Commercial Banking, 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 customers to adjust in difficult times. Notwithstanding the improvement towards the end of the year, HSBC continues 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 per cent as the number of migrated activities and processes increased in accordance with the Group s 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*.

New outlets, the launch of a new jointly-owned life insurance company and a planned card joint venture with Bank of Communications consolidated HSBC s position as the leading foreign bank in mainland China.

Profit from associates and joint ventures in the region was 17 per cent 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.

2008 compared with 2007

Economic briefing

Growth in **mainland China** was steady during 2008, although lower than in previous years. Overall GDP growth totalled 9 per cent in 2008, down from 13 per cent in 2007, as weakness in key export markets led to a slowdown in industrial activity during the final months of the year. The tightening of monetary conditions in 2007 and early 2008 also contributed to the slowdown, although interest rates and reserve requirements were both reduced significantly during the final months of the year and a significant fiscal stimulus package was also announced. Consumer spending continued to advance at a strong pace with retail spending increasing by 21.6 per cent over the course of 2008. After accelerating to an eleven year high of 8.7 per cent in February 2008, consumer price inflation slowed to 1.2 per cent by the year-end, largely reflecting the movements in food and energy prices. The renminbi appreciated by more than 6 per cent against the US dollar during 2008, although the exchange rate was little changed during the second half of the year.

Japan s economy slowed sharply during the course of 2008, with industrial activity declining rapidly during the final quarter of the year in response to much weaker external demand. Contractions were registered in both second and third quarter GDP data, confirming a technical recession, while the unemployment rate rose from 3.8 per cent in January 2008 to 4.4 per cent by the year-end. Inflationary pressures increased during the first half before subsiding during the final months of 2008, while measures of business confidence also fell sharply.

Elsewhere in Asia, most economies followed an uneven pattern of growth during 2008. Policymakers focused on the rise in inflation during the first half of the year, but the sharp slowdown in growth during the final months of 2008 came to dominate, with a series of monetary and fiscal policy measures being introduced across the region to stimulate activity. The sustained rise in inflation prompted the Reserve Bank of **India** to tighten policy by raising both interest rates and reserve requirements during the first half of 2008, before then cutting the cash reserve ratio by 350 basis points and the repo rate by 250 basis points during the final quarter of the year. A recession was confirmed in **Singapore** after GDP contracted for three consecutive quarters in 2008, as an economic slowdown initially focused on specific industries turned more pervasive. After rising to a 26-year high of 7.5 per cent in June 2008, the annual rate of inflation slowed to 4.3 per cent by the year-end.

Inflation also proved the predominant concern in **Vietnam** during the first half of 2008 as the annual rate of consumer price inflation more than doubled to 28.3 per cent, prompting the State Bank of Vietnam to sanction substantial interest rate increases, before these measures were rapidly reversed during the final months of the year. Interest rate increases were also forthcoming in **Indonesia** between May and October 2008, although with growth levels maintaining a relatively robust level during much of the year, a tentative easing cycle was only initiated during the final weeks of 2008. Bank Negara **Malaysia** proved the exception by refraining from interest rate increases during the year, even as consumer price inflation accelerated to 8.5 per cent in July 2008, before cutting the policy rate to 3.25 per cent in November. The outlook for the **South Korean** economy was affected by the open nature of the economy and the relatively high levels of household and corporate sector indebtedness. Full year GDP rose by 2.5 per cent in 2008, down from 5.0 per cent in 2007 and the weakest performance for ten years, while fourth quarter GDP fell by 3.4 per

cent on a year-on-year basis. Rising food prices proved particularly problematic for the **Philippines** during the first half of the year as inflation moved well above the central bank s targeted range,
although the earlier tightening of monetary policy was partially reversed at the end of 2008. Growth slowed sharply in **Taiwan** during the course of the year, driven by deteriorating conditions overseas.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Rest of Asia-Pacific[27]	2007 as reported US$m	2007 adjustments and dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjust- ments[10] US$m	Under- lying change US$m	2008 as reported US$m	Re- ported change[13] %	Under- lying change[13] %
Net interest income	3,049		38	3,087	31	819	3,937	29	27
Net fee income	1,775		22	1,797	3	67	1,867	5	4
Changes in fair value[14]					3		3		
Other income[15]	3,334	(1,081)	15	2,268	70	836	3,174	(5)	37
Net operating income[16]	8,158	(1,081)	75	7,152	107	1,722	8,981	10	24
Loan impairment charges and other credit risk provisions	(561)		15	(546)		(306)	(852)	(52)	(56)
Net operating income	7,597	(1,081)	90	6,606	107	1,416	8,129	7	21
Operating expenses	(3,991)		(12)	(4,003)	(110)	(591)	(4,704)	(18)	(15)
Operating profit	3,606	(1,081)	78	2,603	(3)	825	3,425	(5)	32
Income from associates	1,096		93	1,189		108	1,297	18	9

Profit before tax	4,702	(1,081)	171	3,792	(3)	933	4,722	25

For footnotes, see page 149.

Review of business performance

HSBC s operations in Rest of Asia-Pacific reported a pre-tax profit of US$4.7 billion which was in line with 2007. HSBC continued to increase its presence in key markets, augmenting organic growth with the integration of the operations of The Chinese Bank in Taiwan and the purchase of IL&FS Investsmart Ltd in India, which was completed in September. On an underlying basis, excluding the dilution gains on Chinese associates of US$1.1 billion recorded in 2007 and the acquisitions noted above, profit before tax increased by 25 per cent, with notable growth in South Korea, mainland China, India, and an increased contribution from associates in the region. Branches were added in mainland China, Indonesia, Japan, Malaysia and Bangladesh.

Net interest income increased by 27 per cent, with growth across most major countries and all customer groups. Deposit acquisition and related asset deployment across the region drove net interest income, though this volume growth was partly offset by deposit spread compression in the second half of the year due to declining interest rates, compounded by strong competition to acquire deposits.

In India, net interest income increased by 44 per cent as deposit balances in Personal Financial Services and Commercial Banking rose due to
customer acquisition, notably among small businesses following the launch of the HSBC Direct for Business product. These deposits were deployed in increasing lending, where spreads improved on the corporate lending and credit card portfolios and mortgage spreads widened following a re-pricing in the second half of the year.

In mainland China, net interest income also rose due to deposit growth, as investors increasingly preferred deposits over market-led investments as market sentiment deteriorated. This facilitated an increase in personal lending balances following branch network expansion and successful re-pricing initiatives on corporate and commercial loans.

There was strong growth in net interest income from Balance Sheet Management within Global Banking and Markets, due to lower funding costs and steeper yield curves, notably in Singapore, mainland China, India and Japan.

Net fee income rose by 4 per cent, driven by a growth in fees from personal credit cards and trade and supply chain services. Credit card fees rose, particularly in India, driven by increases in interchange fees from higher cardholder spending and late payment and over-limit fees from higher delinquencies. There were lower fees from investment products and broking across the region, driven by a decline in equity markets and weakened investor sentiment.

Fee income from credit facilities rose, notably in India, Australia and Singapore, reflecting increases in the number of customers.

Net trading income rose by 54 per cent, predominantly due to strong Rates and foreign exchange trading across the region as volatile market conditions continued, encouraging increased corporate hedging activity.

Growth was particularly strong in South Korea, mainland China and Australia due to strategic positioning of HSBC s balance sheet to benefit from the interest rate cuts and foreign exchange volatility in 2008, and increased activity in these local markets. In India, foreign exchange and, to a lesser extent, Rates revenues rose, driven mainly by increased customer activity and high levels of market volatility.

A net expense from *financial instruments designated at fair value* of US$171 million was recorded compared with income of US$121 million in 2007. Declines in equity markets affected unit-linked insurance products, particularly in Singapore. This was largely offset by a corresponding decrease in liabilities to policyholders reflected in *net insurance claims incurred and movement in liabilities to policyholders.*

Net earned insurance premiums decreased by 17 per cent to US$197 million, mainly in Singapore and Malaysia due to lower sales of single premium unit-linked products. This was partly offset by an increase in the sale of general insurance products.

Loan impairment charges rose sharply, increasing by 56 per cent to US$852 million, following a marked deterioration in credit quality across the region in the final quarter of the year. These charges rose most significantly in India and, to a lesser extent, in Australia.

In India, the rise was attributable to increased delinquency across personal lending portfolios, in response to which HSBC took action to restrict mortgage and personal lending. However, HSBC continued to extend credit to selected cards customers, which resulted in volume growth and also contributed to higher loan impairment charges.

In Australia, higher delinquencies arose from the maturing of the cards portfolio and, to a lesser extent, volume growth, in addition to a credit risk provision related to an exposure to an Icelandic Bank. Partly offsetting this, loan impairment charges declined by 41 per cent in Taiwan due to an improvement in asset quality. Similarly, in Thailand, loan impairment charges were 69 per cent lower due to the non-recurrence of charges attributable to the down-grading of certain corporate customers.

Operating expenses increased by 15 per cent to US$4.7 billion. Significant investment in the region continued, notably in mainland China where 29 new outlets were opened and staff numbers increased. Related premises and equipment costs rose accordingly. Expansion was also pursued in Indonesia with the addition of new branches, and in Japan with the rollout of seven HSBC Premier centres. In India, the rise in operating expenses was driven mainly by investment in IT, premises costs and an increase in collection activities as default rates rose. Business growth contributed to higher operating expenses in Australia. Litigation costs in the region rose.

Growth in operating expenses at the Group Service and Software Development Centres was driven by increased volumes of activity as HSBC continued to implement a global resourcing strategy to minimise costs throughout the Group. All related costs are recharged to other Group entities and the income is reported within *Other operating income.*

Profit from associates and joint ventures in the region increased by 9 per cent, notwithstanding a significant impairment recorded in Ping An Insurance in respect of its stake in Fortis Bank. Growth was strong across HSBC s other principal associates, the Bank of Communications and Industrial Bank.

Table of Contents

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

Geographical regions > Rest of Asia-Pacific > Profit before tax by customer groups

Analysis by customer group and global business
Profit before tax

	2009						
Rest of Asia-Pacific[27]	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination**[50] **US$m**	**Total US$m**
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)[42]	**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	**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[43]	**(380)**	**(15)**					**(395)**
Net operating income[16]	**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 data[41]							
	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**	**(7,320)**	**222,139**
Customer accounts	**47,573**	**30,196**	**43,698**	**12,496**	**36**		**133,999**

For footnotes, see page 149.

Table of Contents

Rest of Asia-Pacific[27]	2008 Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
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)[42]	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[43]	42	(14)					28
Net operating income[16]	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
Balance sheet data[41]							
	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 149.

Table of Contents

HSBC HOLDINGS PLC

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

Geographical regions > Rest of Asia-Pacific > Profit before tax by customer group // Middle East

Profit before tax (continued)

	2007						
Rest of Asia-Pacific[27]	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	1,507	750	1,035	59	135	(437)	3,049
Net fee income	594	265	820	82	14		1,775
Trading income/(expense) excluding net interest income	42	86	817	71	(70)		946
Net interest income/(expense) on trading activities	(2)		(21)		(14)	437	400
Net trading income/(expense)[42]	40	86	796	71	(84)	437	1,346
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	73	4	(3)	(1)	37		110
Net income/(expense) from financial instruments designated at fair value	73	4	(3)	(1)	38		111
Gains less losses from financial investments	3	4	28		1		36
Gains arising from dilution of interests in associates					1,081		1,081
Dividend income					6		6
Net earned insurance premiums	209	16			1		226
Other operating income	18	3	44	1	848	(133)	781
Total operating income	2,444	1,128	2,720	212	2,040	(133)	8,411

Net insurance claims[43]	(246)	(7)					(253)
Net operating income[16]	2,198	1,121	2,720	212	2,040	(133)	8,158
Loan impairment charges and other credit risk provisions	(486)	(72)	(3)				(561)
Net operating income	1,712	1,049	2,717	212	2,040	(133)	7,597
Total operating expenses	(1,713)	(532)	(969)	(123)	(787)	133	(3,991)
Operating profit	(1)	517	1,748	89	1,253		3,606
Share of profit in associates and joint ventures	516	351	221		8		1,096
Profit before tax	515	868	1,969	89	1,261		4,702
	%	%	%	%	%		%
Share of HSBC s profit before tax	2.1	3.6	8.1	0.4	5.2		19.4
Cost efficiency ratio	77.9	47.5	35.6	58.0	38.6		48.9
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	29,313	21,397	26,476	2,913	146		80,245
Total assets	36,292	27,524	130,096	9,245	9,487	(4,449)	208,195
Customer accounts	38,625	25,306	45,773	9,491	101		119,296

For footnotes, see page 149.

Table of Contents

Middle East[27]

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$m	Private Banking US$m	Other US$m	Total US$m
2009						
Egypt	**18**	**51**	**97**		**58**	**224**
United Arab Emirates	**(177)**	**(136)**	**307**	**(2)**	**5**	**(3)**
Other	**13**	**45**	**(14)**		**(3)**	**41**
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
United Arab Emirates	133	330	388	4	6	861
Other	80	125	161		1	367
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
2007						
Egypt	10	46	65		32	153
United Arab Emirates	108	262	242	3	2	617
Other	83	101	116			300
Middle East (excluding Saudi Arabia)	201	409	423	3	34	1,070
Saudi Arabia	44	73	72		48	237
	245	482	495	3	82	1,307

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Egypt	**2,553**	2,473	1,853
United Arab Emirates	**13,883**	17,537	14,103
Other	**6,408**	7,285	5,651
	22,844	27,295	21,607

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Egypt	**5,743**	5,363	4,056
United Arab Emirates	**17,498**	19,808	18,455
Other	**9,288**	9,994	8,426
	32,529	35,165	30,937

For footnote, see page 149.

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

Geographical regions > Middle East > 2009

Profit before tax

Middle East[27]	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**1,485**	1,556	1,094
Net fee income	**625**	691	471
Net trading income	**394**	402	297
Gains less losses from financial investments	**16**	8	2
Dividend income	**3**	2	2
Other operating income	**71**	9	17
Total operating income	**2,594**	2,668	1,883
Net insurance claims incurred and movement in liabilities to policyholders			
Net operating income before loan impairment charges and other credit risk provisions	**2,594**	2,668	1,883
Loan impairment charges and other credit risk provisions	**(1,334)**	(279)	(55)
Net operating income	**1,260**	2,389	1,828
Total operating expenses	**(1,001)**	(959)	(773)
Operating profit	**259**	1,430	1,055
Share of profit in associates and joint ventures	**196**	316	252
Profit before tax	**455**	1,746	1,307
	%	*%*	*%*

Share of HSBC s profit before tax	**6.4**	18.8	5.4
Cost efficiency ratio	**38.6**	35.9	41.1
Year-end staff numbers (full-time equivalent)	**8,281**	8,453	8,050

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**22,844**	27,295	21,607
Loans and advances to banks (net)	**8,420**	7,476	7,488
Trading assets, financial assets designated at fair value, and financial investments	**10,230**	8,056	9,840
Total assets	**48,107**	50,952	45,669
Deposits by banks	**1,491**	1,001	2,460
Customer accounts	**32,529**	35,165	30,937

For footnotes, see page 149.

All commentaries on Middle East are on an underlying basis unless stated otherwise.

2009 compared with 2008

Economic briefing

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 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.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Middle East[27]	**2008 as reported US$m**	**2008 acquisitions and disposals**[10] **US$m**	**Currency translation**[11] **US$m**	**2008 at 2009 exchange rates**[10] **US$m**	**2009 acquisitions and disposals**[10] **US$m**	**Underlying change US$m**	**2009 as reported US$m**	**Reported change**[13] **%**	**Underlying change**[13] **%**
Net interest income	**1,556**		**(7)**	**1,549**		**(64)**	**1,485**	**(5)**	**(4)**
Net fee income	**691**		**(4)**	**687**		**(62)**	**625**	**(10)**	**(9)**
Other income[15]	**421**		**(7)**	**414**		**70**	**484**	**15**	**17**
Net operating income[16]	**2,668**		**(18)**	**2,650**		**(56)**	**2,594**	**(3)**	**(2)**
Loan impairment charges and other credit risk provisions	**(279)**		**(1)**	**(280)**		**(1,054)**	**(1,334)**	**(378)**	**(376)**
Net operating income	**2,389**		**(19)**	**2,370**		**(1,110)**	**1,260**	**(47)**	**(47)**
Operating expenses	**(959)**		**11**	**(948)**		**(53)**	**(1,001)**	**(4)**	**(6)**
Operating profit	**1,430**		**(8)**	**1,422**		**(1,163)**	**259**	**(82)**	**(82)**
Income from associates	**316**		**1**	**317**		**(121)**	**196**	**(38)**	**(38)**

Profit before tax	**1,746**	**(7)**	**1,739**	**(1,284)**	**455**	**(74)**	**(74)**

For footnotes, see page 149.

Review of business performance

HSBC s operations in the Middle East reported a pre-tax profit of US$0.5 billion compared with US$1.7 billion in 2008, a decrease of 74 per cent 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 Global Banking and Markets. In Personal Financial Services, HSBC continued to focus on Premier and affluent mass market customers, growing its Premier customer base by 32 per cent compared with 2008. HSBC further expanded its presence in Egypt, opening 15 new branches in 2009.

Net interest income declined by 4 per cent, driven by lower deposit and lending balances and deposit spread compression across all customer groups.

Commercial Banking lending balances fell as trade levels declined. In Personal Financial Services, 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 Personal Financial Services, 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 per cent, due to a decline in custody, insurance and unit trust income as investor sentiment weakened in the difficult

Table of Contents

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

Geographical regions > Middle East > 2009 / 2008

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.
Loan impairment charges and other credit provisions increased by US$1.1 billion as real estate and construction were hard hit in the UAE.

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$62 million, driven by gains arising from the buy-back and extinguishment of HSBC s own debt issued locally.

Loan impairment charges and other credit risk provisions rose significantly from US$0.3 billion to US$1.3 billion, 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 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. Management has taken steps to mitigate losses, including reducing 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 per cent. Staff costs remained broadly flat as higher expenditure in Global Banking and Markets was offset by lower staff costs in Personal Financial Services and Commercial Banking 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 per cent as the Group s share of income from The Saudi British Bank declined as a result of higher loan impairment charges. HSBC s share of income from HSBC Saudi Arabia Ltd declined as a result of a slowdown in IPOs and a decline in assets under management.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Middle East[27]	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
	1,094		5	1,099		457	1,556	42	42

Net interest income							
Net fee income	471	2	473	218	691	47	46
Other income[15]	318	3	321	100	421	32	31
Net operating income[16]	1,883	10	1,893	775	2,668	42	41
Loan impairment charges and other credit risk provisions	(55)	(1)	(56)	(223)	(279)	(407)	(398)
Net operating income	1,828	9	1,837	552	2,389	31	30
Operating expenses	(773)	(5)	(778)	(181)	(959)	(24)	(23)
Operating profit	1,055	4	1,059	371	1,430	36	35
Income from associates	252		252	64	316	25	25
Profit before tax	1,307	4	1,311	435	1,746	34	33

For footnotes, see page 149.

Table of Contents

2008 compared with 2007

Economic briefing

The economies of the **Middle East** performed strongly for much of 2008, although inflationary concerns were a feature for much of the year, driven by the surge in oil prices to record levels and private and public investment expenditure. High oil revenues continued to boost fiscal and current account surpluses throughout the region during 2008, although the impact of the decline in oil prices during the final months of the year, together with the OPEC-mandated production cuts, are expected to lead to slower growth in 2009.

Review of business performance

HSBC s operations in the Middle East performed strongly, reporting a pre-tax profit of US$1.7 billion, an increase of 33 per cent on an underlying basis. Record oil prices which peaked in July 2008 boosted domestic spending on infrastructure and real estate in the first half of 2008. The resulting increase in demand for credit was reflected by growth in both volumes and the average loan size. HSBC also successfully launched new banking products across the region, in addition to growing the Premier customer base. Business volume growth and wider asset spreads drove higher net interest income, and fee income rose as volumes of cards and trade products grew.

As global financial conditions began to worsen in the second half of 2008, liquidity in the region declined, which combined with deteriorating consumer confidence, adversely impacted real-estate prices. This triggered an increase in construction-related unemployment as large developments were cancelled or suspended resulting in an increase in loan impairment charges.

Net interest income increased by 42 per cent driven by balance sheet growth in the region.

In Personal Financial Services, the strong lending growth was driven by increased balances in unsecured lending as both cards in circulation and cardholder spending drove higher card balances. Similarly new personal loan products were launched. Mortgage balances rose in the UAE, driven by increased customer demand. The increase in Commercial Banking lending balances reflected a strong rise in corporate lending aligned to trade and infrastructure investments. Asset spreads benefited
from a decline in local base rates following US dollar interest rate cuts, which resulted in a lower cost of funds.

Growth in personal customer deposits was driven by a significant increase in the number of e-saver and Premier accounts. Deposit spreads narrowed due to declining market interest rates in the region.

There was strong growth in net interest income from Balance Sheet Management, due to early positioning in anticipation of lower market interest rates.

Net fee income rose by 46 per cent driven by higher fees in Global Banking and Markets as increased interest from foreign investors and asset growth drove securities services income. Credit card fees rose, driven by increases in interchange fees from higher cardholder spending, and late payment and over-limit fees from higher delinquencies. Fee income from credit facilities rose reflecting increases in the numbers of customers. Trade and supply chain services contributed strongly to fee income primarily in the construction and infrastructure industries.

Trading income rose by 34 per cent resulting from market uncertainty regarding possible currency revaluations which drove volatility and together with robust client demand, led to higher foreign exchange income.

Loan impairment charges rose significantly, albeit from a low base, to US$279 million as a result of increased delinquency rates on higher personal unsecured lending in the UAE. A deterioration in credit conditions also led to increased charges in Commercial Banking.

Operating expenses were 23 per cent higher, reflecting substantially increased levels of operating volumes, related headcount growth and wage inflation driven by competitive labour market conditions. Non-staff costs rose as a result of higher premises costs, and increased marketing expenditure in line with new product launches.

Profit from associates and joint ventures rose by 25 per cent as the Group s share of income from the Saudi British Bank increased as a result of higher fee income from cards, account management and trade-related businesses. These were partly offset by higher operating expenditure resulting from branch expansion, increased investment in technology and higher performance-related pay.

Table of Contents

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

Geographical regions > Middle East > Profit/(loss) before tax

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

	2009						
Middle East[27]	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination**[50] **US$m**	**Total US$m**
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[42]	**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[43]							
Net operating income[16]	**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**

Balance sheet data[41]

	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**

For footnotes, see page 149.

	2008						
Middle East[27]	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	652	510	362	3	46	(17)	1,556
Net fee income	227	241	217	6			691
Trading income excluding net interest income	47	65	244		24		380
Net interest income/(expense) on trading activities			20		(15)	17	22
Net trading income[42]	47	65	264		9	17	402
Gains less losses from financial investments	14		(6)				8
Dividend income			2				2
Other operating income	21	8	11	3	26	(60)	9
Total operating income	961	824	850	12	81	(60)	2,668
Net insurance claims[43]							
Net operating income[16]	961	824	850	12	81	(60)	2,668
Loan impairment (charges)/ recoveries and other credit risk provisions	(223)	(45)	(12)		1		(279)
Net operating income	738	779	838	12	82	(60)	2,389
Total operating expenses	(511)	(264)	(212)	(8)	(24)	60	(959)
Operating profit	227	515	626	4	58		1,430
Share of profit in associates and joint ventures	62	43	190		21		316
Profit before tax	289	558	816	4	79		1,746
	%	%	%	%	%		%
Share of HSBC s profit before tax	3.1	6.0	8.9		0.8		18.8
Cost efficiency ratio	53.2	32.0	24.9	66.7	29.6		35.9
Balance sheet data[41]							
	US$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 149.

Table of Contents

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

Geographical regions > Middle East > Profit/(loss) before tax // North America > 2009

Profit/(loss) before tax (continued)

	2007						
Middle East[27]	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	458	381	260	1	18	(24)	1,094
Net fee income	172	164	132	3			471
Trading income/(expense) excluding net interest income	30	43	183				256
Net interest income/(expense) on trading activities			(1)		18	24	41
Net trading income/(expense)[42]	30	43	182		18	24	297
Gains less losses from financial investments	2						2
Dividend income			2				2
Other operating income	22	12	9	1	1	(28)	17
Total operating income	684	600	585	5	37	(28)	1,883
Net insurance claims[43]							
Net operating income[16]	684	600	585	5	37	(28)	1,883
Loan impairment charges and other credit risk provisions	(66)	11					(55)
Net operating income	618	611	585	5	37	(28)	1,828
Total operating expenses	(418)	(207)	(171)	(2)	(3)	28	(773)
Operating profit	200	404	414	3	34		1,055
Share of profit in associates and joint ventures	45	78	81		48		252
Profit before tax	245	482	495	3	82		1,307
	%	%	%	%	%		%

Share of HSBC s profit before tax	1.0	2.0	2.1		0.3		5.4
Cost efficiency ratio	61.1	34.5	29.2	40.0	8.1		41.1
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	5,173	10,762	5,630	42			21,607
Total assets	6,045	12,219	26,548	49	4,390	(3,582)	45,669
Customer accounts	11,078	9,585	8,347	1,625	302		30,937

For footnotes, see page 149.

Table of Contents

North America

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$m	Private Banking US$m	Other US$m	Total US$m
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[52]	(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)
2007						
US	(1,824)	377	(1,243)	156	1,468	(1,066)
Canada	265	466	239	8	5	983
Bermuda	13	77	39	10	34	173
Other					1	1
	(1,546)	920	(965)	174	1,508	91

For footnote, see page 149.

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m

US	**156,638**	208,834	233,706
Canada	**47,158**	44,866	53,891
Bermuda	**3,057**	2,514	2,263
	206,853	256,214	289,860

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
US	**99,371**	101,963	100,034
Canada	**41,565**	33,905	37,061
Bermuda	**8,221**	7,664	8,078
	149,157	143,532	145,173

2009 compared with 2008

Economic briefing

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 per cent after a 0.4 per cent 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 per cent 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 per cent by December 2009, although this trend was largely reflective of the

Table of Contents

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

Geographical regions > North America > 2009

Profit/(loss) before tax

North America	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**13,670**	15,218	14,847
Net fee income	**4,817**	5,227	5,810
Net trading income/(expense)	**331**	(3,135)	(542)
Changes in fair value of long-term debt issued and related derivatives	**(3,497)**	3,736	1,750
Net income from other financial instruments designated at fair value	**1**	1	
Net income/(expense) from financial instruments designated at fair value	**(3,496)**	3,737	1,750
Gains less losses from financial investments	**296**	(120)	245
Dividend income	**53**	77	105
Net earned insurance premiums	**309**	390	449
Other operating income	**566**	23	360
Total operating income	**16,546**	21,417	23,024
Net insurance claims incurred and movement in liabilities to policyholders	**(241)**	(238)	(241)
Net operating income before loan impairment charges and other credit risk provisions	**16,305**	21,179	22,783
Loan impairment charges and other credit risk provisions	**(15,664)**	(16,795)	(12,156)
Net operating income	**641**	4,384	10,627
Operating expenses (excluding goodwill impairment)	**(8,391)**	(9,359)	(10,556)
Goodwill impairment		(10,564)	
Operating profit/(loss)	**(7,750)**	(15,539)	71
Share of profit in associates and joint ventures	**12**	11	20

Profit/(loss) before tax	**(7,738)**	(15,528)	91
	%	%	%
Share of HSBC s profit before tax	**(109.3)**	(166.8)	0.4
Cost efficiency ratio	**51.5**	94.1	46.3
Year-end staff numbers (full-time equivalent)	**35,458**	44,725	52,722

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**206,853**	256,214	289,860
Loans and advances to banks (net)	**15,386**	11,458	16,566
Trading assets, financial assets designated at fair value, and financial investments[49]	**123,288**	119,634	133,998
Total assets	**475,014**	596,302	574,318
Deposits by banks	**13,970**	18,181	16,618
Customer accounts	**149,157**	143,532	145,173

For footnotes, see page 149.

All commentaries on North America are on an underlying basis unless stated otherwise.

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 per cent 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 per cent during the first eleven months of 2009 compared with the equivalent period of 2008, led by a sharp contraction

Table of Contents

of output within the manufacturing sector. Labour market conditions deteriorated as the unemployment rate rose from a level of 6.8 per cent in December 2008 to an eleven year high of 8.7 per cent 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 per cent in December 2008 to 0.25 per cent in April 2009, and provided a conditional commitment to maintain this level of interest rates until the end of the second quarter of 2010.

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

	2009 compared with 2008								
North America	**2008 as reported US$m**	**2008 adjust-ments[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjust-ments[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**15,218**		**(79)**	**15,139**		**(1,469)**	**13,670**	**(10)**	**(10)**
Net fee income	**5,227**		**(33)**	**5,194**		**(377)**	**4,817**	**(8)**	**(7)**
Changes in fair value[14]	**3,444**	**(3,444)**			**(3,688)**		**(3,688)**	**(207)**	
Other income/(expense)[15]	**(2,710)**		**(4)**	**(2,714)**		**4,220**	**1,506**	**156**	**155**
Net operating income[16]	**21,179**	**(3,444)**	**(116)**	**17,619**	**(3,688)**	**2,374**	**16,305**	**(23)**	**13**
Loan impairment charges and other credit risk provisions	**(16,795)**		**(8)**	**(16,803)**		**1,139**	**(15,664)**	**7**	**7**
Net operating income	**4,384**	**(3,444)**	**(124)**	**816**	**(3,688)**	**3,513**	**641**	**(85)**	**431**
Operating expenses (excluding goodwill impairment)	**(9,359)**		**58**	**(9,301)**		**910**	**(8,391)**	**10**	**10**
	(10,564)			**(10,564)**		**10,564**		**100**	**100**

Goodwill impairment									
Operating loss	**(15,539)**	**(3,444)**	**(66)**	**(19,049)**	**(3,688)**	**14,987**	**(7,750)**	**50**	**79**
Income from associates	**11**		**(1)**	**10**		**2**	**12**	**9**	**20**
Loss before tax	**(15,528)**	**(3,444)**	**(67)**	**(19,039)**	**(3,688)**	**14,989**	**(7,738)**	**50**	**79**

For footnotes, see page 149.

Review of business performance

In North America, HSBC reported a loss before tax of US$7.7 billion in 2009 compared with a loss of US$15.5 billion in 2008. On an underlying basis, excluding US$3.7 billion of fair value movements on HSBC s own debt, and also excluding an impairment charge of US$10.6 billion in 2008 to fully write-off goodwill in respect of North America Personal Financial Services, the pre-tax loss fell by 52 per cent to US$4.1 billion. This improved performance was largely due to a marked reduction in write-downs and losses in Global Banking and Markets, lower loan impairment charges in Personal Financial Services and lower operating expenses following the closure of the 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 Private Banking, books.

Net interest income in 2009 declined by 10 per cent, 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$4.5 billion of prime mortgages in 2009 in addition to normal sale activity. In 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, direct marketing mailings and new customer account originations were resumed for portions of the sub-prime credit card portfolio which had held up well through the economic downturn.

In November 2009, HSBC entered into an agreement to sell the vehicle finance loan servicing operation and US$1.0 billion of associated loans. This transaction is expected to close in the first quarter of 2010.

On an underlying basis and excluding goodwill impairment in 2008, the pre-tax loss in North America halved.

In December 2009, HSBC Finance revised the write-off period for its real estate secured and other 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 financial results as write-offs were offset with releases of related impairment allowances. However, the write-offs resulted in a US$3.3 billion 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, re-pricing initiatives, lower levels of promotional balances and interest rate floors on portions of the portfolio. In Global Banking and Markets and Commercial Banking, asset spreads widened, primarily due to loan repricing and lower funding costs.

Customer deposit balances were broadly unchanged. In Global Banking and Markets, reduced deposits reflected the decline in assets being funded. This reduction was partly offset in both Personal Financial Services and Commercial Banking, 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 per cent to US$4.8 billion, driven by lower late, overlimit, interchange and cash advance fees in the US credit cards business. This was mainly due to a reduction in 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 Global Banking and Markets, fee income from underwriting increased, driven by higher debt origination volumes.

Net trading income of US$331 million compared with a net trading loss of US$3.1 billion in 2008, primarily due to significantly lower write-downs on exposures in Global Banking and Markets, 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 per cent to US$192 million, as income from ineffective interest rate hedges related to long-term debt issued by the Group s subsidiaries in North America reduced.

Gains less losses from financial investments were US$296 million, compared with a net loss of US$123 million 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.

Table of Contents

Net earned insurance premiums declined by 21 per cent 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$566 million compared with US$26 million 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$241 million 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.

Loan impairment charges and other credit risk provisions decreased by 7 per cent to US$15.7 billion. Lower loan impairment charges in HSBC Finance were partly offset by increases in loan impairment charges and other credit risk provisions in Global Banking and Markets, Commercial Banking, the US prime mortgage book and Private Banking. Loan impairment charges in US consumer finance fell by 12 per cent to US$13.5 billion.

Loan impairment charges in US consumer finance decreased by 12 per cent to US$13.5 billion, due to a stabilisation in delinquency trends. In the Mortgage Services portfolio, loan impairment charges fell by 40 per cent to US$2.1 billion as the portfolio progressed further into run-off. By contrast, there was a 4 per cent 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 per cent, 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 Personal Financial Services in HSBC Bank USA, loan impairment charges rose by 18 per cent to US$616 million, 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 Global Banking and Markets rose from US$198 million to US$621 million, 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 Commercial Banking, loan impairment charges rose by 15 per cent to US$519 million 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 Private Banking, higher loan impairment charges were attributable to a single specific charge.

Further commentary on delinquency trends in the US Personal Financial Services portfolios is provided in Areas of special interest personal lending on page 215.

Operating expenses declined to US$8.4 billion. Apart from the non-recurrence of a US$10.6 billion charge for the impairment of the goodwill of the North American Personal Financial Services 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 the branch network amounted to US$150 million. Staff costs decreased as a result of lower staff numbers, offsetting higher performance-related costs in Global Banking and Markets. 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$143 million following a Federal Deposit Insurance Corporation special assessment in response to the bail out of a number of regional banks.

2008 compared with 2007

Economic briefing

Economic conditions proved very difficult in the **US** during 2008 as the economy entered a period of recession. Overall GDP growth slowed to just 1.1 per cent for the year, down from 2 per cent in 2007. In common with many other economies, much of this weakness was concentrated in the final months of 2008 as fourth quarter GDP registered the largest quarterly decline for 26 years. Economic weakness proved broad-based across most areas of the economy, with the notable exception of net exports. Housing sales and residential construction activity both declined from already depressed levels, with house prices continuing to fall in most regions and mortgage delinquencies continuing to rise. Labour market conditions weakened throughout the course of the year as the unemployment rate rose from 4.9 per cent in January to a 15-year high of 7.2 per cent in December 2008. The annual CPI rate reached a 17-year high of 5.6 per cent in July 2008 before moderating sharply to stand at just 0.1 per cent by the year-end. A combination of falling asset values and weak employment conditions undermined consumer confidence and household spending growth turned negative during the second half of 2008. The Standard & Poor s S&P 500 stock market index fell by 38 per cent during the year. Faced with this deterioration in economic activity and financial conditions, the Federal Reserve lowered short-term interest rates by 425 basis points during the course of 2008, leaving the Funds target rate within a narrow range of between zero and 25 basis points, while a number of liquidity initiatives were also introduced.

Canadian GDP increased by 0.4 per cent during the first eleven months of 2008 compared with the equivalent period of 2007, with growth slowing markedly during the second half of the year, due predominantly to weaker external demand. Labour market conditions deteriorated as the unemployment rate rose from a historical low of 5.8 per cent in January 2008 to finish the year at 6.6 per cent. After rising to a level of 3.5 per cent in August 2008, the headline rate of consumer price inflation slowed to 1.2 per cent by the year-end. The core rate of inflation remained below 2.0 per cent throughout the year. Responding to the deteriorating economic outlook, the Bank of Canada cut its overnight interest rate from 4.25 per cent at the end of 2007 to 1.5 per cent in December 2008.

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

	2008 compared with 2007								
North America	2007 as reported US$m	2007 adjustments and dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjustments[10] US$m	Underlying change US$m	2008 as reported US$m	Reported change[13] %	Underlying change[13] %
Net interest income	14,847	1	7	14,855		363	15,218	2	2
Net fee income	5,810	(105)	1	5,706		(479)	5,227	(10)	(8)
Changes in fair value[14]		1,760	(1,760)			3,444		3,444	96

Other income/(expense)[15]	366	(18)		348		(3,058)	(2,710)	(840)	(879)
Net operating income[16]	22,783	(1,882)	8	20,909	3,444	(3,174)	21,179	(7)	(15)
Loan impairment charges and other credit risk provisions	(12,156)		12	(12,144)		(4,651)	(16,795)	(38)	(38)
Net operating income	10,627	(1,882)	20	8,765	3,444	(7,825)	4,384	(59)	(89)
Operating expenses (excluding goodwill impairment)	(10,556)	98	(6)	(10,464)		1,105	(9,359)	11	11
Goodwill impairment						(10,564)	(10,564)		
Operating profit/(loss)	71	(1,784)	14	(1,699)	3,444	(17,284)	(15,539)	(21,986)	(1,017)
Income from associates	20			20		(9)	11	(45)	(45)
Profit/(loss) before tax	91	(1,784)	14	(1,679)	3,444	(17,293)	(15,528)	(17,164)	(1,030)

For footnotes, see page 149.

Review of business performance

HSBC s operations in North America reported a pre-tax loss of US$15.5 billion in 2008, compared with a pre-tax profit of US$91 million in 2007. On an underlying basis, the loss before tax was US$17.3 billion worse at US$19.0 billion.

Net interest income in North America increased by 2 per cent to US$15.2 billion, driven by Balance Sheet Management activities in Global Banking and Markets which more than offset the decline in Personal Financial Services as lending reduced.

The significant increase in net interest income in the Balance Sheet Management business resulted from correct positioning in anticipation of lower interest rates. Net interest income was also boosted by higher balances within certain loan portfolios in Global Banking and Markets.

Net interest income fell in Personal Financial Services as asset balances declined and deposit spreads narrowed. Deposit spread compression was driven by the competitive environment for retail deposits in which HSBC refrained from passing on the full effects of interest rate cuts to customers. Asset spreads widened, particularly in vehicle finance and credit cards and, to a lesser extent, the real estate secured portfolios as yields declined by less than funding costs in the lower interest rate environment, and the credit card portfolio benefited from APR floors. This was partly offset by a rise in non-performing loans, lower loan prepayments, increased volumes of loan modifications, and lower fees from reduced loan origination volumes. Funding costs declined as a result of lower base rates during the year.

Lending balances declined as the mortgage services portfolio continued to run-off, originations ceased during the year within the dealer and direct-to-consumer channels in vehicle finance, and tighter underwriting criteria in consumer lending constrained customer eligibility for finance. In addition, US$8.2 billion of mortgages were sold from the US real estate secured portfolios during the year. These factors were partly offset by a change in mix towards higher-yielding credit card loans and reduced levels of prepayments that resulted in loans remaining on the balance sheet longer. At the end of February 2009, HSBC authorised the discontinuation as soon as practicable of all new receivable originations of all products by the branch-based consumer lending business of HSBC Finance in North America (see page 215).

Net fee income declined by 8 per cent, driven by reductions in US credit card fees following changes in fee practices implemented since the fourth quarter of 2007 and lower cash advance and interchange fees as a result of reduced volumes. Partly offsetting the decline were increased income from enhancement services due to higher customer acceptance rates of Account Secure Plus and Identity Protection Plan, a rise in syndication, credit and service fees in Commercial Banking and increased fees from asset management.

Trading losses were dominated by write-downs in Global Banking and Markets on legacy exposures as continuing turmoil in credit markets adversely affected valuations of credit and structured credit trading positions, monoline exposures and leveraged and acquisition finance loans. Continued deterioration in the fair value of the run-off portfolio of sub-prime residential mortgage loans held for sale also contributed to the loss. US$3.6 billion in leveraged loans, high yield notes and securities held for balance sheet management were reclassified in 2008 under revised IFRS rules from trading assets to loans and receivables and available for sale, preventing any further mark-to-market trading losses on these assets. If these reclassifications had not been made, the loss before tax would have been US$0.9 billion higher.

The losses on legacy assets were partly offset by strong performances in other trading areas as foreign exchange trading benefited from pronounced market volatility, Rates trading correctly anticipated central bank rate cuts and gains were generated on credit default swaps in Global Banking. Revenues from emerging markets trading and precious metals trading also rose as a result of ongoing market volatility and increased transaction volumes as prices of gold and platinum rose during 2008. Losses on non-qualifying hedge positions in interest rate swaps generated further trading losses. In 2007, the Decision One business, which was closed that year, recorded trading losses of US$263 million.

Net income from financial instruments designated at fair value rose by US$304 million to US$293 million due to income from ineffective hedges related to long-term debt issued by the Group s subsidiaries in North America.

Gains less losses from financial investments declined, mainly due to losses on US government agency securities in 2008 and the non-recurrence of the sale of MasterCard shares, partly offset by gains from the Visa IPO in 2008.

Net earned insurance premiums decreased by 13 per cent to US$390 million, driven by lower credit related premiums in HSBC Finance due to declining loan volumes.

Other operating income declined due to losses on sale of the Canadian vehicle finance businesses and other loan portfolios in 2008, in addition to the non-recurrence of gains on disposal of fixed assets and a small portfolio of private equity investments in 2007.

Net insurance claims incurred and movement in liabilities to policyholders were broadly in line with 2007 at US$238 million.

Loan impairment charges and other credit risk provisions rose sharply, by 38 per cent to US$16.8 billion, reflecting substantially higher impairment charges in HSBC Finance across all portfolios and, in HSBC USA, the deterioration of credit quality in prime residential mortgages, second lien portfolios and private label cards. The main factors driving this deterioration were the continued weakening of the US economy, which led to rising levels of unemployment and personal bankruptcy filings: higher early-stage delinquency and increased roll rates in consumer lending: the ageing of portfolios: and further declines in house prices which increased loss severity and reduced customers ability to refinance and access equity in their homes. Partly offsetting these factors was a reduction in overall lending as HSBC continued to actively reduce its balance sheet and lower its risk profile in the US.

In the Mortgage Services business, loan impairment charges rose by 14 per cent to US$3.5 billion as the 2005 and 2006 vintages continued to season and experience rising delinquency. Run-off of the portfolio slowed in light of continued house price depreciation which, along with the constrained credit environment, restricted refinancing options for personal customers. In consumer lending, loan impairment charges rose by 39 per cent to US$5.7 billion. In the second half of 2008, delinquency rates began to accelerate particularly in the first lien portfolios in the parts of the country most affected by house price depreciation and rising unemployment rates. In HSBC USA, loan impairment charges rose by 76 per cent to US$2.6 billion driven by credit quality deterioration across the Home Equity line of credit, Home Equity loan, prime first lien residential mortgage and private label card portfolios.

Loan impairment charges in US card and retail services rose, driven by portfolio seasoning and rising unemployment, particularly in the second half of 2008, higher levels of personal bankruptcy filings and lower recovery rates. As with mortgages, this was most notable in parts of the country most affected by house price falls and unemployment.

Vehicle finance loan impairment charges rose as delinquencies rose and lower prices resulted in lower recoveries when repossessed vehicles were sold at auction.

Loan impairment charges in Commercial Banking grew to US$449 million from a low base, primarily driven by higher impairment losses due to deterioration across the middle market, commercial real estate and corporate banking portfolios in the US and among firms in the manufacturing, export and commercial real estate sectors in Canada. Higher loan impairment charges and other credit risk provisions in Global Banking and Markets reflected weaker credit fundamentals in the US in 2008.

Operating expenses increased by 90 per cent, driven by US$10.6 billion of impairment charge recognised in respect of North America Personal Financial Services in 2008 to fully write off goodwill. Excluding the goodwill impairment charge, expenses were US$1.1 billion or 11 per cent lower. Staff costs declined, primarily in HSBC Finance, following decisions taken in 2007 to close the acquisition channels for new business in Mortgage Services and a number of consumer lending branches, and integrate the operations of the card businesses. HSBC USA made the decision to close its wholesale and third-party correspondent mortgage business in November 2008, while HSBC Finance took the decision to cease originations in the dealer and direct-to-consumer channels in the vehicle finance business in July 2008. Staff costs in Global Banking and Markets also fell as performance-related compensation and staff numbers both declined.

Other administrative costs decreased as origination activity declined, marketing costs in card and retail services reduced and branch costs in consumer lending fell as tightened underwriting criteria curtailed business and led to branch closures. This was partly offset by higher marketing and occupancy costs in the retail bank reflecting a continued expansion of the branch network, increased community investment activities and higher deposit insurance, collection, payments and cash management and asset management costs in support of business growth.

Table of Contents

Analysis by customer group and global business

Profit/(loss) before tax

	2009						
North America	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
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) [42]	**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[43]	**(241)**						**(241)**

Net operating income/(expense)[16]	**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**
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**
Balance sheet data[41]							
	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**

For footnotes, see page 149.

Table of Contents

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

Geographical regions > North America > Profit/(loss) before tax by customer group

Profit/(loss) before tax (continued)

	2008						
North America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
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)[42]	(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[43]	(238)						(238)

Net operating income/(expense)[16]	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
Balance sheet data[41]							
	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 149.

Table of Contents

North America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
			2007				
Net interest income/(expense)	13,175	1,558	378	273	(17)	(520)	14,847
Net fee income/(expense)	4,571	338	701	279	(79)		5,810
Trading income/(expense) excluding net interest income	(349)	(2)	(871)	11	(78)		(1,289)
Net interest income/(expense) on trading activities	134		137		(44)	520	747
Net trading income/(expense)[42]	(215)	(2)	(734)	11	(122)	520	(542)
Changes in fair value of long-term debt issued and related derivatives					1,750		1,750
Net income/(expense) from other financial instruments designated at fair value			11		(11)		
Net income from financial instruments designated at fair value			11		1,739		1,750
Gains less losses from financial investments	176	(1)	65	2	3		245
Dividend income	47	1	57				105
Net earned insurance premiums	449						449
Other operating income/(expense)	(5)	88	167	34	1,480	(1,404)	360
Total operating income	18,198	1,982	645	599	3,004	(1,404)	23,024
Net insurance claims[43]	(241)						(241)

Net operating income[16]	17,957	1,982	645	599	3,004	(1,404)	22,783
Loan impairment charges and other credit risk provisions	(11,909)	(191)	(46)	(10)			(12,156)
Net operating income	6,048	1,791	599	589	3,004	(1,404)	10,627
Total operating expenses	(7,594)	(893)	(1,562)	(415)	(1,496)	1,404	(10,556)
Operating profit/(loss)	(1,546)	898	(963)	174	1,508		71
Share of profit/(loss) in associates and joint ventures		22	(2)				20
Profit/(loss) before tax	(1,546)	920	(965)	174	1,508		91
	%	%	%	%	%		%
Share of HSBC s profit before tax	(6.4)	3.8	(4.0)	0.7	6.3		0.4
Cost efficiency ratio	42.3	45.1	242.2	69.3	49.8		46.3
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	218,676	38,930	26,186	6,068			289,860
Total assets	252,304	46,247	263,008	20,073	1,095	(8,409)	574,318
Customer accounts	61,824	36,306	30,732	16,187	124		145,173

For footnotes, see page 149.

Table of Contents

HSBC HOLDINGS PLC

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

Geographical regions > Latin America > 2009

Latin America

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$m	Private Banking US$m	Other US$m	Total US$m
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
2007						
Argentina	36	75	90			201
Brazil	293	286	297	9	(6)	879
Mexico	514	333	113	11	9	980
Panama	45	18	16	7		86
Other	5	28	1	(2)		32
	893	740	517	25	3	2,178

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007

	US$m	US$m	US$m
Argentina	**2,319**	2,356	2,485
Brazil	**22,765**	18,255	18,491
Mexico	**12,114**	12,211	18,059
Panama	**5,989**	4,538	4,158
Other	**4,442**	4,927	4,730
	47,629	42,287	47,923

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Argentina	**3,083**	2,988	2,779
Brazil	**39,022**	27,857	26,231
Mexico	**18,195**	17,652	22,307
Panama	**6,996**	5,185	5,062
Other	**5,593**	5,761	4,913
	72,889	59,443	61,292

Profit before tax

Latin America	2009 US$m	2008 US$m	2007 US$m
Net interest income	**5,573**	6,458	5,576
Net fee income	**1,729**	2,167	2,153
Net trading income	**848**	701	548
Changes in fair value of long-term debt issued and related derivatives			
Net income from other financial instruments designated at fair value	**495**	364	320
Net income from financial instruments designated at fair value	**495**	364	320
Gains less losses from financial investments	**168**	176	253
Gains arising from dilution of interests in associates			11
Dividend income	**11**	20	9
Net earned insurance premiums	**1,900**	1,717	1,594
Other operating income	**133**	300	228
Total operating income	**10,857**	11,903	10,692
Net insurance claims incurred and movement in liabilities to policyholders	**(1,833)**	(1,390)	(1,427)
Net operating income before loan impairment charges and other credit risk provisions	**9,024**	10,513	9,265
Loan impairment charges and other credit risk provisions	**(2,526)**	(2,492)	(1,697)
Net operating income	**6,498**	8,021	7,568
Total operating expenses	**(5,375)**	(5,990)	(5,402)
Operating profit	**1,123**	2,031	2,166

Share of profit in associates and joint ventures	**1**	6	12
Profit before tax	**1,124**	2,037	2,178
	%	%	%
Share of HSBC s profit before tax	**15.9**	21.9	9.0
Cost efficiency ratio	**59.6**	57.0	58.3
Year-end staff numbers (full-time equivalent)	**54,288**	58,559	64,404

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**47,629**	42,287	47,923
Loans and advances to banks (net)	**18,608**	14,572	12,675
Trading assets, financial assets designated at fair value, and financial investments	**28,779**	18,753	24,715
Total assets	**115,967**	102,946	102,649
Deposits by banks	**5,421**	5,598	4,092
Customer accounts	**72,889**	59,443	61,292

For footnote, see page 149.

All commentaries on Latin America are on an underlying basis unless stated otherwise.

2009 compared with 2008

Economic briefing

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 per cent below the comparable figure in 2008. The annual CPI rate continued to moderate, falling from 6.5 per cent in December 2008 to 3.6 per cent 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 per cent by the end of the year.

The **Brazilian** economy experienced a mild contraction during the early months of 2009 but

Table of Contents

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

Geographical regions > Latin America > 2009

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 per cent in December 2009. The annual CPI rate moderated from 5.9 per cent in December 2008 to a level slightly below the central banks targeted rate of 4.5 per cent 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 per cent 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 per cent 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.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Latin America	**2008 as reported US$m**	**2008 acquisitions and disposals[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 acquisitions and disposals[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**6,458**		**(783)**	**5,675**		**(102)**	**5,573**	**(14)**	**(2)**
Net fee income	**2,167**		**(291)**	**1,876**		**(147)**	**1,729**	**(20)**	**(8)**
Other income[15]	**1,888**	**(71)**	**(220)**	**1,597**		**125**	**1,722**	**(9)**	**8**
Net operating income[16]	**10,513**	**(71)**	**(1,294)**	**9,148**		**(124)**	**9,024**	**(14)**	**(1)**
Loan impairment charges and other credit risk provisions	**(2,492)**		**294**	**(2,198)**		**(328)**	**(2,526)**	**(1)**	**(15)**
Net operating income	**8,021**	**(71)**	**(1,000)**	**6,950**		**(452)**	**6,498**	**(19)**	**(7)**
	(5,990)		**709**	**(5,281)**		**(94)**	**(5,375)**	**10**	**(2)**

Operating expenses								
Operating profit	**2,031**	**(71)**	**(291)**	**1,669**	**(546)**	**1,123**	**(45)**	**(33)**
Income from associates	**6**		**(2)**	**4**	**(3)**	**1**	**(83)**	**(75)**
Profit before tax	**2,037**	**(71)**	**(293)**	**1,673**	**(549)**	**1,124**	**(45)**	**(33)**

For footnotes, see page 149.

Review of business performance

HSBC s operations in Latin America reported pre-tax profits of US$1.1 billion, compared with US$2.0 billion in 2008. On an underlying basis, pre-tax profits decreased by 33 per cent, primarily attributable to significantly higher loan impairment charges in Personal Financial Services and Commercial Banking and lower revenues in Personal Financial Services. Global Banking and Markets 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. Additional capital was injected into Brazil and Mexico during the fourth quarter of 2009, in line with the Group 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 Personal Financial Services 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.

Table of Contents

Average customer deposit balances rose, resulting from an increase in commercial and Global Banking balances. In Mexico, Personal Financial Services launched new deposit products to mitigate the fall in deposits. Deposits 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 per cent. 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 Global Banking and Markets.

Below inflation increase in operating expenses reflected significant cost control measures in Latin America.

Net trading income rose by 42 per cent due to a strong performance in Global Banking and Markets, 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 per cent, primarily from higher insurance-related assets. This resulted from 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 per cent, 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 per cent, 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 per cent as economic conditions deteriorated across the region. In the first half of 2009, 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 per cent compared with the second half of 2008 and by 27 per cent on the first half of 2009.

In Personal Financial Services, 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 Personal Financial Services fell by 8 per cent in the second half of the year compared with the same period in 2008 and by 27 per cent 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 Global Banking and Markets when compared with a net charge in 2008.

Operating expenses increased slightly by 2 per cent, well below the inflation rates of the main economies in which HSBC operates, 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.

Table of Contents

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

Geographical regions > Latin America > 2008

2008 compared with 2007

Economic briefing

Inflationary pressures developed in **Mexico** during the course of 2008, mostly due to rising commodity prices, as consumer price inflation accelerated from 3.7 per cent in January to 6.5 per cent by the year-end. In response, the Bank of Mexico raised its overnight interest rate by 75 basis points to 8.25 per cent by the end of the year, although a variety of economic indicators pointed to a sharp loss of momentum during the final quarter as global growth slowed.

The **Brazilian** economy performed strongly during the first half of 2008, driven by domestic demand, with the annual rate of consumer price inflation rising from 4.6 per cent in January to 6.4 per cent in July, towards the upper limit of the central banks tolerance range. Conditions within the labour market improved, with the rate of unemployment well below levels observed a year earlier. In line with many other economies within the region, however, conditions weakened markedly towards the end of 2008, with industrial production falling by close to 20 per cent during the fourth quarter.

In **Argentina**, economic activity held at a reasonably robust level for much of the year, although measures of industrial production growth slowed noticeably during the final months of 2008. Declines in commodity prices during the second half of 2008 and the reduced value of exports raised concerns over the level of capital outflow from the country, while domestic currency interest rates increased sharply. The official headline rate of consumer price inflation rose during the first half of 2008, reaching 9.3 per cent in June 2008 before slowing to 7.2 per cent in December, although methodological changes make comparisons over year difficult.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Latin America	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	5,576		155	5,731		727	6,458	16	13
Net fee income	2,153		58	2,211		(44)	2,167	1	(2)
Other income[15]	1,536	(11)	23	1,548	71	269	1,888	23	17
Net operating income[16]	9,265	(11)	236	9,490	71	952	10,513	13	10
Loan impairment charges and other	(1,697)		(64)	(1,761)		(731)	(2,492)	(47)	(42)

credit risk provisions									
Net operating income	7,568	(11)	172	7,729	71	221	8,021	6	3
Operating expenses	(5,402)		(190)	(5,592)		(398)	(5,990)	(11)	(7)
Operating profit	2,166	(11)	(18)	2,137	71	(177)	2,031	(6)	(8)
Income from associates	12			12		(6)	6	(50)	(50)
Profit before tax	2,178	(11)	(18)	2,149	71	(183)	2,037	(6)	(9)

For footnotes, see page 149.

Review of business performance

In Latin America, HSBC reported a pre-tax profit of US$2.0 billion compared with US$2.2 billion in 2007, a decrease of 6 per cent. On an underlying basis, pre-tax profits decreased by 9 per cent as increased revenues were offset by higher loan impairment charges, largely in Mexico and Brazil, and increased operating costs across the region.

Net interest income increased by 13 per cent. Growth in average personal lending volumes was mainly driven by vehicle finance and payroll loans
in Brazil, and credit cards and personal loans in Mexico. Average credit card balances increased as a result of significant organic growth in 2007 which was not repeated in 2008. Commercial loan volume growth was driven by increased lending for working capital and trade finance loans in Brazil, and medium-sized businesses and the real estate sector in Mexico. Increased income on customer liabilities, which was driven by volume growth, particularly in time deposits, was largely offset by a contraction in deposit spreads, primarily on US dollar denominated accounts. Active repricing strategies were deployed

Table of Contents

to mitigate spread compression in the region and to better reflect the credit risk on the loan portfolio. Lower overall spreads on lending products were partly offset by increases in cards in the region, small business loans in Mexico and overdrafts in Brazil. In Argentina, spreads on most products widened.

Net fee income decreased by 2 per cent following a ruling by the Brazilian Central Bank reducing or eliminating certain fees such as charges on early loan repayments and returned cheques. Lower transaction volumes in Personal Financial Services in Brazil also reduced fee income. These were partly offset by product repricing, the introduction of new fees and volume growth, particularly in cards, personal loans, packaged deposit products and payments and cash management.

Trading income rose by 22 per cent largely reflecting favourable positioning against foreign exchange movements and increased foreign exchange sales volumes. Trading losses were registered on certain transactions where an offsetting benefit is reported in *net income from financial instruments designated at fair value*. Losses from defaults on derivative contracts were registered, primarily in Mexico.

Gains less losses from financial investments declined by 24 per cent as gains on the redemption of VISA shares, following its global IPO, and the sale of shares in both Brazil and Mexico were lower than the gains achieved on the sale of shares in a number of companies in Brazil in 2007.

Net earned insurance premiums rose, driven by higher prices and increased sales in the general insurance business, primarily in Argentina. Sales of life assurance products remained strong.

Increased *net insurance claims incurred and movements in liabilities to policyholders* in Argentina were more than offset by a decrease in liabilities to policyholders in Brazil following a decline in the equity market where the investment losses were passed on to unit-linked policyholders. This was compensated for by a similar decrease in *net income from financial instruments designated at fair value.*

Other operating income was broadly in line with 2007. A refinement of the income recognition methodology used in respect of long-term insurance contracts in Brazil in 2008 was offset by a similar adjustment in Mexico in 2007.

Loan impairment charges and other credit risk provisions rose by 42 per cent, mainly relating to credit cards, as organically grown portfolios in Mexico seasoned following market share growth and credit quality deteriorated in Mexico and Brazil. The personal unsecured, vehicle finance and small and medium-sized commercial loan portfolios in Brazil also experienced increased levels of loan impairment. Specific focus was placed on improving the quality of new business, based on underwriting experience and relationship management, and steps were taken to improve collection strategies.

Operating expenses increased by 7 per cent. An increase in staff costs was primarily driven by higher salaries following union-agreed pay rises and redundancy payments following reductions in staff numbers, partly offset by cost savings from the reduced headcount. Administrative expenses rose following an increase in the use of a credit card cashback promotional facility in Mexico which was terminated at the end of 2008. Costs also grew in support of improved operational processes in the region. HSBC benefited in 2008 from the recognition of a tax credit following a court ruling in Brazil granting the right to recover excess taxes paid on insurance transactions and changes in transactional tax legislation. As economic conditions weakened towards the second half of 2008, strategic cost saving measures were implemented throughout the region.

Table of Contents

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

Geographical regions > Latin America > Profit/(loss) before tax by customer group

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

	2009						
Latin America	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
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[42]	**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[43]	**(1,750)**	**(58)**	**(25)**				**(1,833)**

Net operating income[16]	**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**

Balance sheet data [41]

	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**

For footnotes, see page 149.

Table of Contents

Latin America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
	2008						
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[42]	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[43]	(1,281)	(42)	(68)		1		(1,390)
Net operating income[16]	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 data [41]							
	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	(1,378)	102,946
Customer accounts	27,564	14,367	15,384	2,128			59,443

For footnotes, see page 149.

Table of Contents

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

Geographical regions > Latin America > Profit/(loss) before tax by customer group // Products and services

Profit/(loss) before tax (continued)

	2007						
Latin America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	3,983	1,407	410	20	3	(247)	5,576
Net fee income	1,372	485	250	40	6		2,153
Trading income excluding net interest income	67	39	164	2			272
Net interest income on trading activities	10	1	18			247	276
Net trading income[42]	77	40	182	2		247	548
Changes in fair value of long-term debt issued and related derivatives							
Net income from other financial instruments designated at fair value	314		6				320
Net income from financial instruments designated at fair value	314		6				320
Gains less losses from financial investments	120	51	82	1	(1)		253
Gains arising from dilution of interests in associates					11		11
Dividend income	5	2	2				9
Net earned insurance premiums	1,448	66	80				1,594
Other operating income	145	69	31	8	12	(37)	228
Total operating income	7,464	2,120	1,043	71	31	(37)	10,692
Net insurance claims[43]	(1,330)	(37)	(60)				(1,427)

Net operating income[16]	6,134	2,083	983	71	31	(37)	9,265
Loan impairment (charges)/ recoveries and other credit risk provisions	(1,492)	(212)	13		(6)		(1,697)
Net operating income	4,642	1,871	996	71	25	(37)	7,568
Total operating expenses	(3,758)	(1,132)	(481)	(46)	(22)	37	(5,402)
Operating profit	884	739	515	25	3		2,166
Share of profit in associates and joint ventures	9	1	2				12
Profit before tax	893	740	517	25	3		2,178
	%	%	%	%	%		%
Share of HSBC s profit before tax	3.7	3.1	2.1	0.1			9.0
Cost efficiency ratio	61.3	54.3	48.9	64.8	71.0		58.3

Balance sheet data [41]

	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	21,680	16,243	9,935	65			47,923
Total assets	35,181	21,049	46,606	302	261	(750)	102,649
Customer accounts	30,628	15,524	13,950	1,190			61,292

For footnotes, see page 149.

Products and services

Personal Financial Services

Personal Financial Services provides 98 million individual and self-employed customers with financial services in over 60 markets worldwide.

In markets where HSBC already has scale or, in emerging markets where scale can be built over time, HSBC offers its range of personal financial products and services to all customer segments. In other markets, HSBC participates more selectively, targeting only those customer segments which have strong international connectivity or where HSBC s global scale is crucial.

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

HSBC Premier (Premier) provides premium banking services to its customers including personalised relationship management, a single online view of all international accounts, free international funds transfer between HSBC accounts, 24-hour priority telephone access, global travel assistance and wealth management services. There are now over 3.4 million Premier customers, who can use more than 370 specially designated Premier branches and centres in 43 markets.

HSBC Advance offers a range of premium services including preferential day-to-day and international banking while allowing solutions to be customised to meet local requirements.

Wealth management services play an important part in meeting the needs of customers. Insurance products distributed by HSBC through its direct channels and branch networks include life, property and health insurance as well as pensions and credit protection. HSBC also makes available a wide range of investment products. A choice of third-party and proprietary funds offer customers the ability to diversify their investments across a range of best-in-class fund managers chosen after a rigorous and objective selection process. Comprehensive financial planning services covering customers investment, retirement, personal and asset protection needs are offered through qualified financial planning managers.

Personal customers prefer to conduct their financial business at times convenient to them, using the sales and service channels of their choice. This demand for flexibility is met through the increased provision of direct channels such as the internet and self-service terminals, in addition to traditional and automated branches and service centres accessed by telephone.

HSBC is a major global credit card issuer with over 100 million credit cards in force in over 50 markets. In addition to HSBC branded cards, a number of markets offer co-branded credit cards and third-party private label cards (or store cards) through merchant relationships.

High net worth individuals and their families who choose the differentiated services offered within Private Banking are not included in this customer group.

Commercial Banking

HSBC is one of the world s leading and most international banks, with over 3 million Commercial Banking customers in 63 countries and territories, including sole proprietors, partnerships, clubs and associations, incorporated businesses and publicly quoted companies.

HSBC divides its Commercial Banking business into corporate, mid-market, business banking upper and business banking mass segments, allowing the development of tailored customer propositions while adopting a broader view of the entire commercial banking sector, from sole traders to top-end mid-market corporations. This allows HSBC to provide continuous support to companies as they grow in size both domestically and internationally, and ensures a clear focus on the business banking sectors, which are typically the key to innovation and growth in market economies.

HSBC places particular emphasis on geographical collaboration to meet its business customers needs and aims to be recognised as the leading international business bank and the best bank for business in target markets. The range of products and services includes:

Financing: HSBC provides a range of short and longer-term financing options for Commercial Banking customers, both domestically and cross-border, including overdrafts, receivables finance, term loans and property finance. The Group offers forms of asset finance in selected sites and has established specialised divisions providing leasing and instalment finance for vehicles, plant and equipment.

Payments and cash management: HSBC is a leading provider of domestic and cross-border payments, collections, liquidity management and account services worldwide. The Group s extensive network of offices and direct access to numerous local clearing systems enhances its customers ability to manage their cash efficiently on a global basis. Deposits are attracted through current accounts and savings products, in local and foreign currencies.

International trade: HSBC finances and facilitates significant volumes of international trade, under both open account terms and traditional trade finance instruments. HSBC also provides international factoring, commodity and insured export finance, and forfaiting services. The Group utilises its extensive international network to build customer relationships at both ends of trade flows, and maximises efficiency through expertise in document checking and processing, and highly automated systems.

Treasury and capital markets: Commercial Banking customers are volume users of the Group s foreign exchange, derivatives and structured product capabilities, including sophisticated currency and interest rate options.

Commercial cards: HSBC offers commercial card issuing and acquiring services. Commercial card issuing helps customers enhance cash management, improve cost control and streamline purchasing processes. HSBC s card acquiring services enable merchants to accept credit and debit card payments either in person or when the cardholder is not present (e.g. over the internet or by telephone).

Insurance: Through its bancassurance model, HSBC offers a full range of commercial insurance products and services to enable customers and company owners to trade and grow safely. Products include key person and life insurance, employee benefits and a variety of commercial risks such as property, liability, cargo and trade credit insurance. These products are provided by HSBC as a manufacturer or an intermediary utilising preferred strategic partners. Upon the completion of the sale of HSBC Insurance Brokers in 2010 a new partnership will be launched with Marsh, the global insurance broker, to provide intermediary services to HSBC s corporate customers.

Wealth management services: These include advice and products related to savings and investments provided to Commercial Banking customers and their employees through HSBC s worldwide network, with clients being referred to Premier and Private Banking where appropriate.

Investment banking: A small number of Commercial Banking customers need corporate finance and advisory support. These requirements are serviced by the Group on a client-specific basis.

Delivery channels: HSBC deploys a full range of delivery channels, including specific online and direct banking offerings such as HSBCnet and Business Internet Banking.

Global Banking and Markets

Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients worldwide. Managed as a global business, Global Banking and Markets operates a long-term relationship management approach to build a full understanding of clients financial requirements. Sectoral client service teams comprising relationship managers and product specialists develop financial solutions to meet individual client needs. With dedicated offices in over 62 countries and access to HSBC s worldwide presence and capabilities, this business serves subsidiaries and offices of its clients on a global basis.

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

Global Markets

HSBC s operations in Global Markets consist of treasury and capital markets services for supranationals, central banks, corporations, institutional and private investors, financial institutions and other market participants. 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, including research, sales and trading for institutional, corporate and private clients and asset management services;

distribution of capital markets instruments, including debt, equity and structured products, utilising HSBC s global network; and

securities services, where HSBC is one of the world s leading custodians providing custody and clearing services and funds administration to both domestic and cross-border investors.

Global Banking

HSBC s operations in Global Banking consist of financing, advisory and transaction services for corporations, institutional and private investors, financial institutions, and governments and their agencies. Products include:

financing and capital markets, which comprises capital raising, including debt and equity capital, corporate finance and 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

other transaction services, including trade services, factoring and banknotes.

Global Asset Management

HSBC s operations in asset management consist of products and services for institutional investors, intermediaries and individual investors and their advisers.

Principal Investments

This includes private equity, which comprises HSBC s captive private equity funds, strategic relationships with third-party private equity managers and other investments.

Private Banking

HSBC s presence in all the major wealth-creating regions has enabled it to build one of the world s leading private banking groups, providing private banking and trustee services to high net worth individuals and their families from over 90 locations in 42 countries and territories, with client assets of US$367 billion at 31 December 2009.

HSBC Private Bank is the principal marketing name of the HSBC Group s international private banking business. Utilising the most suitable products from the marketplace, HSBC Private Bank works with its clients to offer both traditional and innovative ways to manage and preserve wealth while optimising returns. Products and services offered include:

Private Banking Services: These comprise multi-currency deposit accounts and fiduciary deposits, credit and specialist lending, treasury
trading services, cash management, securities custody and clearing. In addition, HSBC Private Bank works to ensure that its clients have full access to other products and services available throughout HSBC such as credit cards, internet banking, corporate banking, and investment banking.

Private Wealth Management: This 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). By accessing regional expertise in six major advisory centres in Hong Kong, Singapore, Geneva, New York, Paris and London, Private Banking seeks to identify the most suitable investments for clients needs and investment strategies. Corporate Finance Solutions helps provide clients with cross-border solutions for their companies, working in conjunction with Global Banking & Markets.

Private Wealth Solutions: These 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.

Other information

Funds under management

	2009	2008
	US$bn	US$bn
Funds under management		

At 1 January	**735**	844
Net new money	**36**	(1)
Value change	**76**	(159)
Exchange and other	**10**	51
At 31 December	**857**	735

	At 31 December	
	2009	2008
	US$bn	US$bn
Funds under management by business		
Global Asset Management	**423**	370
Private Banking	**251**	219
Affiliates	**3**	2
Other	**180**	144
	857	735

Funds under management at 31 December 2009 were US$857 billion, an increase of 17 per cent when compared with 2008. Both Global Asset Management and Private Banking fund holdings increased, primarily as a result of the improvement in global equity markets during the year.

Global Asset Management funds increased by 14 per cent compared with 2008 to US$423 billion as a result of market performance, strong net flows, particularly in Asia, and favourable foreign exchange movements. Emerging markets funds increased during 2009, driven by market performance gains and net flows. HSBC remains one of the world s largest emerging market asset managers with funds under management of US$90 billion at 31 December 2009.

Private Banking funds under management increased by 15 per cent to US$251 billion at 31 December 2009, driven by strengthening equity markets, mainly in Europe and Hong Kong.

Client assets, which provide an indicator of overall Private Banking volumes and include funds under management, were US$367 billion, up by US$15 billion compared with 2008.

Other funds under management, which are mainly held by a corporate trust business in Asia, increased to US$180 billion.

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 2009, assets held by HSBC as custodian amounted to US$5.2 trillion, 45 per cent higher than the US$3.6 trillion held at 31 December 2008. This was mainly driven by an increase in the market value of assets.

HSBC s 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 2009, the value of assets held under administration by the Group amounted to US$2.8 trillion.

Property

At 31 December 2009, HSBC operated from some 10,100 operational properties worldwide, of which approximately 2,600 were located in Europe, 2,900 in Hong Kong and Rest of Asia-Pacific, 800 in North America, 3,500 in Latin America and 300 in the Middle East. These properties had an area of approximately 70.8 million square feet (2008: 73.6 million square feet).

A gain of US$576 million was recognised in respect of the sale and leaseback of HSBC s headquarters building at 8 Canada Square, London which was effected through the disposal of the Group s entire shareholding in Project Maple II B.V. (PMII) to the National Pension Service of Korea. Gains were also realised on the sale of the head office building in Argentina.

HSBC s freehold and long leasehold properties, together with all leasehold properties in Hong Kong, were valued in 2009. The value of these properties was US$4.1 billion (2008: US$3.3 billion) in excess of their carrying amount in the consolidated balance sheet. In addition, properties with a net book value of US$1,061 million 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 23 on the Financial Statements.

Legal proceedings

On 27 July 2007, the UK Office of Fair Trading (OFT) issued High Court legal proceedings against a number of UK financial institutions, including HSBC Bank, to determine the legal status and enforceability of certain charges applied to their personal customers in relation to unauthorised overdrafts. In a judgement given on 25 November 2009, the Supreme Court held that provided the relevant charges were in plain and intelligible language, the amount of those charges could not be assessed for fairness by either the OFT or the courts. On 22 December 2009, the OFT announced that it would not be continuing the investigation it began in March 2007 into the fairness of unauthorised overdraft charges following detailed consideration of the Supreme Court judgement.

In December 2008, in the US, Bernard L Madoff (Madoff) was arrested and charged with securities fraud and the US Securities and Exchange Commission filed securities fraud charges against Madoff and Madoff Securities. On 29 March 2009, Madoff pleaded guilty to 11 felony cases and was subsequently sentenced to 150 years in prison. Various non-US HSBC group companies provide custodial, administration and similar services to a

Table of Contents

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. HSBC considers that it has good defences to these claims and will continue to defend them vigorously. HSBC is unable reliably to estimate the liability, if any, that might arise as a result of such claims.

Full details are provided in Note 42 on the Financial Statements.

Data security

HSBC Private Bank (Suisse) is currently continuing to investigate a theft of client data which was widely reported in December 2009 as having been supplied to the French authorities. The theft appears to have taken place during a period preceding March 2007. The bank is working closely with the Swiss authorities and its regulator to establish the extent of data involved in the theft in order to protect the interests and rights of its clients and of the Group and to further enhance its security policies and data protection practices.

Footnotes to the Operating and Financial Review

Key performance indicators (page 18)

1 *The percentage increase in net operating income before loan impairment and other credit risk charges since the previous year.*

2 *As a percentage of net operating income before loan impairment charges and other credit risk provisions.*

3 *Other income comprises net operating income before loan impairment charges and other credit risk provisions less net interest income and net fee income.*

4 *Total operating expenses*

divided by net operating income before loan impairment and other credit risk charges.

5 *Net operating income divided by average risk-weighted assets.*

6 *Profit attributable to ordinary shareholders divided by average invested capital.*

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

8 *The percentage increase in dividends per share since the previous year, based on the dividends paid in respect of the year to which the dividend relates.*

9 *Basic earnings per ordinary share is defined in Note 13 on*

the Financial Statements.

Reconciliations of reported and underlying profit/(loss) before tax (pages 21 to 22)

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 (together referred to as adjustments in the tables for HSBC, the Other customer group and certain geographical regions). Comparatives for 2007 include gains arising on the dilution of interests in associates, where relevant. 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 2008.*

13 *Positive numbers are favourable: negative numbers are unfavourable.*

14 *Changes in fair value of long-term debt issued.*

15 *Other income in this context comprises net trading income, net income/(expense) from other financial instruments designated at fair value, gains less losses from financial investments, gains arising from dilution of interests in associates, dividend income, net earned insurance premiums and other operating income less net insurance claims incurred and movement in liabilities to policyholders.*

16 *Net operating income before loan impairment charges and other credit risk provisions.*

17 *Excluding adjustments in 2007.*

Financial summary (pages 23 to 60)

18 *The change in fair value related to movements in the Group s credit spread on long-term debt resulted in an expense of US$6.5 billion in 2009 (2008: income of US$6.6 billion; 2007: income of US$3.1 billion).*

19 *Net interest income includes the cost of funding trading assets, while the related external revenues are reported in trading income. In HSBC s customer group results, the cost of funding trading assets is included with Global Banking and Markets net trading income as an interest expense.*

20 *Gross interest yield is the average annualised interest rate earned on average*

interest-earning assets (AIEA).

21 *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.*

22 *Net interest margin is net interest income expressed as an annualised percentage of AIEA.*

23 *The cost of internal funding of trading assets was US$1,309 million (2008: US$5,547 million; 2007: US$5,433 million) 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.*

24 *Net trading income includes an*

expense of US$444 million (2008: income of US$529 million; 2007: income of US$34 million), associated with changes in the fair value of issued structured notes and other hybrid instrument liabilities derived from movements in HSBC issuance spreads.

25 *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.*

26 *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.

27 *The Middle East is disclosed as a separate geographical region with effect from 1 January 2009. Previously, it formed part of Rest of Asia-Pacific. Comparative data have been restated*

accordingly.

28 *Expressed as a percentage of average invested capital.*

29 *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.*

30 *Return on invested capital is based on the profit attributable to ordinary shareholders of the parent company less goodwill previously amortised in respect of the French regional banks sold in 2008.*

31 *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.*

32 *Interest income on trading assets is reported as Net trading income in the consolidated income statement.*

33 *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.*

34 *Brazilian operations comprise HSBC Bank Brasil S.A.-Banco Múltiplo and subsidiaries, plus HSBC Serviços e Participações Limitada.*

35 *This table analyses interest-bearing bank deposits only. See page 58 for an analysis of all bank deposits.*

36 *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.

37 *This table analyses interest-bearing customer accounts only. See page 59 for an analysis of all customer accounts.*

38 *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.*

39 *Net interest margin is*

calculated as net interest income divided by average interest earning assets.

40 *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 Global Banking and Markets), 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 2009, there were no gains arising from the dilution of interests in associates (2008: nil; 2007: US$1.1 billion) and fair value gains on HSBC s own debt designated at fair value were US$6.2 billion (2008: US$6.7 billion income; 2007: US$2.8 billion expense).

41 *Assets by geographical region and customer group include intra-HSBC items. These items are eliminated, where appropriate, under the heading Intra-HSBC items .*

42 *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.

43 *Net insurance claims incurred and movement in liabilities to policyholders.*

44 *In 2009, Global Markets included a US$444 million expense on the widening of credit spreads on structured liabilities (2008: income of US$529 million; 2007: income of US$34 million).*

45 *Total income earned on securities services products in the Group amounted to US$1.4 billion (2008: US$2.2 billion; 2007: US$2.0 billion), of which US$1.4 billion was in Global Banking and*

Markets (2008: US$2.1 billion; 2007: US$1.9 billion) and US$19 million was in Commercial Banking (2008: US$45 million; 2007: US$33 million).

46 *Total income earned on payments and cash management products in the Group amounted to US$3.8 billion (2008: US$5.2 billion; 2007: US$5.2 billion), of which US$2.8 billion was in Commercial Banking (2008: US$3.5 billion; 2007: US$3.5 billion) and US$1.1 billion was in Global Banking and Markets (2008: US$1.7 billion; 2007: US$1.6 billion).*

47 *Total income earned on other transaction services in the Group amounted to US$1.8 billion (2008: US$1.8 billion; 2007: US$1.4 billion),*

of which US$1.3 billion was in Commercial Banking relating to trade and supply chain (2008: US$1.3 billion; 2007: US$1.0 billion) and US$507 million was in Global Banking and Markets of which US$382 million related to trade and supply chain (2008: US$355 million; 2007: US$270 million) and US$125 million related to banknotes and other (2008: US$126 million; 2007: US$102 million)

48 *Other in Global Banking and Markets includes net interest earned on free capital held in the global business not assigned to products.*

49 *Trading assets and financial investments held in Europe, and by Global Banking and Markets in North America, include financial assets which may be repledged or*

resold by counterparties.

50 *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 Global Banking and Markets. HSBC s Balance Sheet Management business, reported within Global Banking and Markets, provides funding to the trading businesses. To report Global Banking and Markets 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.*

51 *France primarily comprises the domestic operations of HSBC France, HSBC Assurances and the Paris branch of HSBC Bank.*

52 *US includes the impairment of goodwill in respect of Personal Financial Services North America as described in Note 22 on the Financial Statements.*

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil

Background and disclosure policy

(Audited)
As a result of the widespread deterioration in the markets for securitised and structured financial assets and consequent disruption to the global financial system which began in mid-2007, the markets for these assets have remained illiquid and it has remained difficult to observe prices for structured credit risk, including senior tranches of such risk. The ensuing constraint on the ability of financial institutions to access wholesale markets to fund such assets has put additional downward pressure on asset prices. As a consequence, since 2007 many financial institutions have recorded considerable reductions in the fair values of asset values, including their asset-backed securities (ABS s) and leveraged structured transactions, most significantly for sub-prime and Alt-A mortgage-backed securities (MBS s) and collateralised debt obligations (CDO s) referencing these securities.

A further constraint on liquidity within the market for securitised assets emerged in 2009 as rating agencies changed their rating methodologies in response to changed circumstances, precipitating widespread downgrades and the fear of further downgrades across all tranches of securitised paper. This accentuated illiquidity, particularly for those institutions subject to the Basel II framework, which ties capital requirements to external credit ratings without reference to the actual level of expected loss on the securities. In light of these issues around liquidity and the risk to capital from further write-downs, ratings changes and realised losses and impairments in 2009, many financial institutions took steps to reduce leveraged exposures, build their liquidity and raise additional capital.

Volatility in financial markets, particularly in the first half of 2009, resulted in wider transaction spreads, although these narrowed during the second half of the year. Markets for securitised and structured financial assets continued to be severely constrained, and the primary market for all but US government-sponsored issues remained weak.

Notwithstanding these developments, the severe deterioration in the fair value of assets supported by sub-prime and Alt-A mortgages experienced in 2008 began to reverse in 2009 as buyers sought higher yields in the low interest rate environment. For example, spreads tightened modestly on Alt-A assets and sub-prime assets as greater clarity of ultimate losses emerged.

This section contains disclosures about the effect of the ongoing market turmoil on HSBC s securitisation exposures and other structured products. HSBC s principal exposures to the US and the UK mortgage markets take the form of credit risk from direct loans and advances to customers which were originated to be held to maturity or refinancing, details of which are provided on page 218.

Financial instruments which were most affected by the market turmoil include those exposures to direct lending which are held at fair value through profit or loss, or are classified as available for sale, which are also held at fair value. Financial instruments included in these categories comprise ABSs, including MBSs and CDOs, and exposures to and contingent claims on monoline insurers (monolines) in respect of structured credit activities and leveraged finance transactions which were originated to be distributed.

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 this section goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements and listing rules.

HSBC has voluntarily adopted the draft British Bankers Association Code on Financial Reporting Disclosure (the draft BBA Code) for its 2009 Financial Statements. This sets out five disclosure principles together with supporting guidance. The principles are that UK banks will:

- provide high quality and meaningful disclosures useful to decision-making;
- review and enhance their financial instrument disclosures for key areas of interest;
- assess the applicability and relevance of good practice recommendations to their disclosures, acknowledging the importance of such guidance;
- seek to enhance the comparability of financial statement disclosures across the UK banking sector; and
- clearly differentiate in their annual reports between information that is audited and information that is unaudited.

In the context of facilitating an understanding of the ongoing turmoil in markets for securitised and structured assets and in line with the principles of the draft BBA Code, HSBC has continued to assess good practice recommendations issued from time to time by relevant regulators and standard setters.

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

Overview of exposure > Reclassification of financial assets

Specifically, HSBC has considered the recommendations relating to disclosure contained within the following reports:

the Financial Stability Forum: Enhancing market and institutional resilience ;

the Committee of European Banking Supervisors: Banks transparency on activities and products affected by the recent market turmoil and Consultation Paper 30: Disclosure guidelines: Lessons learnt from the financial crisis ; and

the IASB Expert Advisory Panel: Measuring and disclosing the fair value of financial instruments in markets that are no longer active .

The particular topics covered in respect of HSBC s securitisation activities and exposure to structured products are as follows:

overview of exposure;
business model;
risk management;
accounting policies;
nature and extent of HSBC s exposures;
fair values of financial instruments; and
special purpose entities.

Overview of exposure

(Audited)

At 31 December 2009, the aggregate carrying amount of HSBC s exposure to ABSs, trading loans held for securitisation and exposure to leveraged finance transactions was US$79 billion (2008: US$91 billion), summarised in the table below. The majority of these exposures arose in Global Banking and Markets.

HSBC s holdings of available-for-sale ABSs fell by US$8.2 billion to US$48.1 billion in 2009. The associated AFS reserve deficit improved by US$6.5 billion or 35 per cent to US$12.2 billion.

Within the total carrying amount of ABSs on the balance sheet, ABS holdings of US$14.0 billion (2008: US$14.6 billion) are held through vehicles discussed on page 155, where significant first loss protection is provided by external investors on a fully collateralised basis. This includes US$3.3 billion (2008: US$3.5 billion) in respect of sub-prime and Alt-A residential mortgage exposure.

Overall exposure of HSBC

	At 31 December 2009		At 31 December 2008	
	Carrying amount US$bn	**Including sub-prime and Alt-A US$bn**	Carrying amount US$bn	Including sub-prime and Alt-A US$bn

ABSs	**71**	**11**	81	12
fair value through profit or loss	**12**	**1**	14	1
available for sale[1]	**48**	**8**	56	9
held to maturity[1]	**3**		3	
loans and receivables	**8**	**2**	8	2
Loans at fair value through profit or loss	**2**	**2**	4	3
Leveraged finance loans	**6**		6	
loans and receivables	**6**		6	
	79	**13**	91	15

For footnote, see page 195.

Reconciliation of movement in carrying amount of ABSs

	2009
	US$bn
Balance at 1 January 2009	**81.0**
Net ABS sales (principally of US Government agency and sponsored enterprises)	**(5.4)**
Principal amortisation of available-for-sale ABSs (repayment at par)	**(6.1)**
Movement on fair values of available-for-sale ABSs	**4.1**
Net sales, principal amortisation and write-downs of ABSs classified as trading	**(2.1)**
Exchange differences and other movements	**(0.9)**
Balance at 31 December 2009	**70.6**

Table of Contents

Reclassification of financial assets

In October 2008, the IASB issued amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures which permitted an entity to reclassify non-derivative financial assets out of the held-for-trading category as described in the accounting policies in Note 2 (e) on the Financial Statements.

During the second half of 2008, HSBC reclassified US$15.3 billion and US$2.6 billion of financial assets from the held-for-trading category to the loans and receivables and available-for-sale classifications, respectively. The amount reclassified reflected the fair value of the financial assets at the date of reclassification.

The amendment to IAS 39 was restricted to situations where the transferring entity had the intention and ability to hold the transferred position for the foreseeable future, in the case of transfers to the loans and receivable category. Transfers to the available-for-sale category were undertaken when the transferring entity no longer intended to sell the transferred position in the near term.

HSBC did not undertake any further reclassifications under the amendment to IAS 39 during 2009.

Reclassifications of HSBC s financial assets

	At 31 December 2009		At 31 December 2008	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m
Reclassification to loans and receivables				
ABSs	**7,827**	**6,177**	7,991	6,139
Trading loans commercial mortgage loans	**553**	**506**	587	557
Leveraged finance and syndicated loans	**5,824**	**5,434**	5,670	4,239
	14,204	**12,117**	14,248	10,935
Reclassification to available for sale				
Corporate debt and other securities	**1,408**	**1,408**	2,401	2,401
	15,612	**13,525**	16,649	13,336

If these reclassifications had not been made, the Group s profit before tax in 2009 would have risen by US$1.5 billion from US$7.1 billion to US$8.6 billion (2008: a reduction of US$3.5 billion from US$9.3 billion to US$5.8 billion). The rise in profit before tax would have been attributable to increases of US$0.6 billion in the North America segment and US$0.9 billion in the Europe segment (2008: reductions of US$0.9 billion and US$2.6 billion, respectively). These would have arisen due to the increase in the fair value of leveraged loans and ABSs during the year. The following table shows the fair value gains and losses, income and expense recognised in the income statement both before and after the date of reclassification:

HSBC s fair value gains and losses, income and expense

Effect on income statement for 2009			Effect on income statement for 2008		
		Net	Recorded		Net
Recorded	**Assuming**	**effect**	in the	Assuming	effect

	in the income statement[2] US$m	**no reclass-ification[3] US$m**	**of reclass-ification US$m**	income statement[2] US$m	no reclass-ification[3] US$m	of reclass-ification US$m
Financial assets reclassified to loans and receivables						
ABSs	**511**	**767**	**(256)**	303	(1,549)	1,852
Trading loans commercial mortgage loans	**32**	**15**	**17**	17	(13)	30
Leveraged finance and syndicated loans	**434**	**1,494**	**(1,060)**	192	(1,239)	1,431
	977	**2,276**	**(1,299)**	512	(2,801)	3,313
Financial assets reclassified to available for sale						
Corporate debt and other securities	**101**	**301**	**(200)**	22	(202)	224
	1,078	**2,577**	**(1,499)**	534	(3,003)	3,537

For footnotes, see page 195.

Table of Contents

HSBC HOLDINGS PLC

Report of the Directors: Impact of Market Turmoil (continued)

Overview of exposure > Financial effect / ABSs classified as available for sale

Financial effect of market turmoil

As described in Background and disclosure policy on page 151, the dislocation of financial markets which developed in the second half of 2007 continued throughout 2008 and into 2009. For the last four half-year periods, the write-downs incurred by the Group on ABSs, trading loans held for securitisation, leveraged finance transactions and The Group s write-downs as a consequence of market turmoil were US$1.9 billion in 2009, down from US$6.3 billion in 2008.
the movement in fair values on available-for-sale ABSs taken to equity, plus impairment losses on specific exposures to banks, are summarised in the following table:

Financial effect of market turmoil on HSBC

	Half-year to			
	31 Dec 2009 US$bn	**30 Jun 2009 US$bn**	31 Dec 2008 US$bn	30 Jun 2008 US$bn
Write-downs taken to income statement	**(0.6)**	**(1.3)**	(2.3)	(4.0)
Net movement on available-for-sale reserve on ABSs in the period	**5.3**	**1.2**	(10.4)	(6.1)
Closing balance of available-for-sale reserve relating to ABSs	**(12.2)**	**(17.5)**	(18.7)	(8.3)

Virtually all of these were recorded in Global Banking and Markets. During 2009, no further impairment losses were recognised on the collapse of financial institutions as the coordinated actions taken by governments and central banks acted to stabilise market conditions (2008: US$209 million, of which the collapse of Icelandic banks accounted for US$126 million).

Further analyses of the write-downs taken to the income statement by Global Banking and Markets and the net carrying amounts of the positions that generated these write-downs, are shown in the following table:

Global Banking and Markets write-downs/(write-backs) taken to the income statement and carrying amounts

	Write-downs/(write-backs) during half-year to				Carrying amount at			
	31 Dec 2009 US$m	**30 Jun 2009 US$m**	31 Dec 2008 US$m	30 Jun 2008 US$m	**31 Dec 2009 US$m**	**30 Jun 2009 US$m**	31 Dec 2008 US$m	30 Jun 2008 US$m
Sub-prime mortgage-related assets loan securitisation	**80**	**156**	292	301	**758**	**943**	1,213	1,565

credit trading	**17**	**83**	150	665	**282**	**303**	428	1,377
Other ABSs	**(196)**	**103**	486	1,327	**990**	**1,376**	2,201	8,923
Impairments on reclassified assets[4]	**3**	**160**	26		**15,612**	**16,308**	16,649	
Derivative exposure to monolines								
investment grade counterparts	**(78)**	**25**	130	598	**897**	**1,593**	2,089	1,206
non-investment grade counterparts	**45**	**241**	370	608	**408**	**510**	352	78
Leveraged finance loans[5]	**(120)**	**(11)**		278	**196**	**285**	271	7,375
Other credit related items	**(19)**	**5**	95	99	**61**	**116**	186	321
Available-for-sale impairments and other non-trading related items	**833**	**564**	655	55				
	565	**1,326**	2,204	3,931				

For footnotes, see page 195.

Asset-backed securities classified as available for sale

HSBC s principal holdings of ABSs are in the Global Banking and Markets business 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 HSBC has first loss risk.

The table below summarises the Group s exposure to ABSs which are classified as available for sale.

Available-for-sale ABSs exposure

	At 31 December 2009			At 31 December 2008		
	Directly held/ Solitaire[6] US$m	**SPEs US$m**	**Total US$m**	Directly held/ Solitaire[6] US$m	SPEs US$m	Total US$m
Total carrying amount of net principal exposure	**34,040**	**14,021**	**48,061**	41,601	14,610	56,211
Total available-for-sale reserves	**(7,349)**	**(4,864)**	**(12,213)**	(11,528)	(7,204)	(18,732)

	Half year to 31 December			Half year to 30 June		
	Directly held/ Solitaire[6] US$m	**SPEs US$m**	**Total US$m**	**Directly held/ Solitaire[6] US$m**	**SPEs US$m**	**Total US$m**
2009						
Impairment charge:						
borne by HSBC	**883**		**883**	**539**		**539**
allocated to capital note holders[7]		**20**	**20**		**646**	**646**
Total impairment charge	**883**	**20**	**903**	**539**	**646**	**1,185**
2008						
Impairment charge:						
borne by HSBC	224		224	55		55
allocated to capital note holders[7]		159	159		134	134
Total impairment charge	224	159	383	55	134	189

For footnotes, see page 195.

Securities investment conduits (special purpose entities)

In the table above, the total carrying amount of ABSs in respect of SPEs represent holdings in which significant first loss protection is provided through capital notes issued by the securities investment conduits (SIC s), excluding Solitaire.

At each reporting date, an assessment is made of whether there is any objective evidence of impairment in the value of available-for-sale ABSs. Impairment charges incurred on assets held by these SPEs 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 2009 amounted to US$2.2 billion (2008: US$2.2 billion).

On an IFRSs accounting basis, the carrying value of the liability for the capital notes at 31 December 2009 amounted to US$0.7 billion (2008: US$0.9 billion). The impairment charge recognised during 2009 amounted to US$666 million (2008: US$293 million).

At 31 December 2009, the available-for-sale reserve in respect of securities held by the SICs was a deficit of US$5.2 billion (2008: US$7.9 billion). Of this, US$4.9 billion related to ABSs (2008: US$7.2 billion).

Impairments recognised during 2009 from assets held directly or within Solitaire, in recognition of the first loss protection of US$1.2 billion provided by HSBC through credit enhancement and from drawings against the liquidity facility provided by HSBC, were US$1,422 million (2008: US$279 million), based on a notional principal value of securities which were impaired of US$2,641 million (2008: US$570 million). The level of impairment recognised in comparison with the deficit in the available-for-sale reserve is a reflection of the credit quality and seniority of the assets held.

Sub-prime and Alt-A residential mortgage-backed securities

Management judges that the assets which are most sensitive to possible future impairment are sub-prime and Alt-A residential MBSs within HSBC s holdings of available-for-sale ABSs.

Excluding those held in the SPEs discussed above, available-for-sale holdings in these higher risk categories amounted to US$4.9 billion at 31 December 2009 (2008: US$6.1 billion). The deficit in the available-for-sale fair value reserve at 31 December 2009 in relation to these securities was US$4.3 billion (2008: US$6.0 billion).

During 2009, the credit ratings on a proportion of ABSs held directly by HSBC, Solitaire and the SICs were downgraded. In particular, Moody s Investor

Overview of exposure > AFS ABSs impairment // Business model / Risk management / Accounting policies / Nature and extent of exposures

Services downgraded the ratings on substantially all US Alt-A residential MBSs issued during 2006 and 2007, including those held by HSBC.

As discussed on page 178, when assessing available-for-sale ABSs for objective evidence of impairment at each balance sheet date, HSBC considers all available evidence including the performance of the underlying collateral. A downgrade of a security s credit rating is not, of itself, evidence of impairment. Consequently, Moody s actions alone have no direct impact on the measurement of impairment losses. The impairment losses recognised on these securities at 31 December 2009 are set out on page 155.

Available-for-sale ABS impairment and cash loss projections

(Unaudited)

HSBC s regular impairment assessment employs an industry standard model with inputs which are corroborated using observable market data where available. At 31 December 2008, management performed a stress test on the available-for-sale ABS positions, based on the fair value of the positions at that date. The main impacts of the stress test arose from increasing the net effect of expected loss and prepayment rates for Alt-A securities by between a third and a half depending on loan vintage and by removing all credit protection from monolines rated below AAA by S&P on the HELoC positions. The results of the stress test showed that, by applying different inputs to those then observed across the available-for-sale ABS population, a further potential impairment charge to the income statement of some US$2 billion to US$2.5 billion could arise in the period 2009 to 2011 with expected cash losses of US$600 million to US$800 million in the period 2009 to 2012.

In 2009, the Global Banking and Markets available-for-sale ABS portfolio experienced US$1.4 billion of impairment charges with US$378 million of associated expected cash losses. At 31 December 2009, management undertook an analysis of the portfolio to estimate the further potential impairments and expected cash losses on the available-for-sale ABS portfolio. This exercise comprised a further shift of projections as at 31 December 2009 of future loss severities, default rates and prepayment rates. The analysis showed that the portfolio is now primarily sensitive to impairments arising on Alt-A securities. The sensitivity of Global Banking and Markets available-for-sale ABS positions to the loss of protection from monolines reduced during 2009 and is no longer expected to be a material contributor to future impairment charges. The results of the analysis indicate that further impairment charges of some US$1.1 billion and expected cash losses of some US$450 million could arise over the next two to three years. These are at the upper end of the guidance previously given.

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. The assumptions used by management in the roll-forward analysis have been set in the context of further increases in loss severities and elevated levels of default rates partly offset by stable prepayment rates in the short to medium term.

At 31 December 2009, the incurred and projected impairment charges measured for accounting purposes significantly exceeded the expected cash losses on the securities. Over the lives of the available-for-sale ABS securities the cumulative impairment charges will converge towards the level of cash losses.

Business model

(Audited)

Asset-backed securities and leveraged finance

HSBC is or has been involved in the following activities in these areas:

- 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 the structured investment vehicles (SIV s), SICs and money market funds described under Special purpose entities below, 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

originating leveraged finance loans for the purposes of syndicating or selling them down in order to generate a trading profit and holding them in order to earn interest margin over their lives.

These activities are not a significant part of Global Banking and Markets business, and Global Banking and Markets 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 HSBC s US MBSs business, was discontinued in 2007.

Special purpose entities

HSBC enters into certain transactions with customers in the ordinary course of business which involve the establishment of SPEs to facilitate customer transactions. SPEs are used in HSBC s business in order to provide structured investment opportunities for customers, facilitate the raising of funding for customers business activities, or diversify HSBC s sources of funding and/or improve capital efficiency.

The use of SPEs in this way is not a significant part of HSBC s activities and HSBC is not reliant on the use of SPEs for any material part of its business operations or profitability. Detailed disclosures of HSBC s sponsored SPEs are provided on page 181.

Risk management

(Audited)

The effect of the recent market turmoil on HSBC s risk exposures, the way in which HSBC has managed risk exposures in this context, and any changes made in HSBC s risk management polices and procedures in response to the market conditions are set out in the following sections:

Credit risk Credit exposure (see page 206);

Liquidity risk The impact of market turmoil on the Group s liquidity risk position (see page 248); and

Market risk The impact of market turmoil on market risk (see page 252).

Accounting policies

(Audited)

HSBC s accounting policies regarding 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 estimation in respect of valuation of financial instruments as described on page 63.

Nature and extent of HSBC s exposures

(Audited)

This section contains information on HSBC s exposures to the following:

direct lending held at fair value through profit or loss;

ABSs including MBSs and CDOs;

monolines;

credit derivative product companies (CDPC s); and leveraged finance transactions.

MBSs are securities that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal). Where an MBS references mortgages with different risk profiles, the MBS is classified according to the highest risk class. Consequently, an MBS with both sub-prime and Alt-A exposures is classified as sub-prime.

CDOs are securities in which ABSs and/or other related assets have been purchased and securitised by a third-party, or securities which pay a return which is referenced to those assets. CDOs may include exposure to sub-prime mortgage 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, irrespective of the level of sub-prime assets referenced or contained therein, are classified as sub-prime.

HSBC s holdings of ABSs and CDOs, and its direct lending positions, include the following categories of collateral and lending activity:

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

Overview of exposure > Nature and extent of exposures

sub-prime: loans to customers who have limited credit histories, modest incomes, 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. US Home Equity Lines of Credit (HELoC s) are classified as sub-prime. For non-US mortgages, management judgement is used to identify loans with similar risk characteristics to sub-prime, for example, UK non-conforming mortgages (see below);

US Home Equity Lines of Credit: a form of revolving credit facility provided to customers, which is supported by a first or second lien charge over residential property. Global Banking and Markets holdings of HELoCs are classified as US sub-prime residential mortgage assets;

US Alt-A: loans classified as Alt-A are regarded as lower risk than sub-prime, but they share higher risk characteristics than lending under fully conforming standard criteria. US credit scores, as well as the level and completeness of mortgage documentation held (such as whether there is proof of income), are considered when determining whether an Alt-A classification is appropriate. Mortgages in the US which are not eligible to be sold to the major government sponsored mortgage agencies, Ginnie Mae (Government National Mortgage Association), Fannie Mae (the Federal National Mortgage Association) and Freddie Mac (the Federal Home Loan Mortgage Corporation), are classified as Alt-A if they do not meet the criteria for classification as sub-prime;

US Government agency and US Government sponsored enterprises mortgage-related assets: securities that are guaranteed by US Government agencies, such as Ginnie Mae, or are guaranteed by US Government sponsored entities, including Fannie Mae and Freddie Mac;

UK non-conforming mortgage-related assets: UK mortgages that do not meet normal lending criteria. This includes instances where the normal level of documentation has not been provided (for example, in the case of self-certification of income), or where increased risk factors, such as poor credit history, result in lending at a rate that is higher than the normal lending rate. UK non-conforming mortgages are treated as sub-prime exposures; and

other mortgage-related assets: residential mortgage-related assets that do not meet any of the classifications described above. Prime residential mortgage-related assets are included in this category.

HSBC s exposure to non-residential mortgage-related ABSs and direct lending includes:

commercial property mortgage-related assets: MBSs with collateral other than residential mortgage-related assets;

leveraged finance-related assets: securities with collateral relating to leveraged finance loans;

student loan-related assets: securities with collateral relating to student loans; and

other assets: securities with other receivable-related collateral.

Included in the tables on pages 159 to 161 are ABSs which are held through SPEs that are consolidated by HSBC. Although HSBC consolidates these assets in full, the risks arising from the assets are mitigated to the extent of third-party investment in notes issued by those SPEs. For a description of HSBC s holdings of and arrangements with SPEs, see page 181.

The exposure detailed in the table on page 159 includes long positions where risk is mitigated by specific credit derivatives with monolines and other financial institutions. These positions comprise:

- residential MBSs with a carrying amount of US$1.0 billion (2008: US$0.9 billion);
- residential MBS CDOs with a carrying amount of US$15 million (2008: US$39 million); and
- ABSs other than residential MBSs and MBS CDOs with a carrying amount of US$9.2 billion (2008: US$9.8 billion).

In the tables on pages 160 to 161, carrying amounts and gains and losses are given for securities except those where risk is mitigated through specific credit derivatives with monolines, as detailed above, with a total carrying amount of US$10.2 billion (2008: US$10.7 billion). The counterparty credit risk arising from the derivative transactions undertaken with monolines is covered in the monoline exposure analysis on page 163.

Table of Contents

Carrying amount of HSBC s consolidated holdings of ABSs, and direct lending held at fair value through profit or loss

	Trading US$m	Available for sale US$m	Held to maturity US$m	Designated at fair value through profit or loss US$m	Loans and receivables US$m	Total US$m	Of which held through consolidated SPEs US$m
At 31 December 2009							
Sub-prime residential mortgage-related assets	**2,063**	**2,782**			**837**	**5,682**	**3,213**
Direct lending	**1,439**					**1,439**	**913**
MBSs and MBS CDOs[8]	**624**	**2,782**			**837**	**4,243**	**2,300**
US Alt-A residential mortgage-related assets	**191**	**5,403**	**192**		**882**	**6,668**	**3,672**
Direct lending	**113**					**113**	
MBSs[8]	**78**	**5,403**	**192**		**882**	**6,555**	**3,672**
US Government agency and sponsored enterprises mortgage-related assets MBSs[8]	**375**	**13,332**	**2,333**			**16,040**	**322**
Other residential mortgage-related assets	**1,646**	**4,582**		**335**	**1,401**	**7,964**	**3,160**
Direct lending	**452**					**452**	
MBSs[8]	**1,194**	**4,582**		**335**	**1,401**	**7,512**	**3,160**
Commercial property mortgage-related assets MBSs and MBS CDOs[8]	**414**	**7,535**		**103**	**2,143**	**10,195**	**5,730**
Leveraged finance-related assets ABSs and ABS CDOs[8]	**555**	**5,150**			**484**	**6,189**	**4,144**
Student loan-related assets							

ABSs and ABS CDOs[8]	**141**	**4,948**			**145**	**5,234**	**4,127**
Other assets							
ABSs and ABS CDOs[8]	**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**
At 31 December 2008							
Sub-prime residential mortgage-related assets	3,372	3,741		1	453	7,567	4,230
Direct lending	2,789					2,789	1,300
MBSs and MBS CDOs[8]	583	3,741		1	453	4,778	2,930
US Alt-A residential mortgage-related assets	618	5,829	185		1,056	7,688	3,831
Direct lending	246					246	
MBSs[8]	372	5,829	185		1,056	7,442	3,831
US Government agency and sponsored enterprises mortgage-related assets							
MBSs[8]	1,127	20,312	2,412	51		23,902	441
Other residential mortgage-related assets[9]	1,633	4,272		31	1,413	7,349	2,822
Direct lending	677					677	
MBSs[8]	956	4,272		31	1,413	6,672	2,822
Commercial property mortgage-related assets[9]							
MBSs and MBS CDOs[8]	589	6,802		86	2,124	9,601	4,985
Leveraged finance-related assets							
ABSs and ABS CDOs[8]	784	4,489			204	5,477	3,667
Student loan-related assets							
ABSs and ABS CDOs[8]	214	4,809		3	81	5,107	4,028
Other assets							
ABSs and ABS CDOs[8]	3,068	5,957		6,371	2,660	18,056	3,941
	11,405	56,211	2,597	6,543	7,991	84,747	27,945

For footnotes, see page 195.

The above table excludes leveraged finance transactions, which are shown separately on page 165.

HSBC HOLDINGS PLC

Report of the Directors: Impact of Market Turmoil (continued)

Overview of exposure > Nature and extent of exposures

HSBC s consolidated holdings of ABSs, and direct lending held at fair value through profit or loss

	2009				At 31 December 2009			
	Gross fair value Movements							
	Income statement[11] US$m	Other comprehensive income[12] US$m	Realised gains/ (losses) in the income statement[13] US$m	Reclassified[14] US$m	Gross principal[15] US$m	Credit default swap gross protection[16] US$m	Net principal exposure[17] US$m	Carrying amount[18] US$m
Mortgage-related assets								
Sub-prime residential								
Direct lending	(227)		(40)		1,703		1,703	1,439
MBSs[8]	(44)	187	(130)	795	7,483	1,248	6,235	3,419
high grade[10]	(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[8]	(2)	(9)		2	138	15	123	29
high grade[10]		(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[8]	95	661	(143)	1,693	13,546	491	13,055	6,427
high grade[10]	(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[8]								
high grade[10]	**116**	**252**	**(2)**	**(123)**	**15,827**		**15,827**	**16,040**
Other residential								
Direct lending	**79**		**70**		**463**		**463**	**452**
MBSs[8,9]	**71**	**625**	**37**	**50**	**8,741**	**91**	**8,650**	**7,443**
high grade[10]	**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[8,9]	**35**	**702**	**(8)**	**(104)**	**13,734**	**395**	**13,339**	**9,954**
high grade[10]	**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[8]	**(1)**	**721**		**(40)**	**7,516**	**895**	**6,621**	**5,612**
high grade[10]	**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[8]	**(6)**	**569**	**2**	**32**	**7,192**	**224**	**6,968**	**5,122**
high grade[10]	**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[8]	**74**	**415**	**(17)**	**91**	**17,608**	**8,797**	**8,811**	**6,327**
high grade[10]	**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 195.

	2008				At 31 December 2008			
	Gross fair value Movements							
	Income statement[11]	Other comprehensive income[12]	Realised gains/(losses) in the income statement[13]	Reclassified[14]	Gross principal[15]	Credit Default swap gross protection[16]	Net principal exposure[17]	Carrying amount[18]
	US$m	US$m	US$m	US$m	US$m	US$m	US$m	US$m
Mortgage-related assets								
Sub-prime residential								
Direct lending	(494)		7		3,653		3,653	2,789
MBSs[8]	(787)	(1,872)	1	(8)	8,317	794	7,523	4,183
high grade[10]	(244)	(558)	6	(8)	4,298	507	3,791	2,723
rated C to A	(446)	(1,314)	(4)		3,990	287	3,703	1,449
not publicly rated	(97)		(1)		29		29	11
MBS CDOs[8]	(125)	(58)		(50)	1,095	234	861	87
high grade[10]	(14)	(81)			212	27	185	68
rated C to A	(111)	23		(50)	881	207	674	17
not publicly rated					2		2	2
	(1,406)	(1,930)	8	(58)	13,065	1,028	12,037	7,059
US Alt-A residential								
Direct lending	(11)				264		264	246
MBSs[8]	(737)	(6,416)	9	(240)	16,860	436	16,424	7,174
high grade[10]	(446)	(3,012)	17	(82)	9,804	317	9,487	4,869
rated C to A	(292)	(3,404)	(7)	(158)	7,041	119	6,922	2,293
not publicly rated	1		(1)		15		15	12
	(748)	(6,416)	9	(240)	17,124	436	16,688	7,420

US Government agency and sponsored enterprises MBSs[8]								
high grade[10]	(51)	392	40		23,470		23,470	23,902
Other residential								
Direct lending	23		(9)		691		691	677
MBSs[8,9]	(178)	(738)	(72)		8,391	284	8,107	6,511
high grade[10]	(149)	(723)	(75)		7,592	262	7,330	5,915
rated C to A	(28)	(15)	2		717	22	695	549
not publicly rated	(1)		1		82		82	47
	(155)	(738)	(81)		9,082	284	8,798	7,188
Commercial property MBS and MBS CDOs[8,9]	(292)	(2,743)	(27)		13,524	553	12,971	9,232
high grade[10]	(231)	(2,709)	(38)		13,091	553	12,538	8,925
rated C to A	(61)	(31)	11		376		376	264
not publicly rated		(3)			57		57	43
Leveraged finance-related assets ABSs and ABS CDOs[8]	(19)	(1,306)	1		7,392	936	6,456	4,781
high grade[10]	(19)	(1,302)	1		7,373	936	6,437	4,766
rated C to A		(4)			19		19	15
Student loan-related assets ABSs and ABS CDOs[8]	(63)	(1,959)	(4)		7,708	279	7,429	4,963
high grade[10]	(47)	(1,649)	(4)		6,986	279	6,707	4,578
rated C to A	(16)	(310)			722		722	385
Other assets ABS and ABS CDOs[8]	(466)	(1,461)	(107)	(84)	21,112	8,494	12,618	9,462

high grade[10]	(329)	(733)	(81)		11,346	3,049	8,297	6,531
rated C to A	(137)	(728)	(26)	(13)	3,592	343	3,249	1,902
not publicly rated				(71)	6,174	5,102	1,072	1,029
Total	(3,200)	(16,161)	(161)	(382)	112,477	12,010	100,467	74,007

For footnotes, see page 195.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

Overview of exposures > Significant movements / Monolines

Analysis of exposures and significant movements
The majority of the reduction in the holdings of ABS resulted from the disposal of securities issued by government sponsored entities. Further reductions arose largely as a result of principal repayments.
Sub-prime residential mortgage-related assets
Sub-prime residential mortgage-related assets included US$3,746 million (2008: US$5,894 million) relating to US originated assets and US$1,141 million (2008: US$1,100 million) relating to UK non-conforming residential mortgage-related assets. Of the non-high grade assets held of US$1,712 million, US$1,604 million (2008: US$1,426 million) related to US originated assets, reflecting the higher quality of the UK originated assets.

A modest increase in observable values of sub-prime assets took place in 2009. However, further impairment of US$559 million on assets classified as available for sale was recognised in 2009 (2008: US$50 million) as losses were incurred under current accounting impairment rules which require the full fair value deficit to be recognised when objective evidence of impairment as a result of a loss event has an impact on the estimated future cash flows of the instrument, without reference to the amount of the expected loss. The expectation of losses on the underlying assets did not increase from that at 31 December 2008. Of the impairment above, US$312 million (2008: nil) occurred in the SICs and was borne by the capital note holders.
US Alt-A residential mortgage-related assets
During 2009, spreads on Alt-A mortgage-related assets tightened modestly from the levels seen in 2008 and no further deterioration was experienced in the second half of 2009. Further impairments of US$1,372 million (2008: US$510 million) were recorded in respect of Alt-A mortgage-related assets as losses were incurred under the current accounting rules described in the paragraph above, without reference to the amount of expected loss. The expectation of losses in the underlying assets did not increase from that at 31 December 2008. Of the impairment above, US$346 million (2008: US$281 million) occurred in the SICs and was borne by the capital note holders.

During the first half of 2009, the credit ratings on a proportion of ABSs held directly by HSBC, Solitaire and the SICs were downgraded. In particular, Moody s Investor Services downgraded the ratings on substantially all the Group s holdings of US Alt-A residential MBSs issued in 2006 and 2007. The downgrade of assets is reflected in the disclosure of fair value movements in the above tables as if the downgrade had taken effect on 1 January 2009.

The following table shows the vintages of the collateral assets supporting HSBC s holdings of US sub-prime and Alt-A MBSs. Market prices for these instruments generally incorporate higher discounts for later vintages. The majority of HSBC s holdings of US sub-prime MBSs are originated pre-2007; holdings of US Alt-A MBSs are more evenly distributed between pre- and post-2007 vintages.

Vintages of US sub-prime and Alt-A mortgage-backed securities

	Gross principal[15] of US sub-prime mortgage-backed securities at 31 December		Gross principal[15] of US Alt-A mortgage-backed securities at 31 December	
	2009	2008	**2009**	2008
	US$m	US$m	**US$m**	US$m
Mortgage vintage				

Pre-2006	**1,748**	2,012	**2,108**	2,695
2006	**2,827**	4,287	**6,225**	7,712
2007	**1,187**	1,588	**5,213**	6,453
	5,762	7,887	**13,546**	16,860

For footnote, see page 195.

US Government agency and sponsored enterprises mortgage-related assets
During 2009, HSBC reduced its holdings of US Government agency and sponsored enterprises mortgage-related assets by US$7,862 million.
Other residential mortgage-related assets
The majority of other residential mortgage-related assets were originated in the UK (2009: US$4,744 million; 2008: US$4,568 million). No impairments were recognised in respect of these UK

originated assets in 2009 (2008: nil), reflecting credit support within the asset portfolio.

Commercial property mortgage-related assets

Of the total of US$9,954 million (2008: US$9,232 million) of commercial property mortgage-related assets, US$4,292 million related to US originated assets (2008: US$3,182 million). Spreads tightened on both US and non-US commercial property mortgage-related assets during 2009. Impairments of US$88 million (2008: nil) were recognised in 2009 as losses on the underlying assets accelerated.

Leveraged finance-related assets

The majority of assets related to US originated exposures; almost all (2009: 94 per cent; 2008: 99 per cent) were high grade with no impairments recorded in the year (2008: nil).

Student loan-related assets

Holdings in student loan-related assets were US$5,122 million (2008: US$4,963 million). No impairments were recorded on student loan-related assets in 2009 (2008: nil).

Transactions with monoline insurers

HSBC s exposure to derivative transactions entered into directly with monoline insurers

HSBC s principal exposure to monolines is through a number of over-the-counter (OTC) derivative transactions, mainly credit default swaps (CDS s). HSBC entered into these CDSs primarily to purchase credit protection against securities held at the time within the trading portfolio.

During 2009, the notional value of derivative contracts with monolines and HSBC s 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 2009, 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 Standard & Poor s (S&P) at BBB- or above at 31 December 2009, and those that were below BBB- (BBB- is the S&P cut-off for an investment grade classification). As a result of the downgrade of a number of monolines during 2009, exposure to monolines rated below BBB- at 31 December 2009 increased from the position as at 31 December 2008. The Credit risk adjustment column indicates the valuation adjustment taken by HSBC against the net exposures, and reflects HSBC s 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.

HSBC s exposure to derivative transactions entered into directly with monoline insurers

	Notional amount US$m	Net exposure before credit risk adjustment[19] US$m	Credit risk adjustment[20] US$m	Net exposure after credit risk adjustment US$m
At 31 December 2009				
Derivative transactions with monoline counterparties				
Monoline investment grade (BBB or above)	**5,623**	**997**	**(100)**	**897**
Monoline sub-investment grade (below BBB)	**4,400**	**1,317**	**(909)**	**408**

	10,023	**2,314**	**(1,009)**	**1,305**
At 31 December 2008				
Derivative transactions with monoline counterparties				
Monoline investment grade (BBB or above)	9,627	2,829	(740)	2,089
Monoline sub-investment grade (below BBB)	2,731	1,104	(752)	352
	12,358	3,933	(1,492)	2,441

For footnotes, see page 195.

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

Overview of exposure > Monolines / Leveraged finance transactions

The above table can be analysed as follows. HSBC has derivative transactions referenced to underlying securities with a notional value of US$10.0 billion (2008: US$12.4 billion), whose value at 31 December 2009 indicated a potential claim against the protection purchased from the monolines of some US$2.3 billion (2008: US$3.9 billion). On the basis of a credit assessment of the monolines, a credit risk adjustment of US$1.0 billion has been taken (2008: US$1.5 billion), leaving US$1.3 billion exposed (2008: US$2.4 billion), of which US$0.9 billion is recoverable from monolines rated investment grade at 31 December 2009 (2008: US$2.1 billion). The provisions taken imply in aggregate that 90 cents in the dollar will be recoverable from investment grade monolines and 31 cents in the dollar from non-investment grade monolines (2008: 74 cents and 32 cents, respectively).

For the CDSs, market prices are generally not readily available. Therefore the CDSs are valued based upon 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. HSBC s assignment of internal credit ratings is based upon detailed credit analysis, and may differ from external ratings.

For highly-rated monolines, the standard credit risk adjustment methodology (as described on page 170) 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 per cent 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. However, this methodology is 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.

At 31 December 2009, US$2,566 million notional value of securities referenced by monoline CDS transactions with a market value of US$1,863 million, were held in the loans and receivables category, having been included in the reclassification of financial assets described on page 153. At the date of reclassification, the market value of the assets was US$1,926 million. 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 2009 would have been an increase in profit of US$5 million (2008: decrease in profit of US$115 million). This amount represents the difference between the increase in market value of the securities during 2009 and the accretion recognised under the amortised cost method in 2009.

HSBC s exposure to direct lending and irrevocable commitments to lend to monoline insurers

HSBC has minimal liquidity facilities at 31 December 2009 (2008: US$47 million) to monolines, all of which were drawn at 31 December 2009 (2008: US$2 million drawn).

HSBC s exposure to debt securities which benefit from guarantees provided by monoline insurers

Within both the trading and available-for-sale portfolios, HSBC holds 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 2009. For wrapped bonds held in the 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 on page 153.

HSBC s exposure to Credit Derivative Product Companies

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 corporate credit spreads widened, but these exposures reduced during

2009 as corporate credit spreads tightened again. At 31 December 2009, HSBC had purchased from CDPCs credit protection with a notional value of US$5.0 billion (2008: US$6.4 billion) which had a fair value (essentially, replacement cost) of US$0.3 billion (2008: US$1.2 billion), against which a credit risk adjustment (a provision) of US$0.1 billion was held (2008: US$0.2 billion). At 31 December 2009, 83 per cent of exposure was to CDPCs with investment grade ratings (2008: 100 per cent).

Leveraged finance transactions

Leveraged finance transactions include sub-investment grade acquisition or event-driven financing.

The following tables show HSBC s gross commitments and exposure to leveraged finance transactions arising from primary transactions and the movement in that leveraged finance exposure in the year. HSBC s additional exposure to leveraged finance loans through holdings of ABSs from its trading and investment activities is shown in the table on page 159.

HSBC s exposure to leveraged finance transactions

	At 31 December		
	Funded exposures[21] US$m	**Unfunded exposures[22] US$m**	**Total exposures US$m**
2009			
Europe	**3,790**	**368**	**4,158**
Rest of Asia-Pacific	**70**	**22**	**92**
North America	**1,713**	**188**	**1,901**
	5,573	**578**	**6,151**
Held within:			
loans and receivables	**5,569**	**386**	**5,955**
fair value through profit or loss	**4**	**192**	**196**
2008			
Europe	3,554	480	4,034
Rest of Asia-Pacific	25	12	37
North America	1,825	258	2,083
	5,404	750	6,154
Held within:			
loans and receivables	5,401	482	5,883
fair value through profit or loss.	3	268	271

For footnotes, see page 195.

Movement in leveraged finance exposures

	Funded exposures[21]	**Unfunded exposures[22]**	**Total exposures**

	US$m	US$m	US$m
At 1 January 2009	**5,404**	**750**	**6,154**
Additions		**50**	**50**
Fundings	**99**	**(99)**	
Sales, repayments and other movements	**(34)**	**(150)**	**(184)**
Write-backs	**104**	**27**	**131**
At 31 December 2009	**5,573**	**578**	**6,151**

For footnotes, see page 195.

Leveraged finance commitments held by HSBC were US$6.5 billion at 31 December 2009 (2008: US$6.6 billion), of which US$5.9 billion (2008: US$5.8 billion) was funded.

As described on page 153, 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$1.2 billion (2008: net losses of US$1.3 billion) were not taken to the income statement in 2009.

At 31 December 2009, HSBC s principal exposures were to companies in two sectors: US$3.8 billion to data processing (2008:

US$3.6 billion) and US$1.9 billion to communications and infrastructure (2008: US$1.7 billion). During the year, 99 per cent of the total fair value movement not recognised was against exposures in these two sectors (2008: 99 per cent). Subsequent to the end of the year, as part of portfolio management, US$0.6 billion of the data processing exposure was sold.

Fair values of financial instruments

(Audited)

The classification of financial instruments is determined in accordance with the accounting policies set out in Note 2 on the Financial Statements. The use of assumptions and estimation in valuing financial instruments is described on page 63. The following is a description of HSBC s methods of determining fair value and its related control framework, and a quantification of its exposure to financial instruments measured at fair value.

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.

Financial instruments measured at fair value on an ongoing basis include trading assets and liabilities, instruments designated at fair value, derivatives and financial investments classified as available for sale (including treasury and other eligible bills, debt securities, and equity securities).

Fair values of financial instruments carried at fair value

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. To this end, ultimate responsibility for the determination of fair values lies with Finance, which reports functionally to the Chief Financial Officer, Executive Director, Risk and Regulation. Finance establishes the accounting policies and procedures governing valuation and is responsible for ensuring that they comply with all relevant accounting standards.

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.

Models provide a logical framework for the capture and processing of necessary valuation inputs. 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 results of the independent validation process are reported to, and considered by, Valuation Committees. Valuation Committees are composed of valuation experts from several independent support functions (Product Control, Market Risk Management, Quantitative Risk and Valuation Group and Finance) in addition to senior management. The members of each Valuation Committee consider the appropriateness and adequacy of the fair value adjustments and the effectiveness of valuation models. If necessary, they may require changes to model calibration or calibration procedures. The Valuation Committees are overseen by the Valuation Committee Review Group, which consists of Heads of Global Banking and Markets Finance and Risk Functions. All subjective valuation items with a potential impact in excess of US$5 million are reported to the Valuation Committee Review Group.

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. 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.

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 market data available at all upon which to base a determination of fair value (consensus pricing data may, for example, be used). Furthermore, in some cases the majority of the fair value derived from a valuation technique with significant unobservable inputs may be attributable to observable inputs. Consequently, the effect of uncertainty in determining unobservable inputs will generally be less than the overall fair value of the financial instrument being measured. To help in understanding the extent and the range of this uncertainty, additional information is provided in the section headed Effect of changes in significant unobservable assumptions to reasonably possible alternatives below.

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. For all issued debt securities, discounted cash flow modelling is used to separate the change in fair value that may be attributed to HSBC s credit spread movements from movements in other market factors such as benchmark interest rates or foreign exchange rates. Specifically, 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.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

Fair values of financial instruments > Carried at fair value

All net positions in non-derivative financial instruments, and all derivative portfolios, are valued at bid or offer prices as appropriate. Long positions are marked at bid prices; short positions are marked at offer prices.

The fair value of a portfolio of financial instruments is calculated as the product of the number of units and its quoted price and no block discounts are applied.

Fair value adjustments

The valuation models applied for level 2 and level 3 assets incorporate assumptions that HSBC believes would be made by a market participant to establish fair value. 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, including modelling sophistication, the nature of products traded, and the size and type of risk exposures. For this reason, fair value adjustments may not be comparable across the banking industry.

HSBC classifies fair value adjustments as either risk-related or model-related . They form part of the portfolio fair value and are incorporated within the balance sheet values of the product types to which they have been applied. The majority of these adjustments relate to Global Banking and Markets. The magnitude and types of fair value adjustment adopted by Global Banking and Markets are listed in the following table:

Global Banking and Markets fair value adjustments

	At 31 December	
	2009	2008
	US$m	US$m
Type:		
Risk-related	**2,955**	3,796
Bid-offer	**528**	811
Uncertainty	**223**	319
Credit risk adjustment	**2,172**	2,658
Other	**32**	8
Model-related	**457**	487
Model limitation	**391**	381
Other	**66**	106
Inception profit (Day 1 P&L reserves)	**260**	204

Total	**3,672**	4,487

The quantum of fair value adjustments has reduced by US$815 million during the year. 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, following enhancement of a model to incorporate an additional factor, the model value will have changed and so the fair value adjustment in respect of that factor will no longer be required. Similarly, if a position is unwound at a price inclusive of the fair value adjustment, then the fair value adjustment base will decrease, but no profit or loss will result.

The major movements occurred in the bid-offer and credit risk adjustment categories. The reduction of US$283 million in the bid-offer adjustment in 2009 largely reflected decreasing market bid-offer spreads as the market stabilised following the turmoil seen in the latter part of 2008.

The reduction of US$486 million in the credit risk adjustment in 2009 reflected the release of US$716 million due to the commutation of transactions with monoline insurers, which did not result in any material gain or loss being recognised in the income statement. It also reflected lower OTC derivative counterparty exposures, resulting from the tightening of credit spreads, the steepening of yield curves and the recovery in equity markets during the year, offset by increased probability of counterparty default.

Risk-related adjustments

Risk-related adjustments are driven, in part, by the magnitude of HSBC s market or credit risk exposure, and by external market factors, such as the size of market spreads.

Bid-Offer

IAS 39 requires that portfolios are marked at bid or offer, as appropriate. Bid prices represent the price at which a long position could be sold and offer prices represent the price at which a short position could be bought back. 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.

The majority of the bid-offer adjustment relates to OTC derivative portfolios. For each portfolio, the major risk types are identified. These may include, *inter alia*, delta (the sensitivity to changes in the price of an underlying), vega (the sensitivity to changes in volatilities) and basis risk (the sensitivity to changes in the spread between two rates). For each risk type, the net portfolio risks are first classified into buckets, and then a bid-offer spread is applied to each risk bucket based upon the market bid-offer spread for the relevant hedging instrument. The granularity of the risk bucketing is determined by reference to several factors, including the actual risk management practice undertaken by HSBC, the granularity of risk bucketing within the risk reporting process, and the extent of correlation between risk buckets. Within a risk type, the bid-offer adjustment for each risk bucket may be aggregated without offset or limited netting may be applied to reflect correlation between buckets. There is no netting applied between risk types or between portfolios that are not managed together for risk management purposes. There is no netting across legal entities.

Uncertainty

Certain model inputs may be less readily determinable from market data, and/or the choice of model itself may be more subjective, with less market evidence available from which to determine general market practice. 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. Uncertainty adjustments are derived by considering the potential range of derivative portfolio valuation given the available market data. The objective of an uncertainty adjustment is to arrive at a fair value that is not overly prudent but rather reflects a level of prudence believed to be consistent with market pricing practice.

Uncertainty adjustments are applied to various types of exotic OTC derivative. For example, the correlation between one or more market rates may be an important component of an exotic derivative value and an uncertainty adjustment may be taken to reflect the range of possible values that market participants may assume for this parameter.

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. The calculation of the credit risk adjustment against monolines is described on page 163, and for all other counterparties on page 170.

Model-related adjustments

These adjustments are primarily related to internal factors, such as the ability of HSBC s models to incorporate all material market characteristics. A description of each adjustment type is given below:

Model limitation

Models used for portfolio valuation purposes, particularly for exotic derivative products, may be based upon a simplifying set of assumptions that do not capture all material market characteristics or may be less reliable under certain market conditions. 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 outside the core valuation model.

The adjustment methodologies vary according to the nature of the model. The Quantitative Risk and Valuation Group, an independent quantitative support function reporting into Finance, highlights the requirement for model limitation adjustments and develops the methodologies employed. Over time, as model development progresses, model limitations are addressed within the core revaluation 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 the model is based on one or more significant unobservable inputs, in accordance with IAS 39. At trade execution, the adjustment is equal to the inception profit which is the difference between the fair value and the price at which the transaction was undertaken. The balance is amortised to the observability boundary based on the risk profile

169

of the unobservable component. The observability boundary is the point at which during the lifetime of the trade the previously unobservable significant input is expected to become observable, which at the extreme may be the maturity date.

An analysis of the movement in the deferred Day 1 P&L reserve is provided on page 426.

Transaction costs and the future costs of administering the OTC derivative portfolio are not included in the fair value calculation. These, along with trade origination costs such as brokerage fees and post-trade costs, are accounted for as part of either fee expense or operating expenses.

Credit risk adjustment methodology

HSBC adopts a credit risk adjustment (also frequently known as a credit valuation adjustment) against OTC derivative transactions to reflect within fair value the possibility that the counterparty may default, and HSBC may not receive the full market value of the transactions. 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 is described on page 163. The description below relates to the credit risk adjustment taken against counterparties other than monolines, which totalled US$1,009 million at 31 December 2009 (2008: US$1,492 million).

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.

For most products, HSBC uses a simulation methodology to calculate the expected positive exposure. The methodology simulates the range of potential exposures of HSBC to the counterparty over the life of an instrument. The range of exposures is calculated across the portfolio of transactions with a counterparty to arrive at an expected overall exposure. The probability of default assumptions are based upon historic rating transition matrices. The credit rating used for a particular counterparty is that determined by HSBC s internal credit process. Rating transition is taken account of throughout the duration of the exposure. A standard loss given default assumption of 60 per cent is generally adopted. HSBC considers that an appropriate spread to reflect HSBC s own probability of default within the credit risk adjustment calculation is currently zero. Consequently, HSBC does not derive the adjustment on a bilateral basis
and has a zero adjustment against derivative liabilities, often referred to as a debit valuation adjustment . The simulation methodology includes credit mitigants such as counterparty netting agreements and collateral agreements with the counterparty.

For certain types of exotic derivatives where the products are not currently supported by the simulation, or for derivative exposures in smaller trading locations where the simulation tool is not yet available, HSBC adopts an alternative methodology. Alternative methodologies used by HSBC fall into two categories. One method maps transactions against the results for similar products which are accommodated by the simulation tool. Where such a mapping approach is not appropriate, a bespoke methodology is used, generally following the same principles as the simulation methodology, reflecting the key characteristics of the instruments but in a manner that is computationally less intensive. 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 related to the probability of default of the counterparty. A more detailed description of wrong-way risk is included on page 208. For particular transactions 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 HSBC does not net credit risk adjustments across HSBC Group entities.

During 2009, there were no material changes made by HSBC to the methodologies used to calculate the credit risk adjustment.

Consideration of other methodologies for calculation of credit risk adjustments

(Unaudited)

The credit risk adjustment methodology used by HSBC, in the opinion of management, appropriately quantifies the exposure of HSBC to counterparty risk on its OTC derivative portfolio and appropriately reflects the risk management strategy of the business.

HSBC recognises that a variety of credit risk adjustment methodologies are adopted within the banking industry. Some of the key attributes that may differ between these methodologies are:

- the probability of default may be calculated from historical market data, or implied from current market levels for certain transaction types such as credit default swaps, either with or without an adjusting factor;
- some entities derive their own probability of default from a non-zero spread, which has the effect of reducing the overall adjustment;
- differing loss assumptions in setting the level of loss given defaults, which may utilise levels set by regulators for capital calculation purposes; and
- counterparty exclusions, whereby certain counterparty types (for example collateralised counterparties) are excluded from the calculation.

HSBC has estimated the impact of adopting two alternative methodologies on the level of its credit risk adjustment (excluding the monoline credit risk adjustment), as follows:

- adapting HSBC s existing methodology to utilise probabilities of default implied from credit default swaps with no adjustment factor applied and also implying HSBC s own probability of default from credit default swaps, results in an additional adjustment of US$170 million; and
- adapting HSBC s existing methodology to include HSBC s own probability of default from a non-zero spread based on historical data, excluding collateralised counterparties, and applying loss given default assumptions consistent with those used in regulatory capital calculations, results in a reduction of the credit risk adjustment of US$300 million.

A detailed description of the valuation techniques applied to instruments of particular interest follows:

Private equity

HSBC s private equity positions 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. The exercise of judgement is required because of uncertainties inherent in estimating fair value for private equity investments.

Debt securities, treasury and other eligible bills, and equities

The fair value of these instruments is based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, when available. When they are unavailable, the fair value is determined by reference to quoted market prices for similar instruments, adjusted as appropriate for the specific circumstances of the instruments.

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.

In the absence of quoted market prices, fair value is determined using valuation techniques based on the calculation of the present value of expected future cash flows of the assets. The inputs to these valuation techniques are derived from observable market data and, where relevant, assumptions in respect of unobservable inputs. In respect of 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.

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. Finally, some inputs are not observable, but can generally be estimated from historical data or other sources. Examples of inputs

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatility surfaces for commonly traded option products. 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.

Loans, including leveraged loans 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 as described above, and the fair value of the embedded derivative is determined as described in the paragraph above on derivatives.

Fair value valuation bases

The table below provides an analysis of the various bases described above which have been deployed for valuing financial assets and financial liabilities measured at fair value in the consolidated financial statements.

The movement in the balances of assets and liabilities measured at fair value with significant unobservable inputs was mainly attributable to a decrease in the fair value of derivative assets, loans held for securitisation and the disposal of securities in other portfolios. At 31 December 2009, financial instruments measured at fair value using a valuation technique with significant unobservable inputs represented 2 per cent of total assets and liabilities measured at fair value (2008: 2 per cent).

Bases of valuing financial assets and liabilities measured at fair value

		Valuation techniques		
	Quoted market price Level 1 US$m	Using observable inputs Level 2 US$m	With significant unobservable inputs Level 3 US$m	Total US$m
At 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**
At 31 December 2008				
Assets				
Trading assets	234,399	185,369	7,561	427,329
Financial assets designated at fair value	14,590	13,483	460	28,533
Derivatives	8,495	476,498	9,883	494,876
Financial investments: available for sale	103,949	173,157	9,116	286,222
Liabilities				
Trading liabilities	105,584	135,559	6,509	247,652
Financial liabilities designated at fair value	23,311	51,276		74,587
Derivatives	9,896	473,359	3,805	487,060

Table of Contents

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 2009							
Private equity 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**
At 31 December 2008							
Private equity investments	2,689	54	225				
Asset-backed securities	4,264	882		95			565
Leveraged finance		266					33
Loans held for securitisation		2,133					
Structured notes		87			5,294		
Derivatives with monolines				2,441			
Other derivatives				7,347			3,207
Other portfolios	2,163	4,139	235		1,215		
	9,116	7,561	460	9,883	6,509		3,805

At 31 December 2009, available-for-sale ABSs valued using a valuation technique with significant unobservable inputs principally comprised commercial property-related securities, leveraged finance-related securities and Alt-A

securities with no particular concentration in any one category. Assets in other portfolios valued using a valuation technique with significant unobservable inputs were principally holdings in an Asian bond portfolio where the credit spreads are not directly observable.

Trading assets valued using a valuation technique with significant unobservable inputs principally comprised ABSs, loans held for securitisation and other portfolios. The ABSs are classified in Level 3 as a result of the unobservability of the underlying price of the assets. Loans held for securitisations are valued using a proprietary model which utilises inputs relating to the credit spread of the obligor. Other portfolios include holdings in various bonds, preference shares and debentures where the unobservability relates to the prices of the underlying securities. The decrease during the year was due to a reduction in the fair value of loans held for securitisation and disposals of positions within other portfolios.

Derivative products with monolines valued using techniques with unobservable inputs decreased during the year as a result of a decrease in exposure
to the monoline counterparties, primarily as a result of decreasing credit spreads and from commutations undertaken. The primary unobservable input relates to the probability of default of the counterparty. Further details of the transactions with monoline counterparties are shown on page 163.

Derivative products valued using valuation techniques with significant unobservable inputs included certain correlation products, such as foreign exchange basket options, equity basket options, foreign exchange-interest rate hybrid transactions and long-dated option transactions. Examples of the latter are equity options, interest rate and foreign exchange options and certain credit derivatives. Credit derivatives include certain tranched CDS transactions. The decrease in Level 3 derivative assets during the year was mainly due to a decrease in the fair value of structured credit transactions.

Trading liabilities valued using a valuation technique with significant unobservable inputs principally comprised equity-linked structured notes which are issued by HSBC and provide the counterparty with a return that is linked to the performance of certain equity securities, and other portfolios. The notes are classified as Level 3 due to the unobservability of parameters such as long-dated equity volatilities and correlations between equity prices, between equity prices and interest rates and

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

Fair values of financial instruments > Carried at fair value

between interest rates and foreign exchange rates. The movement in Level 3 trading liabilities during the year was primarily due to the issue of new equity derivative linked structures classified in other portfolios, partially offset by transfers out of Level 3 as a result of increased observability of long-dated volatilities.

The increase in derivative liabilities valued using a valuation technique with significant unobservable inputs was primarily attributable to the transfer into Level 3 of swaps linked to securitisation structures whose valuation utilises inputs relating to the prepayment rates for the underlying asset pools
which are unobservable. This was partially offset by transfers out of structured interest rate and equity derivatives due to increased observability of long-dated swaptions and equity volatilities.

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	Held for trading	Designated at fair value through profit or loss	Derivatives	Held for trading	Designated at fair value through profit or loss	Derivatives
	US$m	US$m	US$m	US$m	US$m	US$m	US$m
At 1 January 2009	**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	**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 2009	**10,214**	**6,420**	**1,224**	**4,453**	**8,774**	**507**	**5,192**

Total gains/(losses) recognised in profit or loss relating to those assets and liabilities held on 31 December 2009	**(371)**	**(596)**	**98**	**(3,753)**	**(136)**	**(3)**	**(135)**

For available-for-sale securities, the unobservability of valuations of asset-backed (particularly Alt-A and leveraged finance-related) securities and the Asian bond portfolio discussed on page 173 resulted in assets in these categories being transferred or purchased into Level 3 during 2009. Transfers out of Level 3 were primarily in respect of commercial property related ABSs due to certain valuations in these asset categories becoming observable during 2009.

For trading assets, transfers into Level 3 arose principally on ABSs, fixed income securities and a syndicated loan position where valuations for the specific instruments were not observable. Transfers out also related principally to ABSs and fixed income securities as valuations for specific instruments became observable. Purchases relate primarily to the unwind of certain ABS total return swap funding transactions, in which HSBC s market risk position did not change, but securities were purchased in place of the derivative transactions.

For derivative assets, transfers out of Level 3 were driven by decreases in residual maturity of longer-dated equity options to below the observability boundary, movement in equity prices leading to previously out-of-the money or in-the-money options becoming closer to at-the-money options, and some increased observability of long-dated swaption and foreign exchange volatilities. Transfers in were largely driven by the unobservability of prepayment rates on swaps linked to third-party securitisations.

For held-for-trading liabilities, transfers into Level 3 were primarily due to a reduction in the observability of volatilities and gap risk parameters on embedded derivatives within issued structured notes. Transfers out of Level 3 were driven by similar factors as derivative assets, also relating to embedded derivatives within issued structured notes.

For derivative liabilities, the unobservability of prepayment rates on securitisation swaps was the main reason for transfers into Level 3. Transfers out of Level 3 were driven by similar factors as derivative assets.

During 2009, there were no significant transfers between Levels 1 and 2.

For assets and liabilities classified as held for trading, realised and unrealised gains and losses are presented in the income statement under Trading income excluding net interest income .

Fair value changes on long term debt designated at fair value and related derivatives are presented in the income statement under Changes in fair value of long-term debt issued and related derivatives . The income statement line item Net income/(expense) from other financial instruments designated at fair value captures fair value movements on all other financial instruments designated at fair value and related derivatives.

Realised gains and losses from available-for-sale securities are presented under Gains less losses of financial investments in the income statement while unrealised gains and losses are presented in Fair value gains/(losses) within Available-for-sale investments in other comprehensive income/ (expense).

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 equity**	
	Favourable changes US$m	**Unfavourable changes US$m**	**Favourable changes US$m**	**Unfavourable changes US$m**
At 31 December 2009				
Derivatives, trading assets and trading liabilities[23]	**984**	**(577)**		
Financial assets and liabilities designated at fair value	**102**	**(98)**		
Financial investments: available for sale			**1,161**	**(1,157)**
At 31 December 2008				
Derivatives, trading assets and trading liabilities[23]	1,266	(703)		
Financial assets and liabilities designated at fair value	30	(30)		
Financial investments: available for sale			984	(1,005)

For footnote, see page 195.

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 the assumptions for the derivative portfolios. The increase in the effect of changes in significant unobservable inputs for available-for-sale assets arose from the increase in private equity holdings in Level 3 and from increased sensitivity to the assumptions for ABSs.

Sensitivity of fair values to reasonably possible alternative assumptions by Level 3 instrument type

	Reflected in profit or loss		Reflected in equity	
	Favourable changes US$m	Unfavourable changes US$m	Favourable changes US$m	Unfavourable changes US$m
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)**

Fair values of financial instruments > Carried at fair value

	Reflected in profit or loss		Reflected in equity	
	Favourable changes US$m	Unfavourable changes US$m	Favourable changes US$m	Unfavourable changes US$m
At 31 December 2008				
Private equity investments	28	(28)	234	(261)
Asset-backed securities	90	(91)	667	(660)
Leveraged finance	2	(2)		
Loans held for securitisation	41	(41)		
Structured notes	8	(8)		
Derivatives with monolines	341	(250)		
Other derivatives	652	(224)		
Other portfolios	134	(89)	83	(84)

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, the valuations are assessed on an asset by asset basis using a valuation methodology appropriate to the specific investment, in line with industry guidelines. 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 whose prices are unobservable, models are used to generate the expected value of the asset. The principal assumptions in these models are based on benchmark information about prepayment speeds, default rates, loss severities and the historical performance of the underlying assets. The models used are calibrated by using securities for which external market information is available.

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 market evidence, which may include financial
information, historical experience, CDS spreads and consensus recovery levels.

In the absence of such evidence, management s best estimate is used.

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.

Changes in fair value recorded in the income statement

The following table quantifies the changes in fair values recognised in profit or loss during the year in respect of assets and liabilities held at the end of the year whose fair values are estimated using valuation techniques that incorporate significant assumptions that are not evidenced by prices from observable current market transactions in the same instrument, and are not based on observable market data:

	2009	2008
	US$m	US$m
Recorded profit/(loss) on:		
Derivatives, trading assets and trading liabilities	**(4,620)**	779
Financial assets and liabilities designated at fair value	**95**	109

The loss during the year included changes in the fair value of monoline and CDPC-related credit derivatives which use a valuation technique with significant unobservable inputs. Additionally, there was a decline in the fair value of other structured credit derivatives attributable to the tightening of credit spreads during the year.

In general, many Level 3 instruments are risk managed using derivatives which employ a valuation technique with observable inputs. However, the associated gains on these derivatives in the year are not reflected in the table above. The table details the total change in fair value of these instruments; it does not isolate the component attributable to unobservable inputs.

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		
	Quoted market price Level 1 US$m	Using observable inputs Level 2 US$m	With significant unobservable inputs Level 3 US$m	Total US$m
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**
At 31 December 2008				
Assets				
Derivatives		3,682		3,682
Financial investments: available for sale			2,629	2,629
Liabilities				
Financial liabilities designated at fair valuex	13,321	3,068		16,389
Derivatives		1,324		1,324

Financial investments measured using a valuation technique with significant unobservable inputs 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.

	Assets available for sale US$m
At 1 January 2009	**2,629**
Total gains or losses:	

recognised in profit or loss	**(2)**
recognised in other comprehensive income	**103**
Settlements	**(275)**
At 31 December 2009	**2,455**
Total gains or losses recognised in profit or loss relating to those assets and liabilities held on 31 December 2009	**(2)**

Effect of changes in significant unobservable assumptions to reasonably possible alternatives

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:

	Reflected in equity	
	Favourable changes US$m	**Unfavourable changes US$m**
Financial investments available for sale		
At 31 December 2009	**115**	**(107)**
At 31 December 2008	113	(97)

177

Assessing available-for-sale assets for impairment

HSBC s policy on impairment of available-for-sale assets is described on page 375. The following is a description of HSBC s application of that policy.

A systematic impairment review is carried out periodically of all available-for-sale assets, and all available indicators are considered to determine whether there is any objective evidence that an impairment may have occurred, whether as the result of a single loss event or as the combined effect of several events.

Debt securities

When assessing available-for-sale debt securities for objective evidence of impairment at the balance sheet 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 events 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 ABSs 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 the securities.

At 31 December 2009, the population of available-for-sale ABSs identified as being most at risk of impairment included residential MBSs backed by sub-prime and Alt-A mortgages originated in the US, commercial MBSs orginated in the US and Europe and CDOs with considerable exposure to these sectors. The estimated future cash flows of these securities are assessed to determine whether any of their cash flows are unlikely to be recovered as a result of events occurring on or before the balance sheet date.

In particular, for residential and commercial MBSs the estimated future cash flows are assessed by determining the future projected cash flows arising on the underlying collateral taking into consideration the delinquency status of underlying loans, the probability of delinquent loans progressing to default, the proportion of the advances subsequently recoverable and the prepayment profiles of the underlying assets. 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, in order to determine whether impairment has occurred, the expected future cash flows of the CDOs are compared with the total of the underlying collateral on the non-defaulted assets and the recovery value of the defaulted assets. In the event of a shortfall, the CDO is considered to be impaired.

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.

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.

For impairment losses on available-for-sale equity and debt securities, see pages 31 and 35, respectively. Any impairment losses relating to ABSs recognised in the income statement are recorded as Loan impairment charges and other credit risk provisions . Impairment losses incurred on assets held by consolidated securities investment conduits (excluding Solitaire) are offset by a credit to the impairment line for the amount of the loss borne by capital note holders.

Fair values of financial instruments not carried at fair value

Financial instruments that are not carried at fair value on the balance sheet include loans and advances to banks and customers, deposits by banks, customer accounts, debt securities in issue and subordinated liabilities. Their fair values are, however, provided for information by way of note disclosure and are calculated as described below.

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.

As a consequence of the market turmoil there has been a significant reduction in the secondary market demand for US consumer lending assets. Uncertainty over the extent and timing of future credit losses, together with a near absence of liquidity for non-prime ABSs and loans, continued to be reflected in a low volume of bid prices at 31 December 2009. It is not possible from the indicative market prices that are available to distinguish between the relative discount to nominal value within the fair value measurement that reflects cash flow impairment due to expected losses to maturity, and the discount that the market is demanding for holding an illiquid asset. Under impairment accounting for loans and advances, there is no requirement to adjust the carrying value to reflect illiquidity as HSBC s intention is to fund assets until the earlier of prepayment, charge-off or repayment on maturity. The fair value, by contrast, reflects both incurred loss and loss expected through the life of the asset, a discount for illiquidity and a
credit spread which reflects the market s current risk preferences. This usually differs from the credit spread applicable in the market at the time the loan was underwritten and funded.

The estimated fair values at 31 December 2009 and 31 December 2008 of loans and advances to customers in North America reflected the combined effect of these conditions. As a result, the fair values are substantially lower than the carrying amount of customer loans held on-balance sheet and lower than would otherwise be reported under more normal market conditions. Accordingly, the fair values reported do not reflect HSBC s estimate of the underlying long-term value of the assets. Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

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 coupon rates. In general, contractual cash flows are 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.

For all classes of financial instruments, fair value represents the product of the value of a single instrument, multiplied by the number of instruments held. No block discount or premium adjustments are made. The fair values of intangible assets related to the businesses which originate and hold the financial instruments subject to fair value measurement, such as values placed on portfolios of core deposits, credit card and customer relationships, are not included in the above because they are not classified as financial instruments. Accordingly, an aggregation of fair value measurements does not approximate to the value of the organisation as a going concern.

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

Fair values of financial instruments which are not carried at fair value on the balance sheet

	At 31 December 2009		At 31 December 2008	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m

Assets				
Loans and advances to banks	**179,781**	**179,658**	153,766	153,363
Loans and advances to customers	**896,231**	**855,780**	932,868	876,239
Financial investments: debt securities	**17,526**	**18,097**	14,013	15,057
Financial investments: treasury and other eligible bills	**101**	**101**		
Liabilities				
Deposits by banks	**124,872**	**124,856**	130,084	130,129
Customer accounts	**1,159,034**	**1,160,036**	1,115,327	1,115,291
Debt securities in issue	**146,896**	**145,888**	179,693	170,599
Subordinated liabilities	**30,478**	**30,307**	29,433	28,381

Fair values of financial instruments held for sale which are not carried at fair value on the balance sheet

	At 31 December 2009		At 31 December 2008	
	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	**1,356**	**1,316**	11	11
Financial investments: debt securities			37	37

Analysis of loans and advances to customers by geographical segment

	At 31 December 2009		At 31 December 2008	
	Carrying amount US$m	**Fair Value US$m**	Carrying amount US$m	Fair value US$m
Loans and advances to customers				
Europe	**439,481**	**431,158**	426,191	417,256
Hong Kong	**99,381**	**99,694**	100,220	100,490
Rest of Asia-Pacific[24]	**80,043**	**79,972**	80,661	77,391
Middle East[24]	**22,844**	**22,538**	27,295	27,296
North America[25]	**206,853**	**174,957**	256,214	211,346
Latin America	**47,629**	**47,461**	42,287	42,460
	896,231	**855,780**	932,868	876,239

For footnotes, see page 195.

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:

Fair values of HSBC Holdings financial instruments not carried at fair value on the balance sheet

	2009		2008	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m
Assets				
Loans and advances to HSBC undertakings	**23,212**	**23,871**	11,804	12,670
Liabilities				
Amounts owed to HSBC undertakings	**3,711**	**3,827**	4,042	4,218
Debt securities in issue	**2,839**	**3,141**		
Subordinated liabilities	**14,406**	**15,666**	14,017	13,940

Special purpose entities

This section contains disclosures about HSBC-sponsored SPEs that are included in HSBC s consolidated balance sheet, with a particular focus on SPEs containing exposures affected by the turmoil in credit markets which began in mid-2007, and those that are not consolidated by HSBC under IFRSs. In addition to the disclosures about SPEs, information on other off-balance sheet arrangements has been included in this section.

HSBC enters into certain transactions with customers in the ordinary course of business which involve the establishment of SPEs 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. HSBC s involvement with SPE transactions is described below.

HSBC-sponsored SPEs

HSBC sponsors the formation of entities which are designed to accomplish certain narrow and well-defined objectives, such as securitising financial assets or effecting a lease, and this requires a form of legal structure that restricts the assets and liabilities within the structure to the single purpose for which it was established. HSBC consolidates these SPEs when the substance of the relationship indicates that HSBC controls them. In assessing control, all relevant factors are considered, including qualitative and quantitative aspects. For example:

Qualitative factors in substance:

- the activities of the SPE are being conducted on behalf of HSBC according to HSBC s specific business needs so that it obtains benefit from the SPE s operation. This might be evidenced, for example, by HSBC providing a significant level of support to the SPE; and

- HSBC has the decision-making powers to obtain the majority of the benefits of the activities of the SPE.

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

SPEs > SIVs and conduits

Quantitative factors - hereinafter referred to as the majority of risks and rewards of ownership . In substance:

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; and

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.

In a number of cases, these SPEs are accounted for off-balance sheet under IFRSs where HSBC does not have the majority of the risks and rewards of ownership of the SPE. However, in certain circumstances and after careful consideration of the facts, HSBC consolidates an SPE when the qualitative features of its involvement indicate that, in substance, the activities of the SPE are being conducted on behalf of HSBC, even though HSBC does not obtain the majority of risks and rewards of ownership.

HSBC reassesses the required consolidation accounting tests whenever there is a change in the substance of the relationship between HSBC and an SPE, for example, when the nature of HSBC s involvement or the governing rules, contractual arrangements or capital structure of the SPE change. The most significant categories of SPEs are discussed in more detail below.

Structured investment vehicles and conduits

Structured investment vehicles

Structured investment vehicles (SIV s) are SPEs which invest in diversified portfolios of interest-earning assets, generally funded through issues of commercial paper (CP), medium-term notes (MTN s) and other senior debt to take advantage of the spread differentials between the assets in the SIV and the funding cost. Prior to the implementation of Basel II, it was capital efficient to many bank investors to invest in highly-rated investment securities in this way. HSBC sponsored the establishment of two SIVs, Cullinan Finance Limited (Cullinan) and Asscher Finance Limited (Asscher) which are now in the process of voluntary liquidation following completion of the transfer of their portfolios of investment securities and derivatives to the three new structured investment conduits (SIC s) established in 2008 in order to remove the risk of having to make forced asset sales. Mazarin Funding Limited (Mazarin), an asset-backed CP conduit, and Barion Funding Limited (Barion), a term-funding vehicle, were set up in respect of Cullinan; and Malachite Funding Limited (Malachite), a term-funding vehicle, was set up in respect of Asscher. Cullinan and Asscher retain only residual cash balances to facilitate the voluntary liquidation process.

At 31 December 2009, all the capital notes in Cullinan and Asscher had been redeemed and replaced by capital notes in the new SICs (2008: 8.7 per cent of Asscher s capital notes remained outstanding).

Conduits

HSBC sponsors and manages two types of conduits which issue CP: multi-seller conduits and SICs. HSBC has consolidated these conduits from inception because it is exposed to the majority of risks and rewards of ownership.

Securities investment conduits

Solitaire, HSBC s principal securities investment conduit, purchases highly rated ABSs to facilitate tailored investment opportunities. HSBC s other SICs, Mazarin, Barion and Malachite, evolved from the restructuring of HSBC s sponsored SIVs as discussed above.

Multi-seller conduits

These vehicles were established for the purpose of providing access to flexible market-based sources of finance for HSBC s clients, for example, to finance discrete pools of third-party originated trade and vehicle finance loan receivables. HSBC s principal multi-seller conduits are Regency Assets Limited (Regency), Bryant Park Funding Limited LLC (Bryant Park), Abington Square Funding LLC (Abington Square , inactive since March 2008) and Performance Trust.

The multi-seller conduits purchase or fund interests in diversified pools of third-party assets financed by issuing CP or drawing advances from HSBC. The cash flows received by the conduits from the third-party assets are used to service the funding and provide a commercial rate of return for HSBC for structuring, for various other administrative services, and for the liquidity and credit support it gives to the conduits. The asset pools acquired by the conduits are structured so that the credit enhancement the conduits receive, which equates to senior investment grade ratings, and the benefit of liquidity facilities typically provided by HSBC mean that the CP issued by the multi-seller conduits is itself highly rated.

Table of Contents

Ratings analysis of assets held by HSBC s SIVs and conduits

	Solitaire US$bn	Other SICs US$bn	Total SICs US$bn	Total multi-seller conduits US$bn	Total SIVs US$bn
S&P ratings at 31 December 2009					
AAA	**5.2**	**6.7**	**11.9**	**6.2**	
AA	**3.0**	**4.1**	**7.1**	**1.3**	
A	**0.8**	**6.0**	**6.8**	**1.8**	
BBB	**0.7**	**0.8**	**1.5**	**0.5**	
BB	**0.2**	**0.3**	**0.5**	**0.5**	
B	**0.4**	**0.3**	**0.7**		
CCC	**1.0**	**1.0**	**2.0**		
CC	**0.3**	**0.4**	**0.7**		
D	**0.1**	**0.1**	**0.2**		
Total investments	**11.7**	**19.7**	**31.4**	**10.3**	
Cash and other investments	**1.1**	**0.3**	**1.4**	**0.6**	
	12.8	**20.0**	**32.8**	**10.9**	
S&P ratings at 31 December 2008					
AAA	8.1	12.0	20.1	6.1	0.3
AA	0.7	1.4	2.1	1.8	
A	1.0	4.7	5.7	1.6	
BBB	0.8	1.0	1.8	1.2	
BB	0.3	0.4	0.7	0.2	
B	0.1	0.2	0.3	0.5	
CCC	0.2	0.2	0.4	1.8	
D				0.3	
Total investments	11.2	19.9	31.1	13.5	0.3
Cash and other investments	0.9	0.3	1.2	0.4	0.1
	12.1	20.2	32.3	13.9	0.4

The migration to lower ratings during 2009 is a result of the performance of the underlying assets being outside the expectations established at inception of the original securitisations, and changes to the ratings methodology of the principal rating agencies.

At 31 December 2009, 6.8 per cent of the SICs exposures to sub-prime and US Alt-A mortgages, which in aggregate amounted to US$0.4 billion, remained AAA rated (2008: 62.7 per cent, US$4.2 billion), while 30.5 per cent, which in aggregate amounted to US$1.8 billion, remained investment grade (2008: 94 per cent, US$6.3 billion).

It should be noted that securities purchased by SICs typically benefit from substantial transaction-specific credit enhancements such as subordinated tranches and/or excess spread, which absorb any credit losses before they fall on the tranche held by the SPE.

At 31 December 2009, the SIVs did not hold any CP issued by SICs set up by HSBC (2008: US$0.3 billion). As described above, by 31 December 2008 all the original assets held by the SIVs had been transferred to the new SICs, with the exception of residual cash balances.

Weighted average life of portfolios

Weighted average life (years)	**Solitaire**	**Other SICs**	**Total SICs**	**Total multi-seller conduits**	**Total SIVs**
At 31 December 2009	**6.3**	**4.1**	**4.9**	**2.4**	
At 31 December 2008	5.8	3.9	4.6	1.6	

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

SPEs > SIVs and conduits

Composition of asset portfolio

	Solitaire US$bn	Other SICs US$bn	Total SICs US$bn	Total multi-seller conduits[26] US$bn	Total SIVs US$bn
Asset class at 31 December 2009					
Structured finance					
Vehicle loans and equipment leases				3.0	
Consumer receivables				0.8	
Credit card receivables	0.2		0.2	1.3	
Residential MBSs	3.8	4.6	8.4	0.3	
Commercial MBSs	2.4	3.3	5.7	0.2	
Auto floor plan				0.5	
Trade receivables				2.8	
Student loan securities	2.3	1.8	4.1		
Vehicle finance loan securities	0.1	0.2	0.3		
Leverage loan securities	1.9	2.3	4.2		
Other ABSs	1.0	1.8	2.8	1.2	
	11.7	14.0	25.7	10.1	
Finance					
Commercial bank securities and deposits	0.1	4.8	4.9	0.6	
Investment bank debt securities		0.8	0.8		
Finance company debt securities		0.2	0.2	0.2	
Other assets	1.0	0.2	1.2		
	1.1	6.0	7.1	0.8	
	12.8	20.0	32.8	10.9	
Sub-prime mortgages	0.7	1.5	2.2		
US Alt-A	1.9	1.8	3.7		
	2.6	3.3	5.9		

Asset class at 31 December 2008
Structured finance

Vehicle loans and equipment leases				3.9	
Consumer receivables				0.7	
Credit card receivables	0.2		0.2	1.4	
Residential MBSs	4.4	5.7	10.1	0.6	
Commercial MBSs	2.1	3.1	5.2	0.2	
Auto floor plan				2.2	
Trade receivables				2.7	
Student loan securities	2.2	2.0	4.2		
Vehicle finance loan securities		0.3	0.3		
Leverage loan securities	1.5	2.2	3.7		
Other ABSs	0.8	1.3	2.1	1.7	
	11.2	14.6	25.8	13.4	
Finance					
Commercial bank securities and deposits		4.4	4.4	0.4	
Investment bank debt securities		0.5	0.5		
Finance company debt securities		0.4	0.4		0.3
Other assets	0.9	0.3	1.2	0.1	0.1
	0.9	5.6	6.5	0.5	0.4
	12.1	20.2	32.3	13.9	0.4
Sub-prime mortgages	0.9	1.3	2.2		
US Alt-A	2.3	2.2	4.5		
	3.2	3.5	6.7		

For footnote, see page 195.

Asset analysis by geographical origination for multi-seller conduits[27]

	At 31 December 2009 US$bn	2008 US$bn
Europe	**6.1**	7.5
Rest of Asia-Pacific	**0.6**	0.9
North America	**4.2**	5.5
	10.9	13.9

For footnote, see page 195.

Total assets by balance sheet classification

	Solitaire US$bn	Other SICs US$bn	Total SICs US$bn	Total multi-seller conduits US$bn	Total SIVs US$bn
At 31 December 2009					
Financial instruments designated at fair value	**0.1**		**0.1**		
Loans and advances to banks				**0.3**	
Loans and advances to customers				**10.3**	
Financial investments	**11.6**	**19.8**	**31.4**		
Other assets	**1.1**	**0.2**	**1.3**	**0.3**	
	12.8	**20.0**	**32.8**	**10.9**	
At 31 December 2008					
Financial instruments designated at fair value	0.1		0.1		
Derivative assets		0.2	0.2	0.1	
Loans and advances to banks		0.1	0.1		0.1
Loans and advances to customers				13.4	
Financial investments	11.1	19.9	31.0		0.3
Other assets	0.9		0.9	0.4	
	12.1	20.2	32.3	13.9	0.4

Funding structure

Solitaire Provided	Other SICs Provided	Total SICs Provided	Total multi-seller conduits Provided	Total SIVs Provided

	Total US$bn	by HSBC US$bn	Total US$bn	by HSBC US$bn	Total US$bn	by HSBC US$bn	Total US$bn	by HSBC US$bn	Total US$bn	by HSBC US$bn
At 31 December 2009										
Capital notes			**0.7**		**0.7**					
Drawn liquidity facility	**7.6**	**7.6**			**7.6**	**7.6**				
Commercial paper	**10.8**	**0.7**	**10.1**	**10.1**	**20.9**	**10.8**	**10.3**			
Medium-term notes			**3.8**	**3.8**	**3.8**	**3.8**				
Term repos executed			**10.2**	**10.2**	**10.2**	**10.2**				
	18.4	**8.3**	**24.8**	**24.1**	**43.2**	**32.4**	**10.3**			
At 31 December 2008										
Capital notes			0.9		0.9					
Drawn liquidity facility	2.4	2.4			2.4	2.4				
Commercial paper	17.2	8.3	10.5	10.4	27.7	18.7	12.9	2.1		
Medium-term notes			3.4	3.4	3.4	3.4			0.1	
Term repos executed	0.8	0.8	13.3	13.3	14.1	14.1				
	20.4	11.5	28.1	27.1	48.5	38.6	12.9	2.1	0.1	

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

SPEs > SIVs and conduits / Money market funds / CNAV funds

Weighted average life of the funding liabilities

	Solitaire Years	Other SICs Years	Total SICs Years	Total multi-seller conduits Years	Total SIVs Years
At 31 December 2009					
CP funding	**0.2**	**0.1**	**0.1**	**0.1**	**n/a**
MTN funding		**10.3**	**10.3**		**n/a**
At 31 December 2008					
CP funding	0.1	0.2	0.1	0.1	n/a
MTN funding	n/a	7.3	7.3	n/a	0.1

The majority of CP and MTN funding issued by the SIVs was repaid in full during 2008 using the proceeds from the asset sales to the new SICs. The CP and MTNs matured in early 2009.

HSBC s maximum exposure

Conduits

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 2009, HSBC s exposure amounted to US$13.6 billion (2008: US$15.5 billion). First loss protection is provided through the capital notes issued by Mazarin, which are substantially all held by third parties.

In addition, at 31 December 2009, HSBC held 1.3 per cent of Mazarin s capital notes (2008: 1.3 per cent), which have a par value of US$17 million (2008: US$17 million), and a carrying amount of US$0.6 million (2008: US$0.6 million).

Barion and Malachite

These SICs are term funded by HSBC, consequently HSBC s primary exposure to them is represented by the amortised cost of the debt required to support the non-cash assets of the vehicles. At 31 December 2009 this amounted to US$10.5 billion (2008: US$11.7 billion).

First loss protection is provided through the capital notes issued by these vehicles, which are substantially all held by third parties.

In addition, at 31 December 2009, HSBC held 3.76 per cent (2008: 3.53 per cent) of the capital notes issued by these vehicles which have a par value of US$37 million (2008: US$35 million), and a carrying amount of US$2.0 million (2008: US$1.3 million).

Solitaire

CP issued by Solitaire benefits from a 100 per cent liquidity facility provided by HSBC. First loss credit protection against CP-funded securities, after any transaction-specific credit enhancement (as described on page 155) and retained reserves, is provided by HSBC in the form of letters of credit with a combined notional value of US$1.2 billion at 31 December 2009 (2008: US$1.2 billion).

At 31 December 2009, US$7.6 billion of Solitaire s assets were funded by the draw-down of the liquidity facility (2008: US$2.4 billion). HSBC is exposed to credit losses on the drawn amounts.

HSBC s maximum exposure to Solitaire is limited to the amortised cost of non-cash equivalent assets, which represents the risk that HSBC may be required to fund the vehicle in the event the debt is redeemed without reinvestment from third parties.

HSBC s maximum exposure at 31 December 2009 amounted to US$18.4 billion (2008: US$20.4 billion).

Multi-seller conduits

HSBC provides transaction-specific liquidity facilities to each of its multi-seller conduits, designed to be drawn in order to ensure the repayment of the CP issued. At 31 December 2009, the committed liquidity facilities amounted to US$14.4 billion (2008: US$17.1 billion).

First loss protection is provided through transaction-specific credit enhancements, for example, over-collateralisation and excess spread. These credit enhancements are provided by the originator of the assets and not by HSBC. In addition, a layer of secondary loss protection is provided by HSBC in the form of programme-wide enhancement facilities,

Table of Contents

and at 31 December 2009 this amounted to US$0.6 billion (2008: US$0.6 billion). HSBC s maximum exposure is equal to the transaction-specific liquidity facilities offered to the multi-seller conduits, as described above.

The liquidity facilities are set to support total commitments and therefore exceed the funded assets at both 31 December 2009 and 31 December 2008.

In consideration of the significant first loss protection afforded by the structure, the credit enhancements and a range of indemnities provided by the various obligors, HSBC carries only a minimal risk of loss from the programme.

Structured investment vehicles

Cullinan and Asscher s only assets are cash equivalents with liabilities to the extent of the liquidation costs and cash balances due to Mazarin, Barion and Malachite. These remain HSBC s only residual exposure in respect of the SIVs (2008: Cullinan held Mazarin CP amounting to US$0.3 billion).

Money market funds

HSBC has established and manages a number of money market funds which provide customers with tailored investment opportunities with a set of narrow and well-defined objectives. In most cases, they are not consolidated by HSBC because the Group s holdings in them are not of sufficient size to represent the majority of the risks and rewards of ownership.

Investors in money market funds generally have no recourse other than to the assets in the funds, so asset holdings are designed to meet expected fund liabilities. Usually, money market funds are constrained in their operations should the value of their assets and their ratings fall below predetermined thresholds. The risks to HSBC are, therefore, contingent, arising from the reputational damage which could occur if an HSBC-sponsored money market fund was thought to be unable to meet withdrawal requests on a timely basis or in full.

In aggregate, HSBC has established money market funds with total assets of US$99 billion at 31 December 2009 (2008: US$102.7 billion).

The main sub-categories of money market funds are:

US$73.6 billion (2008: US$72.0 billion) in Constant Net Asset Value (CNAV) funds, which invest in shorter-dated and highly-rated
money market securities with the objective of providing investors with a highly liquid and secure investment;

US$0.7 billion (2008: US$2.7 billion) in French domiciled *dynamique* (dynamic) funds and Irish enhanced funds, together Enhanced Variable Net Asset Value (Enhanced VNAV) funds, which invest in longer-dated money market securities to provide investors with a higher return than traditional money market funds; and

US$24.7 billion (2008: US$28.0 billion) in various other money market Variable Net Asset Value (VNAV) funds, including funds domiciled in Brazil, France, India and Mexico.

These money market funds invest in diverse portfolios of highly-rated debt instruments, and historically included limited holdings in instruments issued by SIVs. At 31 December 2009, these funds had no exposure to instruments issued by SIVs (2008: US$0.5 billion).

Constant Net Asset Value funds

During 2008, action was taken by HSBC in respect of the CNAV funds to maintain their AAA rating and mitigate any forced sale of liquid assets to meet potential redemptions. As a consequence, HSBC incurred losses totalling US$114 million in 2008.

As a result of this action, HSBC concluded that the relationship with these CNAV funds had substantively changed, so HSBC consolidated them from 30 September 2008. It was not necessary for any further action to be taken by HSBC in 2009 in respect of maintaining the rating of the CNAV funds.

Total assets of HSBC s CNAV funds which are on-balance sheet

	At 31 December	
	2009	2008
	US$bn	US$bn
ABSs	**0.3**	0.8
Certificates of deposit	**16.6**	13.0
CP	**12.0**	13.5
Asset-backed CP	**4.6**	4.6
Floating rate notes		5.2
Government agency bonds	**6.6**	1.9
Other assets	**2.3**	4.8
Total	**42.4**	43.8

The associated liabilities included on HSBC s balance sheet at 31 December 2009 amounted to US$41.5 billion (2008: US$43.1 billion) and are shown in Other liabilities . The associated interest income from the funds and the expense payable to third-party holders of units in the funds are presented within Net interest income on trading activities .

HSBC s maximum exposure

HSBC s maximum exposure to consolidated and unconsolidated CNAV funds is represented by HSBC s investment in the units of each CNAV fund, and by the maximum limit of any letters of limited indemnity provided to the CNAV funds. HSBC s exposure to investment in units within the CNAV funds at 31 December 2009 amounted to US$1.0 billion (2008: US$0.7 billion). There was no exposure to letters of limited indemnity (2008: US$58 million).

Enhanced Variable Net Asset Value funds

Enhanced VNAV funds price their assets on a fair value basis and, consequently, prices may change from one day to the next. These funds pursue an enhanced investment strategy, as part of which investors accept greater credit and duration risk in the expectation of higher returns.

During 2008, HSBC consolidated two of its French dynamic money market funds as a result of continued redemptions by unitholders. HSBC s aggregate holdings in these funds at 31 December 2009 amounted to 0.5 billion (US$0.6 billion (2008: 0.5 billion (US$0.6 billion)).

HSBC s maximum exposure

HSBC s maximum exposure to consolidated and unconsolidated Enhanced VNAV and consolidated and unconsolidated VNAV funds is represented by its investment in the units of each fund. HSBC s maximum exposure at 31 December 2009 amounted to US$0.6 billion (2008: US$0.6 billion) and US$0.2 billion (2008: US$1.6 billion), for Enhanced VNAV and VNAV funds, respectively.

Total assets of HSBC s money market funds which are on-balance sheet by balance sheet classification

	At 31 December	
	2009	2008
	US$bn	US$bn
Cash		0.3
Trading assets	**42.8**	43.3
Other assets	**0.3**	2.3
	43.1	45.9

Non-money market investment funds

Through its fund management business, HSBC has established a large number of non-money market funds to enable customers to invest in a range of assets, typically equities and debt securities. At the launch of a fund HSBC, as fund manager, usually provides a limited amount of initial capital known as seed capital to enable the fund to start purchasing assets. These holdings are normally redeemed over time. The majority of these funds are off-balance sheet for HSBC because the Group s limited economic interest means it does not have the majority of the risks and rewards of ownership. As the non-money market funds explicitly provide investors with tailored risk, the risk to HSBC is restricted to its own investments in the funds.

In aggregate, HSBC has established non-money market funds with total assets of US$255.4 billion at 31 December 2009 (2008: US$200.3 billion).

The main sub-categories of non-money market funds are:

US$115.6 billion (2008: US$83.1 billion) in specialist funds, comprising fundamental active specialists and active quantitative specialists;

US$121.7 billion (2008: US$96.2 billion) in local investment management funds which invest in domestic products, primarily for retail and private clients; and

US$18.1 billion (2008: US$21.0 billion) in multi-manager funds which offer fund of funds and manager of manager products across a diversified portfolio of assets.

Total assets of HSBC s on-balance sheet non-money market funds by balance sheet classification

	At 31 December	
	2009	2008
	US$bn	US$bn
Cash	**0.2**	0.4
Trading assets	**0.2**	0.2
Financial instruments designated at fair value	**5.3**	2.3
Financial investments		0.8
	5.7	3.7

HSBC s maximum exposure

HSBC s maximum exposure to consolidated and unconsolidated non-money market funds is represented by its investment in the units of each respective fund. HSBC s exposure at 31 December 2009 amounted to US$6.8 billion (2008: US$4.4 billion).

Securitisations

HSBC uses SPEs to securitise customer loans and advances that it has originated, mainly in order to diversify its sources of funding for asset origination and for capital efficiency purposes. In such cases, 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. Credit enhancements to the underlying assets may be used to obtain investment grade ratings on the senior debt issued by the SPEs. HSBC has also established securitisation programmes in the US and Germany where loans originated by third parties are securitised. Most of these vehicles are not consolidated by HSBC as it is not exposed to the majority of risks and rewards of ownership in the SPEs. In 2009, demand for the securitised products remained low.

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 such customer loans and advances to an SPE, using securitisations commonly known as synthetic securitisations. These SPEs are consolidated when HSBC is exposed to the majority of risks and rewards of ownership.

Total assets of HSBC s securitisations which are on-balance sheet, by balance sheet classification

	At 31 December	
	2009	2008
	US$bn	US$bn
Trading assets	**0.9**	1.3
Loans and advances to customers	**35.4**	50.8
Other assets	**1.4**	1.1
Derivatives	**1.2**	1.4
	38.9	54.6

These assets include US$0.9 billion (2008: US$1.3 billion) of exposure to US sub-prime mortgages.

Total assets of HSBC s securitisations which are off-balance sheet

	2009	2008
	US$bn	US$bn
HSBC originated assets	**0.6**	0.6
Non-HSBC originated assets:		
term securitisation programmes	**10.5**	13.5
	11.1	14.1

HSBC s financial investments in off-balance sheet securitisations at 31 December 2009 amounted to US$0.1 billion (2008: US$0.2 billion). These assets include assets which are classified as available-for-sale securities and measured at fair value, and have been securitised by HSBC under arrangements by which HSBC retains a continuing involvement in them. Further details are provided in Note 20 on the Financial Statements.

HSBC s maximum exposure

The 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. HSBC is not obligated to provide further funding. At 31 December 2009, HSBC s maximum exposure to consolidated and unconsolidated securitisations amounted to US$8.0 billion (2008: US$8.0 billion).

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 (ASF) transactions.

Structured credit transactions

HSBC provides structured credit transactions to third-party professional and institutional investors who wish to obtain exposure, sometimes on a leveraged basis, to a reference portfolio of debt instruments. In such structures, the investor receives returns referenced to the underlying portfolio by purchasing notes issued by the SPEs. HSBC enters into contracts with the SPEs, generally in the form of derivatives, in order to pass the required risks and rewards of the reference portfolios to the SPEs. HSBC s risk in relation to the derivative contracts with the SPEs is managed within HSBC s trading market risk framework (see Market risk on page 250).

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. 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. When this retained exposure represents ABSs, it has been included in Nature and extent of HSBC s exposures on page 157.

Often, transactions are facilitated through SPEs to enable the notes issued to the investors to be rated. The SPEs are not consolidated by HSBC when the investors bear substantially all the risks and rewards of ownership through the notes.

The total fair value of liabilities (notes issued and derivatives) in structured credit transaction SPEs was US$20.6 billion at 31 December 2009 (2008: US$21.2 billion). There were no SPEs that were consolidated by HSBC included in these amounts (2008: US$0.3 billion).

Other uses of SPEs

HSBC participates in Public-Private Partnerships to provide financial support for infrastructure projects initiated by government authorities. The funding structure is commonly achieved through the use of SPEs. HSBC consolidates these SPEs when it is exposed to the majority of risks and rewards of the vehicles.

HSBC s ASF business specialises in leasing and arranging finance for aircraft and other physical assets, which it is customary to ring-fence through the use of SPEs, and in structured loans and deposits,
where SPEs introduce cost efficiencies. HSBC consolidates these SPEs when the substance of the relationship indicates that HSBC controls the SPE.

HSBC s risks and rewards of ownership in these SPEs are in respect of its on-balance sheet assets and liabilities.

HSBC s maximum exposures to SPEs

The following tables show the total assets of the various types of SPEs, and the amount and types of funding provided by HSBC to these SPEs. The tables also show HSBC s maximum exposure to the SPEs and, within that exposure, the types of 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. The aggregation of such maximum exposures across the different forms of SPEs results in a theoretical total maximum exposure number. The elements of the maximum exposure to an SPE are not necessarily additive and a detailed explanation of how maximum exposures are determined is provided under each category of SPE.

HSBC s maximum exposure to consolidated SPEs affected by the recent market turmoil

	SIVs	Securities investment conduits[28]	Multi-seller conduits	CNAV funds	Enhanced VNAV funds	Enhanced WNAV funds	Non-money market funds Specialist funds	Non-money market funds Local funds[29]	Securit-isations[30]	Other	Total
	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn	US$bn
At 31 December 2009											
Total assets		**32.8**	**10.9**	**42.4**	**0.7**		**0.4**	**5.3**	**38.9**		**131.4**
Direct lending[31]									**0.9**		**0.9**
ABSs[31]		**25.7**		**0.3**	**0.2**						**26.2**
ABCP				**4.6**							**4.6**
Other		**7.1**	**10.9**	**37.5**	**0.5**		**0.4**	**5.3**	**38.0**		**99.7**
Funding provided by HSBC		**32.4**		**0.9**	**0.6**		**0.1**	**5.3**	**2.9**		**42.2**
CP		**10.8**									**10.8**
MTNs		**3.8**							**2.8**		**6.6**
Junior notes									**0.1**		**0.1**
Term repos executed		**10.2**									**10.2**
Investments in funds				**0.9**	**0.6**		**0.1**	**5.3**			**6.9**
Drawn liquidity facility		**7.6**									**7.6**
Capital notes[32]											
Total maximum exposure to consolidated SPEs		**42.5**	**14.4**	**0.9**	**0.6**		**0.1**	**5.3**	**7.9**		**71.7**
Liquidity and credit enhancements											
Deal-specific liquidity facilities			**14.4**								**14.4**
Indemnities[34]											
Programme-wide liquidity facilities		**29.1**									**29.1**
Programme-wide limited credit enhancements		**1.2**	**0.6**								**1.8**
									0.1		**0.1**

Other liquidity and
credit
enhancements

191

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

SPEs > Maximum exposure to SPEs

HSBC s maximum exposure to consolidated SPEs affected by the recent market turmoil (continued)

	SIVs US$bn	Securities investment conduits[28] US$bn	Multi-seller conduits US$bn	CNAV funds US$bn	VNAV funds US$bn	Enhanced VNAV funds US$bn	Non-money market funds: Specialist funds US$bn	Non-money market funds: Local funds[29] US$bn	Securit-isations[30] US$bn	Other US$bn	Total US$bn
At 31 December 2008											
Total assets	0.4	32.3	13.9	43.8	0.7	1.4	0.6	3.1	54.6	0.3	151.1
Direct lending[31]									1.3		1.3
ABSs[31]		25.8		0.8							26.6
ABCP				4.6							4.6
Other	0.4	6.5	13.9	38.4	0.7	1.4	0.6	3.1	53.3	0.3	118.6
Funding provided by HSBC		38.6	2.1	0.7	0.6	1.3	0.2	3.2	0.7	0.2	47.6
CP		18.7	2.1								20.8
MTNs		3.4							0.4	0.2	4.0
Junior notes									0.3		0.3
Term repos executed		14.1									14.1
Investments in funds				0.7	0.6	1.3	0.2	3.2			6.0
Drawn liquidity facility		2.4									2.4
Capital notes[32]											
Total maximum exposure to consolidated SPEs[33]		47.6	17.1	0.8	0.6	1.3	0.2	3.2	7.8	0.2	78.8
Liquidity and credit enhancements											
Deal-specific liquidity facilities			17.1								17.1
Indemnities[34]				0.1							0.1

Programme-wide liquidity facilities	34.8					34.8
Programme-wide limited credit enhancements	1.2	0.6				1.8
Other liquidity and credit enhancements					0.1	0.1

For footnotes, see page 195.

Table of Contents

HSBC s maximum exposure to unconsolidated SPEs

	Securitisations[35]		Money market funds[35]			Non-money market funds[35]				
	HSBC originated assets US$bn	Non-HSBC originated assets[36] US$bn	CNAV funds US$bn	VNAV funds US$bn	Enhanced VNAV funds US$bn	Specialist funds US$bn	Local funds[37] US$bn	Multi-manager funds US$bn	Other US$bn	Total US$bn
At 31 December 2009										
Total assets	**0.6**	**10.5**	**31.2**		**24.7**	**115.2**	**116.4**	**18.1**	**20.6**	**337.3**
Funding provided by HSBC		**0.1**	**0.1**		**0.2**	**1.1**	**0.2**	**0.1**	**8.8**	**10.6**
MTNs		**0.1**							**8.8**	**8.9**
Investments in funds			**0.1**		**0.2**	**1.1**	**0.2**	**0.1**		**1.7**
Total maximum exposure to unconsolidated SPEs		**0.1**	**0.1**		**0.2**	**1.1**	**0.2**	**0.1**	**3.2**	**5.0**
At 31 December 2008										
Total assets	0.6	13.5	28.2	2.0	26.6	82.5	93.1	21.0	20.9	288.4
Funding provided by HSBC		0.2			0.3		1.0		8.3	9.8
MTNs		0.2							8.3	8.5
Investments in funds					0.3		1.0			1.3
Total maximum exposure to unconsolidated SPEs		0.2			0.3		1.0		4.1	5.6

For footnotes, see page 195.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Impact of Market Turmoil (continued)

SPEs > Third-party sponsored SPEs // Other off-balance sheet / Footnotes

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 quantified below.
HSBC s commitments under liquidity facilities to third-party SIVs, conduits and securitisations

	Commit-ments US$bn	**Drawn US$bn**
At 31 December 2009		
Third-party conduits	**1.3**	**0.3**
Third-party securitisations	**0.7**	**0.1**
	2.0	**0.4**
At 31 December 2008		
Third-party conduits	1.1	0.1
Third-party securitisations	0.6	0.1
	1.7	0.2

Other exposures to third-party SIVs, conduits and securitisations where a liquidity facility has been provided

	At 31 December	
	2009	2008
	US$bn	US$bn
Derivative assets	**0.1**	

Other off-balance sheet arrangements and commitments

Financial guarantees, letters of credit and similar undertakings
Note 39 on the Financial Statements describes various types of guarantees and discloses the maximum potential future payments under such arrangements. Credit risk associated with all forms of guarantees is assessed in the same manner as for on-balance sheet credit advances and, where necessary, provisions for assessed impairment are included in Other provisions .
Commitments to lend
Undrawn credit lines are disclosed in Note 39 on the Financial Statements. The majority by value of undrawn credit lines arise from open to buy lines on personal credit cards, advised overdraft limits and other pre-approved loan products, and mortgage offers awaiting customer acceptance. HSBC generally has the right to change or terminate any

conditions of a personal customer s overdraft, credit card or other credit line upon notification to the customer. In respect of corporate commitments to lend, in most cases HSBC s position will be protected through restrictions on access to funding in the event of material adverse change.

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 page 165.

Footnotes to Impact of Market Turmoil

1 *Total includes holdings of ABSs issued by Freddie Mac and Fannie Mae.*

2 *Income and expense recorded in the income statement represents the accrual of the effective interest rate and, for 2009, also includes US$163 million in respect of impairment (2008: US$26 million). 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$1,371 million was recorded in the period up to reclassification.*

3 *Effect on the income statement during the period had the reclassification not occurred.*

4 *Included in the write-downs during the half year to 31 December 2008 were US$26 million relating to reclassified*

leveraged finance exposures, which had previously been presented under leveraged finance loans.

5 *The carrying amount includes funded loans plus the net exposure to unfunded leveraged finance commitments, held within fair value through the profit or loss.*

6 *Directly held includes assets held by Solitaire where HSBC provides first loss protection and assets held directly by the Group.*

7 *Impairment charges allocated to capital note holders represent impairments where losses would be borne by external third-party investors in the structures.*

8 *Mortgage-backed securities (MBS s), asset-backed securities (ABS s) and collateralised debt obligations (CDO s).*

9 *During 2009, for disclosure purposes, certain other residential MBSs were reclassified to commercial property mortgage-related assets. Comparatives*

have been restated accordingly.

10 *High grade assets rated AA or AAA.*

11 *Gains or losses on the net principal exposure (footnote 17) recognised in the income statement as a result of changes in the fair value of the asset.*

12 *Fair value gains and losses on the net principal exposure (footnote 17) recognised in other comprehensive income as a result of the changes in the fair value of available-for-sale assets.*

13 *Realised fair value gains and losses on the net principal exposure (footnote 17) recognised in the income statement as a result of the disposal of assets or the receipt of cash flows from assets.*

14 *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 17) of available-for-sale assets. Payments are the contractual cash*

flows received on the assets.

15 *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.*

16 *A credit default swap (CDS) gross protection is the gross principal of the underlying instrument that is protected by CDSs.*

17 *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.*

18 *Carrying amount of the net principal exposure.*

19 *Net exposure after legal netting and any other relevant credit mitigation prior to deduction of the credit risk adjustment.*

20 *Cumulative fair value adjustment recorded against OTC derivative*

counterparty exposures to reflect the creditworthiness of the counterparty.

21 *Funded exposure represents the loan amount advanced to the customer, less any fair value write-downs, net of fees held on deposit.*

22 *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.*

23 *Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.*

24 *The Middle East is disclosed as a separate geographical region with effect from 1 January 2009. Previously, it formed part of Rest of Asia-Pacific. Comparative data have been restated accordingly.*

25 *The reasons for the significant difference between carrying amount and fair*

value of loans and advances to customers in North America are discussed on page 179.

26 *Assets within multi-seller conduits are classified as collateralised loans. Under IFRSs, the conduits cannot recognise the underlying assets.*

27 *For details of the geographical origin of the mortgage loans held at fair value and ABSs, including those represented by MBSs and CDOs held in consolidated SIVs and securities investment conduits, see Nature and extent of HSBC s exposures on page 157.*

28 *The securities investment conduits include Mazarin, Barion, Malachite and Solitaire.*

29 *Local investment management funds.*

30 *Also includes consolidated SPEs that hold mortgage loans held at fair value.*

31 *These assets only include those measured at fair value. For details on the geographical*

origin of the mortgage loans held at fair value and ABSs, including those represented by MBSs and CDOs held in consolidated SIVs and securities investment conduits, see Nature and extent of HSBC s exposures on page 157. The geographical origin of the loans and receivables held by the multi-seller conduits is disclosed on page 185.

32 *The carrying amount of HSBC s holding of capital notes in the securities investment conduits amounted to US$2.6 million (2008: US$1.9 million) with a par value of US$54 million (2008: US$52 million).*

33 *Total maximum exposure to consolidated SPEs as at 31 December 2008 has been restated to reflect more accurately the Group s exposure to certain securitisation vehicles in which a proportion of the maximum exposure to risk of loss is borne by third-party noteholders.*

34 *Two limited letters of indemnity which were in place in*

respect of CNAV funds at 31 December 2008 expired in April 2009.

35 *HSBC s financial investments in off-balance sheet money market funds and non-money market funds have been classified as available-for-sale securities, and measured at fair value. HSBC s financial investments in off-balance sheet securitisations have been classified as trading assets and available-for-sale securities, and measured at fair value.*

36 *In the US, HSBC has established securitisation programmes where term-funded SPEs are used to securitise third-party originated mortgages, mainly sub-prime and Alt-A residential mortgages. The majority of these SPEs are not consolidated by HSBC as it is not exposed to the majority of the risk and rewards of ownership in the SPEs. No liquidity facility has been provided by HSBC.*

37 *Local investment management funds.*

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk

Regulation and supervision > UK / Hong Kong

1 *Unaudited.*

2 *Audited.*

3 *Audited where indicated.*

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. 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 HSBC s 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 294.

HSBC s operations throughout the world are regulated and supervised by approximately 540 different central banks and regulatory authorities in those jurisdictions in which HSBC has 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 HSBC operates 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 HSBC operates will determine to some degree HSBC s ability to expand into new markets, the services and products that HSBC will be able to offer in those markets and how HSBC structures 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 HSBC 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, the Group s 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 HSBC s lead regulator, the FSA is responsible for authorising and supervising all HSBC s 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 HSBC s 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 supervisor of HSBC 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 management and allocation on pages 285 to 291. 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 per cent 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 HSBC s senior executives to discuss HSBC s adherence to the FSA s prudential guidelines. They also regularly discuss fundamental matters relating to HSBC s 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, HSBC has 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

HSBC is 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 HSBC s US business.

HSBC and its 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 its control of HSBC Bank USA, N.A., McLean, Virginia (HBUS); HSBC Trust Company (Delaware), N.A., Wilmington, Delaware (HTCD); and Wells Fargo HSBC Trade Bank, N.A., San Francisco, California (WFTB). HSBC North America Holdings Inc. (HNAH), formed to hold HSBC s 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 their 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.

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 three US banks, HBUS, HTCD, and WFTB 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).

HSBC Bank USA and HTCD are subject to risk-based assessments from the Federal Deposit Insurance Corporation (FDIC), which insures deposits generally to a maximum of US$100,000 per depositor for domestic deposits. In October 2008, the FDIC raised the maximum amount of insured deposits to US$250,000 per depositor and, on 20 May 2009, extended the increased limit until 31 December 2013. On 1 January 2014, the limit will return to US$100,000 for all deposit accounts, except for certain retirement accounts which remain insured up to US$250,000 per depositor. The FDIC bases assessments on supervisory ratings, financial ratios and long-term debt issuer ratings, with those banks in the highest rated categories paying lower assessments. Due to projected shortfalls in the FDIC fund as a result of continuing bank failures, the FDIC has required all insured banks, including HBUS and HTCD, to prepay their insurance premium for the next three years.

In October 2008, the FDIC announced its Temporary Liquidity Guarantee Programme (TLGP), under which the FDIC will guarantee (i) newly-issued senior unsecured debt issued by eligible, participating institutions, and (ii) certain non-interest bearing transaction accounts. HNAH and its subsidiary banks and bank holding companies elected to participate in both components of the TLGP, as applicable. The FDIC is phasing out this programme, and will cease guaranteeing newly-issued debt on 30 April 2010.

HSBC s 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.

Risk management

(Unaudited)

Introduction

All HSBC s activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks or combinations of risks. The most important categories of risk that the Group is exposed to are credit risk (including cross-border country risk), market risk, operational risks in various forms, liquidity risk, insurance risk, pension risk, residual value risk, reputational risk and sustainability (environmental and social) risks. Market risk includes foreign exchange, interest rate and equity price risks.

The management of these various risk categories is discussed below. Insurance risk is managed by the Group s insurance businesses together with their own credit, liquidity and market risk functions, distinct from those covering the rest of HSBC due to the different nature of their activities but under risk oversight at Group level.

The risk profiles of HSBC Group and of individual operating entities change constantly under the influence of a wide range of factors. The risk management framework established by the Group fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions.

Risk governance and ownership

A well-established risk governance and ownership structure ensures oversight of, and accountability for, the effective management of risk at Group, regional, customer group and operating entity levels.

The Board approves the Group s risk appetite framework, plans and performance targets for the Group and its principal operating subsidiaries, the appointment of senior officers, the delegation of authorities for credit and other risks and the establishment of effective control procedures. Under authority delegated by the Board, the Group Management Board (GMB) through its separately convened Risk Management Meeting (RMM) formulates high-level Group risk management policy, exercises delegated risk authorities and oversees the implementation of risk appetite and controls. It monitors all categories of risk, receives reports on performance and emerging issues, determines action to be taken and reviews the efficacy of HSBC s risk management framework.

Primary responsibility for managing risk at operating entity level lies with the respective boards and Chief Executive Officers, as custodians of their balance sheets. In their oversight and stewardship of risk management at Group level, however, GMB and RMM are supported by a dedicated Global Risk function headed by the Group Chief Risk Officer (GCRO), who is a member of both bodies and reports to the Chief Financial Officer, Executive Director, Risk and Regulation within the integrated Finance and Risk function, which the latter represents on the Board.

Global Risk has functional responsibility for the principal financial risk types, namely retail and wholesale credit, market, operational, security and fraud risks. For these it establishes Group policy, exercises Group-wide oversight and provides reporting and analysis of portfolio composition trends on a global and regional basis to senior management. Accountability and consistent control across the Global Risk function is provided through the Global Risk Management Board, chaired by the GCRO, the members of which include the Chief Risk Officers of HSBC s regions and the heads of risk disciplines within Group Management Office (GMO). The regional governance bodies for key risk matters reflect those in place at the centre. Functional units at the entity and regional levels report to Group Risk. GMO helps build the Group s risk management capacity through staff selection, training, development, performance assessment and remuneration the GCRO is jointly responsible with business heads for setting the performance goals of senior Global Risk officers. Global Risk also co-ordinates the continued development of the Group s risk appetite, economic capital and stress testing frameworks, and engages in discussions with regulators and in industry forums on risk and regulatory policy developments, assesses their implications and makes recommendations accordingly. In addition, the GCRO is a member of the Group Portfolio Oversight Committee, chaired by the Group Treasurer, which governs the portfolio management activities of Global Banking.

Risk appetite

HSBC s risk appetite framework describes the quantum and types of risk that HSBC is prepared to take in executing its strategy. It is central to an integrated approach to risk, capital and business management and supports the Group in achieving its return on equity objectives, as well as being a key element in meeting the Group s obligations under pillar 2 of Basel II.

The formulation of risk appetite considers HSBC s risk capacity, its financial position, the strength of its core earnings and the resilience of its reputation and brand. It is expressed both qualitatively, describing which risks are taken and why, and quantitatively. HSBC senior management attaches quantitative metrics to individual risk types to ensure that:

- underlying business activity may be guided and controlled, so that it continues to be aligned to the risk appetite framework;
- key assumptions underpinning risk appetite can be monitored and, as necessary, adjusted through subsequent business planning cycles; and
- business decisions anticipated to be necessary to mitigate risk are flagged and acted upon promptly.

The risk appetite framework, governed by the Board and overseen in its implementation on an ongoing basis by GMB and RMM, is also maintained at regional and customer group levels. It operates through two key mechanisms:

- the framework itself defines the governance bodies, processes, metrics and other features of how HSBC addresses risk appetite as part of its ongoing business; and
- periodic risk appetite statements define, at various levels in the business, the desired level of risk commensurate with return and growth targets and in line with the corporate strategy and stakeholder objectives.

The risk appetite framework covers both the beneficial and adverse aspects of risk. Within it, economic capital is the common currency through which risk is measured and used as the basis for risk evaluation, capital allocation and performance measurement across regions and customer groups. Risk appetite is executed through the operational limits that control the levels of risk run by the Group, regions and customer groups and is measured using risk-adjusted performance metrics.

Scenario stress testing

Scenario analysis and stress testing are important mechanisms in understanding the sensitivities of the Group capital and business plans to the adverse effects of extreme, but plausible, events. As well as considering the potential financial effect on plans, a key output of this tool is the consideration and establishment of management action plans for mitigating such events should they, or similar events, arise.

Group Risk regularly assesses regulatory capital supply against demand under a range of stress

Table of Contents

scenarios, including projected global economic downturns more severe than that which is currently being experienced. Qualitative and quantitative techniques are used to estimate the potential impact on HSBC s capital position of such scenarios. HSBC also participates, where appropriate, in standard scenario analyses requested by regulatory bodies.

In particular, this framework has aided management in mitigating some of the effects of the global financial crisis. While the prediction of future events cannot cover all eventualities, nor precisely identify future events, a number of the scenarios analysed in the past provided additional management insight into the actions necessary to mitigate the risks when similar events occurred.

In addition to the suite of risk scenarios considered for the HSBC Group, each major subsidiary conducts regular macro-economic and event-driven scenario analyses specific to that region under the Group governance framework. Executive managers from across HSBC meet regularly to consider and debate the outcome of these scenarios and formulate recommended management actions. Macro-economic analyses are considered regularly by GMB.

Risk control culture

HSBC s risk management policies are encapsulated in the Group Standards Manual and cascaded in a hierarchy of policy manuals throughout the Group to communicate standards, instructions and guidance to employees. They support the formulation of risk appetite and establish procedures for monitoring and controlling risks, with timely and reliable reporting to management. HSBC regularly reviews and updates its risk management policies, systems and methodologies to reflect changes in law, regulation, markets, products and emerging best practice.

It is the responsibility of all Group officers to identify, assess and manage risk within the scope of their assigned responsibilities. Personal accountability, reinforced by the Group s governance structure and instilled by training and experience, helps to foster throughout the Group a disciplined and constructive culture of risk management and control.

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 the Group s holdings of debt securities. Among the risks in which the Group engages, credit risk generates the largest regulatory capital requirement.

The objectives of credit risk management, underpinning sustainably profitable business, are principally to maintain a strong culture of responsible lending and a robust risk policy and control framework; to both partner and challenge the business line in defining and implementing risk appetite, with its continuous re-evaluation under actual and scenario conditions; and to ensure independent, expert scrutiny of credit risks, their costs and their mitigation.

The credit risk governance structures and control frameworks implemented by the Group are designed for all stages of economic and financial cycles. During 2009, a number of processes, for example, crisis management and new product review, were enhanced in response to recent best practice recommendations of industry and regulatory bodies. Central credit risk oversight and independent review activities have been reinforced within a common operating model for the responsibilities and interaction of GMO Risk, regionally integrated risk functions and country-based management.

Credit Risk is part of the Global Risk function, and the heads of its retail, wholesale and market risk disciplines within GMO, as well as regional Chief Risk Officers and certain country Chief Credit Officers and the Head of Risk Strategy, report to the GCRO.

Across the Group, Credit Risk fulfils the role of an independent credit control unit, while engaging in dialogue with business teams to set priorities, refine risk appetite, and monitor and report higher-risk exposures. Credit risk and risk capital management policies and methodologies, including analytical model developments and management information, are enhanced in the light of experience gained, for instance through the roll-out of the Group s advanced internal ratings-based (IRB) approach to Basel II. See also Capital Management on page 285.

The Credit Risk function within GMO provides high-level oversight and management of credit risk for HSBC worldwide. Its responsibilities include:

formulating Group credit policy. Compliance, subject to approved dispensations, is mandatory for all HSBC s operating companies, which must develop and record in local instruction manuals their detailed credit policies and procedures, consistent with Group policy;

guiding HSBC s operating companies on the Group s appetite for credit risk exposure to specified market sectors, activities and banking products. GMO Risk controls exposures to certain higher-risk sectors and closely monitors exposure to others, including real estate, the automotive sector, certain non-bank financial institutions, structured products and leveraged finance transactions. When necessary, restrictions are imposed on new business or exposures, which may be capped at Group and/or entity level;

undertaking independent review and objective assessment of risk. GMO Risk assesses all commercial non-bank credit facilities and exposures including those embedded in derivatives that are originated or renewed by HSBC s operating companies over designated limits, prior to the facilities being committed to customers or transactions being undertaken. Operating companies may not confirm credit approval without this concurrence;

monitoring the performance and management of portfolios across the Group. GMO Risk tracks emerging trends and conducts in-depth portfolio reviews, overseeing the effective management of any adverse characteristics;

controlling centrally exposures to sovereign entities, banks and other financial institutions. HSBC s credit and settlement risk limits to counterparties in these sectors are approved and managed by GMO Risk to optimise the use of credit availability and avoid excessive risk concentration;

controlling exposure for all debt securities held; where a security is not held solely for the purpose of trading, a formal issuer risk limit is established;

establishing and maintaining HSBC s policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the Group s capital base and remain within internal and regulatory limits. GMO Risk also monitors HSBC s intra-Group exposures to ensure they are maintained within regulatory limits and ensures that policy and practice are fully aligned to evolving regulatory requirements;

controlling cross-border exposures, through the imposition of country limits with sub-limits by maturity and type of business. Country limits are determined by taking into account economic and political factors, and applying local business knowledge. Transactions with countries deemed to be higher risk are considered on a case by case basis;

maintaining and developing HSBC s risk rating framework and systems, to classify exposures meaningfully and enable focused management of the risks involved. The GCRO chairs the Credit Risk Analytics Oversight Committee, which reports to the RMM and oversees risk rating model governance for both wholesale and retail business. Rating methodologies, based upon a wide range of analytics and market data-based tools, are core inputs to the assessment of customer risk. For larger facilities, while full use is made of automated risk-rating processes, the ultimate responsibility for setting risk ratings rests with the final approving executive;

assisting the Risk Strategy unit in the development of stress-testing scenarios, economic capital measurement and the refinement of key risk indicators and their reporting, embedded within the Group s business planning processes;

reporting on aspects of the HSBC credit risk portfolio to the RMM, the Group Audit Committee and the Board of Directors of HSBC Holdings by way of a variety of regular and ad hoc reports covering:

- risk concentrations;
- retail portfolio performance at Group entity, regional and overall Group levels;
- specific higher-risk portfolio segments;
- a risk map of the status of key risk topics, with associated preventive and mitigating actions;
- individual large impaired accounts, and impairment allowances/charges for all customer segments;
- country limits, cross-border exposures and related impairment allowances;
- portfolio and analytical model performance data; and
- stress-testing results and recommendations;

managing and directing credit risk management systems initiatives. A centralised database covers substantially all the Group s direct lending exposures, to deliver an increasingly granular level of management reporting. A uniform credit application process for banks is operational throughout the Group and a similar corporate credit application system covers almost all Group corporate business by value;

providing advice and guidance to HSBC s operating companies, to promote best practice throughout the Group on credit-related matters such as sustainability risk, new products and training; and

acting on behalf of HSBC Holdings as the primary interface, for credit-related issues, with external parties including the Bank of England, the FSA, local regulators, rating agencies, corporate analysts, trade associations and counterparts in the world s major banks and non-bank financial institutions.

Each HSBC operating company is required to implement credit policies, procedures and lending guidelines that meet local requirements while conforming to Group standards. Credit approval authorities are delegated by the Board of Directors of HSBC Holdings to the most senior Chief Executive Officers, who receive commensurate delegations from their own boards. In each major subsidiary, a Chief Risk Officer or Chief Credit Officer reports to the local Chief Executive Officer or Chief Operating Officer on credit-related issues, while maintaining a direct functional reporting line to the GCRO.

Credit quality

(Audited)

Each operating company is responsible for the quality and performance of its credit portfolios and for monitoring and controlling all credit risks in them, including those subject to central approval by Group Risk. This includes managing its own risk concentrations by market sector, geography and product. Local systems are in place throughout the Group to enable operating companies to control and monitor exposures by customer and retail product segments. A Credit Review and Risk Identification team reports directly to each regional Chief Risk Officer, and reviews the robustness and effectiveness of key risk measurement, monitoring and control activities.

HSBC s 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 the Group s retail businesses, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

HSBC s historical risk rating system based on a judgemental assessment of the likelihood and impact of delinquency was superseded in 2008 for financial reporting purposes and, for all significant risk management decisions employing credit risk ratings, by a more risk-sensitive and granular methodology. This facilitates the IRB approach under Basel II adopted by the Group to support calculation of its minimum credit regulatory capital requirement. For further details, see Credit quality of financial instruments on page 225.

Special attention is paid to problem exposures, which are subject to more frequent and intensive review and reporting, in order to accelerate remedial action. Where appropriate, HSBC s local operating companies maintain or establish specialist units to provide customers with support in order to help them avoid default wherever possible.

Periodic risk-based audits of operating companies credit processes and portfolios are undertaken by HSBC s Internal Audit function. Audits include consideration of the adequacy and clarity of credit policy/procedure manuals; an overview of homogeneous portfolios of similar assets to assess the quality of the loan book and other exposures; consideration of any oversight or review work performed by credit risk management functions and the adequacy of impairment calculations; a review of analytical model governance and implementation; a review of management objectives and a check that Group and local standards and policies are adhered to in the approval and management of credit facilities.

Individually significant accounts are reviewed on a sample basis to ensure that risk ratings are appropriate, that credit and collection procedures have been properly followed and that where deterioration is evident, impairment allowances are raised in accordance with the Group s established procedures. Internal Audit discusses with management any risk ratings it considers to be inappropriate; after discussion, its final recommendations for revised ratings must then be adopted.

Impairment assessment

(Audited)

When impairment losses occur, HSBC reduces 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, the carrying amount of the asset is reduced directly. For further details, see Accounting policies on page 369.

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.

It is HSBC s policy that each operating company creates allowances for impaired loans promptly and consistently.

Management regularly evaluates the adequacy of the established allowances for impaired loans by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics with historical trends and assessing the impact of current economic conditions.

Individually assessed impairment allowances

These are determined by evaluating exposure to loss, case by case, on all individually significant accounts and all other accounts that do not qualify for the collective assessment approach outlined below. Loans are treated as impaired as soon as there is objective evidence that an impairment loss has been incurred. 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.

In determining the level of allowances on such accounts, the following factors are typically considered:

- 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, generating sufficient cash flow to service debt obligations;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency;
- the amount and timing of expected receipts and recoveries;
- 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 value of security and likelihood of successfully realising it;
- the existence of other credit mitigants and the ability of the providers of such credit mitigants to deliver as contractually committed; and

when available, the secondary market price of the debt.

The level of impairment allowances on individually significant accounts that are above defined materiality thresholds is reviewed at least semi-annually, and more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and of actual and anticipated receipts. For significant commercial and corporate debts, specialised loan work-out teams with experience in insolvency and specific market sectors are used to manage the lending and assess likely losses.

Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed impairment allowances

Impairment is assessed on a collective basis in two circumstances:

- to cover losses that 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 impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics. A collective impairment allowance is calculated to reflect impairment losses incurred at the balance sheet date which will only be individually identified in the future.

The collective impairment allowance is determined having taken into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, risk rating or product segment);
- 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 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 relevant portfolio. In general, the periods used vary between four and twelve months although, in exceptional cases, longer periods are warranted.

The basis on which impairment allowances for incurred but not yet identified losses is established in each reporting entity is documented and reviewed by senior Finance and Credit Risk management to ensure conformity with Group policy.

Homogeneous groups of loans

Two methodologies are used to calculate impairment allowances where large numbers of relatively low-value assets are managed using a portfolio approach, typically:

- low-value, homogeneous small business accounts in certain countries or territories;
- residential mortgages that have not been individually assessed;
- credit cards and other unsecured consumer lending products; and
- motor vehicle financing.

When appropriate empirical information is available, the Group uses roll rate methodology. This employs a statistical analysis of historical trends of default and the amount of consequential loss, based on the delinquency of accounts within a portfolio of homogeneous accounts. Other historical data and current economic conditions are also evaluated when calculating the appropriate level of impairment allowance required to cover inherent loss. In certain highly developed markets, models also take into account behavioural and account management trends 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, the Group uses a basic formulaic approach based on historical loss rate experience.

Generally, historical experience is the most objective and relevant information from which to begin to assess inherent loss within each portfolio. In circumstances where historical loss experience provides less relevant information about the inherent loss in a given portfolio at the balance sheet date for example, where there have been changes in economic conditions or regulations management considers the more recent trends in the portfolio risk factors which may not be adequately reflected in its statistical models and, subject to guidance from Group Finance and GMO Risk, adjusts impairment allowances accordingly.

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 are normally written off, either partially or in full, when there is no realistic prospect of further recovery. Where loans are secured, this is generally after receipt of any proceeds 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.

In the case of residential mortgages and second lien loans in HSBC Finance, loan carrying amounts in excess of net realisable value are written off at or before the time foreclosure is completed or when settlement is reached with the borrower. If there is no reasonable expectation of recovery, and foreclosure is pursued, unconstrained by delays required by law or regulation, 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 periods stated above. Collections procedures may continue after write-off.

Following the earlier decision to cease underwriting through the Group s US consumer mortgage lending business and, given the reduced ability of customers to refinance their facilities which changed their historical behaviour patterns, HSBC Finance shortened the write-off period from 240 days or later to 180 days contractually past due. The effect of this change was an acceleration of write-offs which reduced gross loans and advances by US$3.3 billion, with a corresponding reduction in impairment allowances and impaired loans. There has been no significant impact on net loans and advances or loan impairment charges. The effect on the current period has been quantified where relevant to the appropriate disclosure.

Cross-border exposures

Management assesses the vulnerability of countries to foreign currency payment restrictions when considering impairment allowances on cross-border exposures. This assessment includes an analysis of the economic and political factors existing at the time. Economic factors include the level of external indebtedness, the debt service burden and access to external sources of funds to meet the debtor country s financing requirements. Political factors taken into account include the stability of the country and its government, threats to security, and the quality and independence of the legal system.

Impairment allowances are assessed in respect of all qualifying exposures within these 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;
- performing facilities with a principal (excluding security) of US$1 million or below; or
- performing facilities with maturity dates shorter than three months.

Credit exposure

Maximum exposure to credit risk

(Audited)

HSBC s exposure to credit risk covers a broad range of asset classes, including derivatives, trading assets, loans and advances to customers, loans and advances to banks and financial investments. Credit exposure in 2009 remained diversified across these asset classes, though the balance of the Group s credit exposure changed in 2009 due to the run-off of consumer finance assets in the US and greater deployment of deposit inflows into debt securities. In addition, a significant decline in volatility in financial markets led to lower derivative assets and a reduced exposure to loss in the event of default on derivative contracts. The lower volatility, steepening yield curves and narrowing credit spreads resulted in a fall in the fair value of outstanding derivative contracts. The level of offsetting derivative balances moved in line with the decline in balances of maximum exposure.

There was a deterioration in 2009 in the credit quality of loans and advances to the commercial real estate sector, notably in parts of Europe, the Middle East and North America.

Exposure to personal lending secured on residential property remained significant. HSBC suffered from continuing weakness in credit conditions in the US mortgage market. However, in the UK, despite lower activity in the housing market as a whole, the credit quality of HSBC s mortgage business remained good throughout 2009 and was well secured. Exposure to the Hong Kong residential mortgage market also remained well-secured. For further commentary on personal lending, see Areas of Special Interest Personal Lending on page 215.

Loss experience continued to be concentrated in the personal lending portfolios, primarily in the US with 75 per cent of loan impairment charges and other credit risk provisions arising in Personal Financial Services in 2009 compared with 85 per cent in 2008. In 2009, 12 per cent of the Group s loan impairment charges and other credit risk provisions arose in Commercial Banking, compared with 9 per cent in 2008. Loan impairment charges in Global Banking and Markets were 6 per cent of total, loan impairment charges and other credit risk provisions compared with 3 per cent in 2008.

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 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 HSBC 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.

Maximum exposure to credit risk
(Audited)

	At 31 December 2009			At 31 December 2008		
	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	**60,655**		**60,655**	52,396		52,396
Items in the course of collection from other banks	**6,395**		**6,395**	6,003		6,003
Hong Kong Government certificates of indebtedness	**17,463**		**17,463**	15,358		15,358
Trading assets	**386,070**	**(8,496)**	**377,574**	405,451	(13,227)	392,224
Treasury and other eligible bills	**22,346**		**22,346**	32,458		32,458
Debt securities	**201,598**		**201,598**	199,619		199,619
Loans and advances to banks	**78,126**		**78,126**	73,055		73,055
Loans and advances to customers	**84,000**	**(8,496)**	**75,504**	100,319	(13,227)	87,092
Financial assets designated at fair value	**22,198**		**22,198**	17,540		17,540
Treasury and other eligible bills	**223**		**223**	235		235
Debt securities	**20,718**		**20,718**	16,349		16,349
Loans and advances to banks	**354**		**354**	230		230
Loans and advances to customers	**903**		**903**	726		726
Derivatives	**250,886**	**(189,606)**	**61,280**	494,876	(383,308)	111,568
	1,076,012	**(91,127)**	**984,885**	1,086,634	(83,398)	1,003,236

Loans and advances held at amortised cost:						
to banks	**179,781**	**(116)**	**179,665**	153,766	(126)	153,640
to customers	**896,231**	**(91,011)**	**805,220**	932,868	(83,272)	849,596
Financial investments	**360,034**		**360,034**	292,984		292,984
Treasury and other similar bills	**58,434**		**58,434**	41,027		41,027
Debt securities	**301,600**		**301,600**	251,957		251,957
Other assets	**36,373**	**(4)**	**36,369**	40,859	(5)	40,854
Endorsements and acceptances	**9,311**	**(4)**	**9,307**	10,482	(5)	10,477
Other	**27,062**		**27,062**	30,377		30,377
Financial guarantees and similar contracts	**53,251**		**53,251**	52,318		52,318
Loan and other credit-related commitments[1]	**558,050**		**558,050**	604,022		604,022
	2,827,387	**(289,233)**	**2,538,154**	3,068,441	(479,938)	2,588,503

For footnote, see page 291.

Collateral and other credit enhancements

(Audited)

Collateral held against financial instruments presented in the above table is described in more detail below.

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 HSBC s transactions with each one on any
single day. Settlement risk on many transactions, particularly those involving securities and equities, is substantially mitigated by settling through assured payment systems or on a delivery-versus-payment basis.

Treasury, other eligible bills and debt securities

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured, except for ABSs and similar instruments, which are secured by pools of financial assets.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Credit exposure > Maximum exposure / Concentration of exposure

Derivatives
The International Swaps and Derivatives Association (ISDA) Master Agreement is HSBC s preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of over-the-counter 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 HSBC s 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 market-contingent counterparty risk inherent in outstanding positions.

Loans and advances
It is HSBC s policy, when lending, to do so on the basis of the customer s capacity to repay, rather than rely primarily on the value of security offered. Depending on the customer s standing and the type of product, facilities may be provided unsecured. Whenever available, collateral can be an important mitigant of credit risk.

The guidelines applied by operating companies in respect of the acceptability of specific classes of collateral or credit risk mitigation and the determination of valuation parameters are subject to regular review to ensure that they are supported by empirical evidence and continue to fulfil their intended purpose. The principal collateral types employed by HSBC are as follows:

- 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, including credit default swaps and structured credit notes, and securitisation structures are used to hedge or transfer credit risk within the Group s loan portfolio.

HSBC does 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.

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. 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. Wrong-way risk can be seen in the following examples:

- when the counterparty is resident and/or incorporated in an emerging market and seeks to sell a non-domestic currency in exchange for its home currency;
- when the trade involves the purchase of an equity put option from a counterparty whose shares are the subject of the option;

- the purchase of credit protection from a counterparty who is closely associated with the reference entity of the credit default swap or total return swap; and

- the purchase of credit protection on an asset type which is highly concentrated in the exposure of the counterparty selling the credit protection.

HSBC uses a range of tools to monitor and control wrong-way risk, including requiring entities to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines. The Credit Risk Management functions undertake control and monitoring processes and a regular meeting of a committee comprising senior management from Global Markets, Credit, Market Risk Management and Finance is responsible for reviewing and actively managing wrong-way risk, including allocating capital.

Securities held for trading

(Unaudited)

Total securities held for trading within trading assets were US$259 billion at 31 December 2009 (2008: US$254 billion). The largest concentration of these assets was government and government agency securities, which amounted to US$135 billion, or 52 per cent of overall trading securities (2008: US$143 billion, 56 per cent). This included US$22 billion (2008:

US$32 billion) of treasury and other eligible bills. Corporate debt and other securities were US$84 billion or 32 per cent of overall trading securities, in line with 2008 s level of US$83 billion. Included within total securities held for trading were US$41 billion (2008: US$50 billion) of debt securities issued by banks and other financial institutions.

A more detailed analysis of securities held for trading is set out in Note 16 on the Financial Statements and an analysis of credit quality is provided on page 225.

Debt securities, treasury and other eligible bills

(Unaudited)

At US$360 billion, total financial investments excluding equity securities were 23 per cent higher at 31 December 2009 than at the end of 2008. Debt securities, at US$302 billion, represented the largest concentration of financial investments at 84 per cent of the total, compared with US$252 billion (86 per cent) at 31 December 2008. HSBC s holdings of corporate debt, ABSs and other securities were spread across a wide range of issuers and geographical regions, with 37 per cent invested in securities issued by banks and other financial institutions. In total, holdings in ABSs decreased by US$8 billion due to a combination of movements in fair values, principal amortisations and write-downs.

Total financial investments excluding equity securities increased by 23 per cent to US$360 billion in 2009.

Investments in securities of governments and government agencies of US$171 billion were 46 per cent of overall financial investments, 8 percentage points higher than in 2008. US$58 billion of these investments comprised treasury and other eligible bills.

A more detailed analysis of financial investments is set out in Note 19 on the Financial Statements and an analysis by credit quality is provided on page 225.

The insurance businesses held diversified portfolios of debt and equity securities designated at fair value (2009: US$25 billion; 2008: US$20 billion) and debt securities classified as financial investments (2009: US$35 billion; 2008: US$28 billion). A more detailed analysis of securities held by the insurance businesses is set out on page 273.

Derivatives

(Unaudited)

Derivative assets at 31 December 2009 were US$251 billion, a decline of 49 per cent from 31 December 2008, primarily in foreign exchange, interest rate and credit derivatives. The main drivers of the reduction were fair value movements across the entire portfolio arising from lower levels of volatility within the financial markets, steepening yield curves and narrowing credit spreads.

Exposure to derivative assets fell by 49 per cent in 2009 to US$251 billion.

Loans and advances

(Unaudited)

At constant exchange rates, gross loans and advances to customers (excluding the financial sector) at 31 December 2009 declined by US$83 billion or 9 per cent from 31 December 2008.

Personal lending represented 47 per cent of total gross loans and advances to customers. Residential mortgages of US$261 billion represented 28 per cent of total gross advances to customers and constituted the Group s largest concentration in a single exposure type. As a result of continued run-off in the US consumer finance exit portfolios, personal lending within North America fell to be broadly in line with European exposure.

Corporate, commercial and financial lending, including settlement accounts, amounted to 52 per cent of total gross loans and advances to customers at 31 December 2009. The largest industry concentrations were to non-bank financial institutions and commercial real estate lending at 10 per cent and 8 per cent, respectively, of total gross lending to customers.

Exposure to non-bank financial institutions principally comprised secured lending on trading accounts, primarily through repo facilities.

Commercial, industrial and international trade lending declined moderately in 2009, falling as a proportion of total lending by a single percentage point to 21 per cent of total gross loans and advances to customers. Within this category, the largest concentration of lending was to the service sector, which amounted to 6 per cent of total gross lending to customers.

Loans and advances to banks were widely distributed across major institutions in 2009.

Further discussion of significant movements in credit quality of the personal lending and wholesale

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Credit exposure > Concentration of exposure

lending portfolios is set out in Areas of Special Interest on pages 214 to 218.
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.

Gross loans and advances by industry sector
(Unaudited)

	At 31 December 2008 US$m	**Constant currency effect US$m**	**Movement on a constant currency basis US$m**	**At 31 December 2009 US$m**
Gross loans and advances to customers				
Personal[2]	440,227	**22,169**	**(28,190)**	**434,206**
Residential mortgages[2,3]	243,337	**13,567**	**3,765**	**260,669**
Other personal[2,4]	196,890	**8,602**	**(31,955)**	**173,537**
Corporate and commercial	407,474	**30,384**	**(54,768)**	**383,090**
Commercial, industrial and international trade	209,840	**16,125**	**(29,837)**	**196,128**
Commercial real estate	70,969	**4,668**	**(6,248)**	**69,389**
Other property-related	30,739	**1,783**	**(2,002)**	**30,520**
Government	6,544	**185**	**(40)**	**6,689**
Other commercial[5]	89,382	**7,623**	**(16,641)**	**80,364**
Financial	101,085	**5,419**	**(9,854)**	**96,650**
Non-bank financial institutions	99,536	**5,248**	**(9,547)**	**95,237**
Settlement accounts	1,549	**171**	**(307)**	**1,413**
	7,991		**(164)**	**7,827**

Asset-backed securities reclassified				
Total gross loans and advances to customers[6]	956,777	**57,972**	**(92,976)**	**921,773**
Gross loans and advances to banks	153,829	**7,413**	**18,646**	**179,888**
Total gross loans and advances	1,110,606	**65,385**	**(74,330)**	**1,101,661**

For footnotes, see page 291.

Gross loans and advances to customers by industry sector
(Audited)

	2009 US$m	2008 US$m	2007 US$m	2006 US$m	2005 US$m
Personal[2]	**434,206**	440,227	500,834	476,146	420,476
Residential mortgages[2,3]	**260,669**	243,337	269,068	265,337	238,546
Other personal[2,4]	**173,537**	196,890	231,766	210,809	181,930
Corporate and commercial	**383,090**	407,474	400,771	343,107	278,709
Commercial, industrial and international trade	**196,128**	209,840	202,038	162,109	130,802
Commercial real estate	**69,389**	70,969	72,345	60,366	51,815
Other property-related	**30,520**	30,739	33,907	27,165	22,196
Government	**6,689**	6,544	5,708	8,990	8,218
Other commercial[5]	**80,364**	89,382	86,773	84,477	65,678
Financial	**96,650**	101,085	99,148	62,458	52,174
Non-bank financial institutions	**95,237**	99,536	96,781	59,204	50,032
Settlement accounts	**1,413**	1,549	2,367	3,254	2,142
Asset-backed securities reclassified	**7,827**	7,991			
Total gross loans and advances to customers[6]	**921,773**	956,777	1,000,753	881,711	751,359
Impaired loans	**30,606**	25,352	19,582	15,071	12,338

as a percentage of gross loans and advances to customers	**3.3%**	2.6%	2.0%	1.7%	1.6%
Total impairment allowances	**25,542**	23,909	19,205	13,578	11,357
as a percentage of total gross loans and advances	**2.8%**	2.5%	1.9%	1.5%	1.5%

For footnotes, see page 291.

Loans and advances to customers by industry sector and by geographical region (Audited)

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[7] US$m	Middle East[7] US$m	North America US$m	Latin America US$m	Gross loans and advances to customers US$m	Gross loans by industry sector as a % of total gross loans %
At 31 December 2009								
Personal[2]	**162,562**	**47,946**	**32,514**	**6,405**	**163,934**	**20,845**	**434,206**	**47.2**
Residential mortgages[2,3]	**109,872**	**35,292**	**21,983**	**1,898**	**86,591**	**5,033**	**260,669**	**28.3**
Other personal[2,4]	**52,690**	**12,654**	**10,531**	**4,507**	**77,343**	**15,812**	**173,537**	**18.9**
Corporate and commercial	**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	**6,284**				**1,543**		**7,827**	**0.8**

reclassified								
Total gross loans and advances to customers (TGLAC[6,8])	**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[8]	**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[8]	**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%**	
	US$m	US$m	US$m	US$m	US$m	US$m	US$m	
At 31 December 2008								
Personal	141,532	46,087	29,887	7,524	195,534	19,663	440,227	46.0
Residential mortgages[3]	87,267	33,014	18,244	1,941	98,383	4,488	243,337	25.4
Other personal[4]	54,265	13,073	11,643	5,583	97,151	15,175	196,890	20.6
Corporate and commercial	219,640	52,186	47,394	18,732	47,291	22,231	407,474	42.5
Commercial, industrial and international trade	121,047	20,186	29,294	10,853	15,178	13,282	209,840	21.9
Commercial real estate	32,704	14,233	6,713	1,431	13,504	2,384	70,969	7.4
Other property-related	7,666	10,296	3,541	1,587	7,234	415	30,739	3.2
Government	1,864	951	579	1,181	352	1,617	6,544	0.7
Other commercial[5]	56,359	6,520	7,267	3,680	11,023	4,533	89,382	9.3
Financial	62,620	2,680	4,193	1,453	27,746	2,393	101,085	10.6
Non-bank financial institutions	61,823	2,402	3,940	1,447	27,560	2,364	99,536	10.4

Settlement accounts	797	278	253	6	186	29	1,549	0.2
Asset-backed securities reclassified	6,258				1,733		7,991	0.9
TGLAC[6]	430,050	100,953	81,474	27,709	272,304	44,287	956,777	100.0
Percentage of TGLAC by geographical region	44.9%	10.6%	8.5%	2.9%	28.5%	4.6%	100.0%	
Impaired loans	6,774	852	835	279	14,285	2,327	25,352	
as a percentage of TGLAC	1.6%	0.8%	1.0%	1.0%	5.2%	5.3%	2.6%	
Total impairment allowances	3,859	733	813	414	16,090	2,000	23,909	
as a percentage of TGLAC	0.9%	0.7%	1.0%	1.5%	5.9%	4.5%	2.5%	

For footnotes, see page 291.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Credit exposure > Concentration of exposure

Gross loans and advances to customers by country within Rest of Asia-Pacific, Middle East and Latin America (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 2009					
Rest of Asia-Pacific[7]					
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**
Other	**1,138**	**1,967**	**1,020**	**7,907**	**12,032**
	21,983	**10,531**	**10,338**	**38,187**	**81,039**
Middle East[7] (excluding Saudi Arabia)					
Egypt	**4**	**326**	**126**	**2,132**	**2,588**
United Arab Emirates	**1,650**	**2,881**	**1,395**	**8,848**	**14,774**
Other	**244**	**1,300**	**1,145**	**4,171**	**6,860**
	1,898	**4,507**	**2,666**	**15,151**	**24,222**
Latin America					
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**
	5,033	**15,812**	**2,998**	**26,339**	**50,182**

At 31 December 2008					
Rest of Asia-Pacific[7]					
Australia	3,598	783	1,621	3,350	9,352
India	1,112	1,482	493	3,332	6,419
Indonesia	27	527	26	1,410	1,990
Japan	57	160	808	4,818	5,843
Mainland China	1,303	12	2,784	7,423	11,522
Malaysia	2,699	1,624	941	4,263	9,527
Singapore	4,209	3,301	2,448	3,521	13,479
South Korea	2,153	682	34	2,497	5,366
Taiwan	2,217	705	14	1,497	4,433
Other	869	2,367	1,085	9,222	13,543
	18,244	11,643	10,254	41,333	81,474
Middle East[7] (excluding Saudi Arabia)					
Egypt		275	125	2,106	2,506
United Arab Emirates	1,693	3,748	2,118	10,214	17,773
Other	248	1,560	775	4,847	7,430
	1,941	5,583	3,018	17,167	27,709
Latin America					
Argentina	41	707	60	1,648	2,456
Brazil	376	8,585	694	9,578	19,233
Mexico	2,150	3,665	1,024	6,094	12,933
Panama	1,105	1,076	569	1,877	4,627
Other	816	1,142	452	2,628	5,038
	4,488	15,175	2,799	21,825	44,287

For footnote, see page 291.

Loans and advances to banks by geographical region
(Audited)

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[7] US$m	Middle East[7] US$m	North America US$m	Latin America US$m	Gross loans and advances to banks US$m	Impairment allowances US$m
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)
At 31 December 2005	44,369	42,751	14,514	5,045	10,331	8,964	125,974	(9)

For footnote, see page 291.

Country distribution of outstandings and cross-border exposures
(Unaudited)

HSBC controls the risk associated with cross-border lending, essentially that foreign currency will not be made available to local residents to make payments, through a centralised structure of internal country limits which are determined by taking into account relevant economic and political factors. Exposures to individual countries and cross-border exposure in 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 1 per cent of HSBC s 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, CDs and debt and equity securities (net of short positions), and exclude accrued interest and intra-HSBC exposures.

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 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**
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
At 31 December 2007				
UK	32.3	2.2	47.5	82.0
US	14.0	11.4	29.5	54.9
France	38.8	1.7	1.9	42.4
Germany	30.3	5.9	5.6	41.8
The Netherlands	21.4	0.2	4.2	25.8

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

At 31 December 2009, HSBC had in-country foreign currency and cross-border amounts outstanding to counterparties in The Netherlands of between 0.75 per cent and 1 per cent of total assets; in aggregate, US$19.6 billion.

At 31 December 2008, HSBC had in-country foreign currency and cross-border amounts outstanding to counterparties in Japan of between 0.75 per cent and 1.0 per cent of total assets; in aggregate, US$24.4 billion.

At 31 December 2007, HSBC had in-country foreign currency and cross-border amounts outstanding to counterparties in Hong Kong, Belgium and Ireland of between 0.75 per cent and 1.0 per cent of total assets. The aggregate in-country foreign currency and cross-border amounts outstanding were Hong Kong, US$19.7 billion, Belgium, US$19.3 billion and Ireland, US$19.3 billion.

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 major corporate entities. The Group s wholesale portfolios are well diversified across geographical and industry sectors, with exposure subject to portfolio controls governing concentration risk. Overall credit quality showed some signs of deterioration during 2009, as companies were affected by the global economic downturn, although in the second half credit conditions eased on the back of successful refinancing activity earlier in the year.

The widespread intervention by many governments to stabilise and, in some cases to recapitalise, banks and other financial intermediaries had a positive effect in reducing fears of a systemic threat to financial markets. Notwithstanding this, many wholesale customers and counterparties faced the twin challenges of a reduction in available credit and liquidity, and reduced demand for their products and services; this encouraged them to reduce indebtedness through portfolio disposals, extend the duration of short-term finance and focus increasingly on cost efficiency.

HSBC has worked closely with its customers to identify problem areas early and minimise the likelihood and impact of potentially adverse situations. During 2009, the Group improved the structure of its credit exposures by, for example, adjusting tenor and adding collateral in response to the heightened risks. HSBC also played a positive role in maintaining credit supply, where possible.

Commercial real estate

Commercial real estate and other property-related lending at 31 December 2009 of US$100 billion declined by 8 per cent from 31 December 2008 on a constant currency basis and represented 11 per cent of total loans and advances to customers. In 2009, the sector experienced a deterioration in credit quality, particularly in parts of Europe, including the UK, and in the Middle East and North America, due to a decline in asset values, a rise in rent shortfalls from vacant properties or non-payment, a contraction in demand for new housing, a prospective fall in rental cash flows and significantly restricted refinancing options. As a result of these factors, portfolio impairment occurred in a limited number of cases. The Group s long-standing policies on asset origination which focus on relationships with long-term customers and appropriate initial leverage and interest coverage ratios played a key role in minimising impairment. While individual regions differ in their approach, the Group s origination loan-to-value ratios are typically less than 65 per cent.

Automotive sector

The global automotive industry has seen a significant deterioration in market conditions and prospects over a prolonged period, as new entrants and legacy cost issues, primarily in the US and Europe, have taken effect. Declining sales volumes, exacerbated by the current economic downturn, have increased the incidence of financial stress on equipment manufacturers, suppliers and dealers. In the second half of 2009, the industry saw some consolidation and, although there were tentative signs of an increase in sales, these should be viewed in the light of the various government scrappage schemes for older vehicles in the US and Europe.

HSBC has adopted a cautious approach towards this industry for a number of years, prioritising commitments to stronger global manufacturers and limiting exposure to those firms considered most likely to be affected by an industry downturn. As a result, HSBC did not have any significant direct exposure to the major US vehicle manufacturers which entered Chapter 11 bankruptcy restructuring during 2009. HSBC had some exposure to North American vehicle dealers and suppliers, but this was minimal in the context of the Group. Exposure to the industry is controlled by a global appetite cap that is reviewed regularly at the Group Risk Management Meeting.

Dubai and the UAE

In November 2009, Dubai World, a Dubai government-owned firm, requested a creditor standstill on its debt repayments and those of some of its subsidiaries. The announcement prompted a significant sell-off in markets across the world. Abu Dhabi announced that it would offer additional assistance to Dubai, providing liquidity and a platform for the debt restructuring process to continue.

HSBC, as the longest-established bank in the region, has a longstanding relationship with the government of Dubai and its related entities. HSBC has contributed from the earliest days to the development of Dubai as an emerging economy and continues to maintain supportive relationships with all parts of the UAE. HSBC will continue to offer its support to the government of Dubai in achieving a workable resolution of its current liquidity problems.

HSBC s exposure within Dubai is acceptably spread and is primarily to operating companies within the emirate. HSBC is playing a prominent role in restructuring indebtedness in order to help restore confidence in the region.

In the UAE, gross customer loans and advances fell from US$18 billion at 31 December 2008 to US$15 billion at 31 December 2009. Although the Middle East represents 2 per cent of the Group s balance sheet, it remains a region to which HSBC is strongly committed.

Sovereign counterparties

The overall quality of the Group s sovereign risk exposure remained satisfactory during 2009, with the large majority of both in-country and cross-border limits extended to countries with strong internal credit risk ratings. There was no significant downward shift in the quality of the exposure although, given the higher debt and weaker fiscal positions of many Western governments, there is increased potential for deterioration in sovereign risk profiles before budgetary re-balancing is achieved. In order to manage this, the Group regularly updates its assessments of higher-risk countries and adjusts its risk appetite to reflect such changes.

Leveraged financing

The Group operates a controlled approach towards leveraged finance origination with caps on underwriting and final hold levels in place. This puts a premium on successfully distributing risk in order to create capacity under the caps. Group exposure to leveraged finance transactions remained modest in relation to overall exposure.

Personal lending

(Unaudited)

HSBC provides a broad range of secured and unsecured personal lending products to meet customer needs. Given the diverse nature of the markets in which HSBC operates, the range is not standardised across all countries but is tailored to meet the demands of individual markets while using appropriate distribution channels and, wherever possible, standard global IT platforms.

Personal lending includes advances to customers for asset purchase, such as residential property and motor vehicles, where the loans are typically secured on the assets being acquired. HSBC also offers 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 2009, credit exposure in the personal lending portfolios continued to be affected by adverse global economic conditions, particularly increased unemployment levels and the restricted availability of refinancing which limited the ability of many customers to service financial obligations in line with contractual commitments. This led to delinquency levels and loan impairment charges remaining high, although management action in recent years to run off the US consumer finance exit portfolios and curtail originator activity helped reduce the overall impairment charge.

The commentary that follows is on an underlying basis.

At 31 December 2009, total personal lending was US$434 billion, a decline of 6 per cent from 31 December 2008, driven by run-off in the US consumer finance exit portfolios. Within Personal Financial Services total loan impairment charges and other credit risk provisions of US$19.9 billion were 3 per cent lower than in 2008 and were concentrated in North America (US$14.4 billion) and, to a lesser extent, Europe (US$2.0 billion) and Latin America (US$2.0 billion).

In early March 2009, HSBC Finance announced the discontinuation of new customer account originations for all products offered by its Consumer Lending business and closed approximately 800 Consumer Lending branch offices. In November 2009, it entered into an agreement to sell its vehicle loan servicing operations to Santander Consumer USA Inc. (SC USA) as well as an aggregate US$1.0 billion of vehicle finance loans, both delinquent and non-delinquent. Under a separate agreement, SC USA will service the remainder of

HSBC s US vehicle finance portfolio. The transaction is currently expected to close in the first quarter of 2010.

The Consumer Lending business historically provided real estate secured, vehicle finance and personal non-credit card loans. Loans were offered with both revolving and closed-end terms and with fixed or variable interest rates, and were originated through branches, direct mail and the internet. Prior to the first quarter of 2007, HSBC Finance s Mortgage Services business acquired loans from correspondent lenders and, before September 2007, also originated loans sourced through mortgage brokers. The vehicle finance business originated vehicle loans through its dealer and direct-to-consumer origination channels and through its autos-in-branches programme in the Consumer Lending branch offices, until these originations were discontinued.

In December 2009, HSBC Finance revised the write-off period for its real estate secured and Consumer Lending unsecured portfolios in order to reflect changed customer behaviour. As a consequence of this, real estate secured 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. Similarly, for Consumer Lending unsecured products, balances are now written off no later than the end of the month in which the account becomes 180 days delinquent. This change in write-off period was reflected in lower recoverable balances and lower impairment reserves at 31 December 2009.

Total US personal lending at 31 December 2009 stood at US$135 billion, a decline of 21 per cent compared with the end of 2008, as HSBC ran off certain portfolios in the consumer finance business and improved the credit quality of the Card and Retail Services portfolio through tightening underwriting criteria.

Residential mortgage lending balances in the US declined by 19 per cent to US$66 billion, driven by the decision to close all Consumer Lending branches and run off the legacy consumer finance portfolios. The decrease in balances included a US$2.0 billion reduction relating to the revised write-off period referred to above and the sale of US$4.5 billion of prime mortgage loans in HSBC Bank USA. US mortgage lending is discussed in greater detail on page 218.

Total personal lending fell by 6 per cent in 2009. In the US, personal lending was reduced by 21 per cent.

Other personal lending in the US fell by 23 per cent to US$69 billion, partly due to the run-off in the unsecured Consumer Lending portfolio. Credit card balances also declined, by 16 per cent to US$39 billion, due to lower consumer spending and steps taken by the Group to mitigate risk, including tightening initial credit lines and sales authorisation criteria, closing inactive accounts, decreasing credit lines, restricting underwriting criteria, limiting cash access, reducing marketing expenditure and, in the private label portfolio, ending certain third-party relationships. HSBC ceased originations in those segments of the cards portfolio most affected by the current housing and economic downturn. The decline in balances included US$1.3 billion relating to the revised write-off period for second lien mortgages and other unsecured personal lending.

The Cards business remains a continuing business in the US for HSBC, comprising both general and private label portfolios. The general Cards portfolio has approximately US$23 billion in loans. According to The Nilson Report, HSBC is the sixth largest issuer of MasterCard and Visa credit cards in the US, based on loan balances.

The Private Label Credit Card (PLCC) business, with balances of US$15.6 billion, has approximately 14 million active customer accounts and 32 active merchant relationships. The Nilson Report lists HSBC s private label servicing portfolio as the third largest portfolio in the US. At 31 December 2009, PLCC loans were sourced from the following business lines: approximately 45 per cent in consumer electronics, 24 per cent in power sport vehicles, 16 per cent in department stores, and 7 per cent of loans in furniture stores. The private label financing products are generated through merchant retail locations, merchant catalogue and telephone sales, and direct mail and internet applications.

Motor vehicle finance balances in the US declined by 47 per cent to US$5.8 billion, reflecting the 2008 decision to run off the portfolio in HSBC Finance. As noted above, in November 2009, HSBC agreed to sell the vehicle finance loan servicing operation and US$1.0 billion of associated loans.

Table of Contents

Total personal lending
(Unaudited)

	UK US$m	Rest of Europe US$m	US[9] US$m	Rest of North America US$m	Other regions[10] US$m	Total US$m
At 31 December 2009						
Residential mortgages[2]	**100,667**	**9,205**	**65,784**	**20,807**	**64,206**	**260,669**
Other personal lending[2]	**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[2]	**129,685**	**32,877**	**135,059**	**28,875**	**107,710**	**434,206**
Impairment allowances						
Residential mortgages[2]	**(151)**	**(41)**	**(4,416)**	**(7)**	**(233)**	**(4,848)**
Other personal lending[2]	**(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[2]	**(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%**
At 31 December 2008						
Residential mortgages	78,346	8,921	80,946	17,437	57,687	243,337

Other personal lending	29,274	24,991	89,562	7,589	45,474	196,890
motor vehicle finance		99	10,864	137	6,201	17,301
credit cards	11,215	1,695	46,972	1,469	13,426	74,777
second lien mortgages	1,160	2	14,614	803	503	17,082
other	16,899	23,195	17,112	5,180	25,344	87,730
Total personal lending	107,620	33,912	170,508	25,026	103,161	440,227
Impairment allowances						
Residential mortgages	(10)	(22)	(5,109)	(4)	(174)	(5,319)
Other personal lending	(1,197)	(441)	(9,911)	(192)	(1,909)	(13,650)
motor vehicle finance		(5)	(426)	(1)	(175)	(607)
credit cards	(385)	(165)	(4,255)	(51)	(805)	(5,661)
second lien mortgages	(50)		(2,397)	(41)		(2,488)
other	(762)	(271)	(2,833)	(99)	(929)	(4,894)
Total impairment allowances on personal lending	(1,207)	(463)	(15,020)	(196)	(2,083)	(18,969)
as a percentage of total personal lending	1.1%	1.4%	8.8%	0.8%	2.0%	4.3%

For footnotes, see page 291.

Total personal lending in the UK increased by 8 per cent to US$130 billion, driven by growth in residential mortgage lending at HSBC Bank and First Direct as HSBC grew market share in UK mortgage lending (discussed in greater detail below). Other personal lending in the UK declined by 11 per cent to US$29 billion, primarily due to reduced customer demand for credit.

In Latin America, gross loans and advances to personal customers declined by 9 per cent to US$21 billion. Residential mortgage lending increased by 6 per cent, while other personal lending fell by 13 per cent. The reduction in other personal lending was largely in Mexico, where balances decreased by 30 per cent to US$2.7 billion following management action to mitigate risk and restrict originations in the credit cards portfolio to address the adverse credit experience which developed in 2008. Similarly, in Brazil, personal lending declined by 6 per cent to US$11 billion at 31 December 2009 as steps were taken to improve credit quality by tightening underwriting criteria.

For an analysis of loan impairment allowances and impaired loans, see page 230.

Mortgage lending

The Group offers 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. HSBC underwrites 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. Introductory interest-only mortgages are typically where 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 a low initial rate, either variable or fixed, before resetting to a higher rate once the introductory period is over. These include adjustable-rate mortgages (ARM s) and loans on which the interest rate is periodically changed based on a reference price.

Offset mortgages are products linked to a current or savings account, where interest earned is used to repay mortgage debt.

US mortgage lending

US mortgage lending, comprising residential mortgage and second lien lending, made up 18 per cent of the Group s gross loans and advances to personal customers at 31 December 2009.

Balances declined by 19 per cent compared with 2008 to US$78 billion, including a reduction of US$2.3 billion attributed to the revision of the write-off period referred to above. The decrease was driven by the continued run-off of the Mortgage Services portfolio and actions taken since mid-2007 to reduce risk and discontinue, from the first quarter of 2009, new originations in the Consumer Lending business. In addition, HSBC Bank USA sold US$4.5 billion of prime mortgage loans in 2009 on top of normal sale activity. The overall rate of decline in real-estate secured balances continued to slow due to a reduction in loan prepayments, as the continuing weakness in the US economy limited the number of refinancing options available to customers.

Including the US$2.3 billion decline in balances due to the acceleration of write-offs, mortgage lending in HSBC Finance fell from US$74 billion at 31 December 2008 to US$61 billion at 31 December 2009 as set out in the table on page 221. Balances outstanding in the Consumer Lending business were US$40 billion at 31 December 2009, of which approximately 95 per cent were fixed rate loans and 88 per cent were first lien. The Mortgage Services business had US$22 billion in outstanding balances at 31 December 2009, of which approximately 62 per cent were fixed rate loans and 86 per cent were first lien.

Mortgage lending in the US fell by 19 per cent to US$78 billion and rose in the UK by 15 per cent to US$102 billion.

As a consequence of the turmoil in mortgage lending markets in the US, there was a significant amount of federal and state legislative and regulatory focus on this activity in 2009. Increased regulatory oversight over residential mortgage lenders occurred at both state and federal level. Several regulators, legislators and other governmental bodies promoted particular views of appropriate or model loan modification programmes, loan products, and foreclosure and loss-mitigation practices. HSBC Finance has developed a modification programme that employs procedures which are believed to be responsive to customers needs, and continues to enhance and refine these practices as other programmes are announced and the results of customer assistance efforts are evaluated. It continues to be active in various initiatives to help people keep their homes, and participates in local events sponsored by industry participants, regulators and consumer advocates.

The mortgage portfolios in both Consumer Lending and Mortgage Services are now expected to remain on the balance sheet for a longer period than was assumed when they were originated. Reduced mortgage prepayment rates and higher levels of loan modifications have had the effect of extending the projected average life of these loan portfolios. As a result, both net interest income and asset valuations have increasingly become exposed to rising interest rates as the average life of funding has declined while the average life of mortgage asset portfolios has grown.

In HSBC Bank USA, mortgage lending declined from US$22 billion at 31 December 2008 to US$16 billion at 31 December 2009 following initiatives taken to reduce risk. This included the ongoing sale of the majority of new residential loan originations to government-sponsored enterprises and private investors and, in 2009, additional sales of US$4.5 billion of prime adjustable and fixed rate residential mortgage loans. At the end of 2009, approximately 32 per cent of the HSBC Bank USA mortgage portfolio were fixed rate loans and 75 per cent were first lien.

Further 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 221.

UK mortgage lending

Total mortgage lending in the UK increased by 15 per cent on a constant currency basis to US$102 billion at 31 December 2009, with HSBC increasing its market share of UK mortgage lending through the success of the RateMatcher promotion and other campaigns within the UK secured lending growth strategy.

HSBC was able both to grow market share and maintain high credit quality despite adverse UK market conditions because of the consistent application of conservative underwriting standards and constraints on some competitors in growing their lending exposure. Almost all new business originations are made through HSBC s own salesforce and mainly to existing customers holding a current or savings account relationship with the Group. HSBC does not accept self-certification of income and restricts lending to purchase residential property for rental.

UK mortgage impairments and delinquency balances deteriorated slightly but remained at relatively low levels despite higher unemployment. House prices recovered, and the portfolio remained well secured, reflecting the continuing benefit from management decisions taken in 2007 and 2008 to reduce market share when property prices were rising to unsustainably high levels. In the HSBC Bank Mortgage Portfolio, excluding First Direct, the percentage of loans that were 30 days or more delinquent declined from 1.8 per cent at 31 December 2008 to 1.6 per cent in 2009. The average loan-to-value ratio for new business in this portfolio in 2009 was 54.6 per cent, a decrease of 4.2 percentage points on the previous year.

Interest-only mortgage balances increased by 21 per cent to US$45 billion compared with 2008, driven by an increase in balances at First Direct following marketing initiatives, and competitive pricing. The majority of these mortgages were offset mortgages linked to a current account for which delinquency rates remained at very low levels.

Second lien balances, which were all held by HFC Bank Ltd (HFC) in the UK, declined by 17 per cent to US$1.1 billion at 31 December 2009 as the portfolio was placed in run-off during the year. Within this portfolio, two months or more delinquency rates increased from 6 per cent at 31 December 2008 to 6.6 per cent at 31 December 2009, despite a decline in delinquencies in dollar terms as balances declined at a faster pace.

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.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Areas of special interest > Personal lending / Mortgage lending // US personal lending credit quality

Mortgage lending products
(Unaudited)

	UK US$m	Rest of Europe US$m	US[9] US$m	Rest of North America US$m	Other regions[10] US$m	Total US$m
At 31 December 2009						
Residential mortgages[11]	**100,667**	**9,205**	**65,784**	**20,807**	**64,206**	**260,669**
Second lien mortgages[11]	**1,068**	**2**	**11,786**	**695**	**472**	**14,023**
Total mortgage lending[11]	**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[11]	**(151)**	**(41)**	**(4,416)**	**(7)**	**(233)**	**(4,848)**
Second lien mortgages[11]	**(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[12]	**6,412**		**20,229**	**163**	**488**	**27,292**
Other loan-to-value ratios greater than 90 per cent[13]	**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%**

At 31 December 2008						
Residential mortgages	78,346	8,921	80,946	17,437	57,687	243,337
Second lien mortgages	1,160	2	14,614	803	503	17,082
Total mortgage lending	79,506	8,923	95,560	18,240	58,190	260,419
Second lien as a percentage of total mortgage lending	1.5%		15.3%	4.4%	0.9%	6.6%
Impairment allowances						
Residential mortgages	(10)	(22)	(5,109)	(4)	(174)	(5,319)
Second lien mortgages	(50)		(2,397)	(41)		(2,488)
Total impairment allowances on mortgage lending	(60)	(22)	(7,506)	(45)	(174)	(7,807)
Interest-only (including endowment) mortgages	33,782	553		1,427	993	36,755
Affordability mortgages, including ARMs	4,740	824	28,571	311	4,166	38,612
Other	153				82	235
Total interest-only and affordability mortgages	38,675	1,377	28,571	1,738	5,241	75,602
as a percentage of total mortgage lending	48.6%	15.4%	29.9%	9.5%	9.0%	29.0%
Negative equity mortgages[12]	3,268		21,904	86	1,635	26,893
Other loan-to-value ratios greater than 90 per cent[13]	8,978	107	19,009	1,737	2,122	31,953
Total negative equity and other mortgages	12,246	107	40,913	1,823	3,757	58,846
as a percentage of total mortgage lending	15.4%	1.2%	42.8%	10.0%	6.5%	22.6%

For footnotes, see page 291.

HSBC Finance held approximately US$61 billion of residential mortgage and second lien loans and advances to personal customers secured on real estate at 31 December 2009, 14 per cent of the Group s gross loans and advances to personal customers. A breakdown of these balances by portfolio was as follows:

220

Table of Contents

HSBC Finance US mortgage lending[14]
(Unaudited)

	At 31 December 2009				At 31 December 2008			
	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[15]	**13,596**	**37,639**	**98**	**51,333**	16,288	43,873	91	60,252
Other[15]	**8,168**	**1,867**	**6**	**10,041**	11,339	2,324	35	13,698
Adjustable-rate	**7,070**	**1,867**		**8,937**	9,530	2,324	33	11,887
Interest-only	**1,098**		**6**	**1,104**	1,809		2	1,811
	21,764	**39,506**	**104**	**61,374**	27,627	46,197	126	73,950
First lien[15]	**18,710**	**34,913**	**77**	**53,700**	23,188	40,334	93	63,615
Second lien[15]	**3,054**	**4,593**	**27**	**7,674**	4,439	5,863	33	10,335
	21,764	**39,506**	**104**	**61,374**	27,627	46,197	126	73,950
Stated income[16]	**3,905**			**3,905**	5,667			5,667
Impairment allowances	**2,419**	**3,167**	**1**	**5,587**	3,819	3,403	1	7,223
as a percentage of total mortgage lending	**11.1%**	**8.0%**	**1.0%**	**9.1%**	13.8%	7.4%	0.8%	9.8%

For footnotes, see page 291.

US personal lending credit quality

(Unaudited)

During 2009, challenging economic conditions in the US continued, marked by further declines in the housing market, rising unemployment, tight credit conditions and reduced economic growth. Although the economic recession continued to deepen into the first half of 2009, signs of stabilisation and improvement began to appear in the second half of the year. While the ongoing financial market disruption continued to affect credit and liquidity throughout the year, an improvement in conditions which began in the second quarter and continued through the rest of the year, strengthened liquidity and narrowed credit spreads. The recovery in market confidence stemmed largely from various government actions taken to restore faith in the capital markets and stimulate consumer spending, and success in these initiatives is bolstering
consumer and business sentiment. The pace of job losses eased in the second half of 2009, and this helped the housing market, though the first-time homebuyer tax credit and the low interest rates were the main forces driving up home sales and shrinking inventories of unsold properties. This resulted in some house price stabilisation in the latter half of

2009, particularly in the middle and lower price sector.

US unemployment rates, which have been a major factor in the deterioration of credit quality in the country, were 10 per cent in December 2009, an increase of 260 basis points since December 2008. Unemployment rates in 16 states were greater than the US national average and unemployment rates in 10 states were at or above 11 per cent, including California and Florida, with more than 5 per cent of HSBC Finance s total loan balances.

HSBC Finance: geographical concentration of US lending[14,17]
(Unaudited)

	Mortgage lending as a percentage of:		Other personal lending as a percentage of:		
	total lending %	total mortgage lending %	total lending %	total other personal lending %	percentage of total lending %
California	6	11	5	11	11
New York	3	7	3	7	7
Florida	3	7	3	6	6
Texas	2	4	4	8	6
Pennsylvania	3	6	2	5	5
Ohio	3	5	2	5	5

For footnotes, see page 291.

Credit risk > Areas of special interest > US personal lending credit quality

Mortgage lending

In line with its exit strategy for non-prime real estate secured mortgage lending, HSBC continued to reduce mortgage lending exposure in the US and balances declined from US$96 billion to US$78 billion as the portfolios ran off.

Although delinquency increased during 2009, credit quality deteriorated at a slower rate than in previous years as the effect of higher unemployment was not as severe as expected due to actions previously taken by HSBC to reduce risk in the loan portfolio.

Following the revision of the write-off period described on page 205, two months and over delinquent balances in the real estate secured portfolios of HSBC Finance decreased in dollar terms but, excluding the effects of the change, they rose. Delinquent balances also increased in HSBC Bank USA. Increased delinquency reflected portfolio seasoning in an environment of continuing weakness in the housing market and diminished availability of refinancing opportunities. In addition, delays to foreclosure caused by changes in some state government practices and backlogs in court proceedings resulted in balances that would otherwise have proceeded to foreclosure remaining reported as contractually delinquent.

Excluding the effects of revising the write-off period:

- delinquency in the Consumer Lending business increased, primarily in the 2006, 2007 and 2008 vintages of the first lien real estate secured portfolio. Two months or more delinquent balances rose from US$5.6 billion in 2008 to US$7.4 billion at 31 December 2009, and two months or more delinquency rates grew from 12.1 per cent to 18.2 per cent;

- two months or more delinquent balances in the Mortgage Services portfolio declined from US$4.7 billion in 2008 to US$4.5 billion at 31 December 2009 as the portfolio continued to season, and two months or more delinquency rates increased from 17 per cent in 2008 to 19.6 per cent at 31 December 2009 as balances declined at a faster pace than delinquencies.

At HSBC Bank USA, the level of dollar delinquency increased within the first lien prime residential mortgage and Home Equity mortgage loan portfolios, reflecting the weakened US economy, high unemployment and continued deterioration of the US housing market. Delinquency rates also rose, in part due to lower balances as mortgage portfolios were sold to third parties. In 2009, HSBC Bank USA sold US$4.5 billion of mortgage portfolios to third parties and it continued to sell the majority of new mortgage loan originations to government-sponsored enterprises and private investors. Two months or more delinquencies increased from 3.4 per cent to 7.5 per cent at 31 December 2009, as delinquency balances increased from US$0.7 billion to US$1.2 billion, while balances declined.

In HSBC Finance, loss rates on the sale of foreclosed properties were broadly stable throughout 2009 but were higher than those incurred in 2008 as house prices continued to fall. The number of properties foreclosed decreased, in part due to delays in foreclosure proceedings and the lengthening by certain states of the foreclosure process. HSBC 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 further details, see HSBC Finance loan modifications and re-ageing on page 224.

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. HSBC Finance has typically experienced loss on default for second lien loans approaching 100 per cent of the amount owing, as any equity in the property is initially applied to the first lien loan. Excluding the effects of the change to the write-off period, in the

HSBC Finance Mortgage Services second lien portfolio, two months or more delinquency rates decreased to 17.3 per cent at 31 December 2009 as the portfolio continued to run off. In the Consumer Lending second lien portfolio, two months or more delinquency rates increased to 18.6 per cent at 31 December 2009. In HSBC Bank USA, second lien two months or more delinquency rates increased from 3.5 per cent at 31 December 2008 to 4 per cent at 31 December 2009.

Stated-income mortgage balances in HSBC Finance declined from US$5.7 billion to US$3.9 billion as the portfolio continued to run off. The decline included US$0.2 million as a result of the revised write-off period referred to on page 205. These mortgages were underwritten on the basis of borrowers representations of annual income and were not verified by supporting documents and, as a result, represent a higher than average level of risk. Two months or more delinquency rates decreased to 22.7 per cent at 31 December 2009. In HSBC Bank USA, stated-income balances decreased from US$2.2 billion to US$2.1 billion and delinquency

Table of Contents

rates increased from 8.7 per cent at 31 December 2008 to 11.1 per cent at 31 December 2009.

Affordability mortgages are those in which the customer s monthly payments are set at a low initial rate, either fixed or variable, before resetting to a higher rate once the initial introductory period is over. At 31 December 2009, HSBC Finance had US$10 billion of affordability mortgages, compared with US$14 billion at 31 December 2008, as the portfolio continued to run off. Excluding the effects of revising the write-off period, in dollar terms, delinquencies in this portfolio declined during 2009 but, as balances declined at a faster rate, delinquency rates increased. At HSBC Bank USA, affordability mortgage balances of US$11 billion at 31 December 2009 compared with US$15 billion at 31 December 2008.

Credit cards

In the US credit card portfolio, two months or more delinquent balances declined from US$2.0 billion to US$1.8 billion, while in percentage terms they rose from 6.8 per cent at 31 December 2008 to 7.4 per cent at 31 December 2009 as loan balances declined at a faster pace than delinquencies. In the private label cards portfolio, two months and over delinquent balances declined from US$0.7 billion to US$0.6 billion while contractual delinquency increased from 4 per cent at 31 December 2008 to 4.1 per cent at 31 December 2009. The decline of balances in both portfolios was a result of actions taken to tighten underwriting criteria in order to reduce the risk profile of the portfolio, lower customer spending and, in the private label business, terminate certain unprofitable partner relationships. The decrease in delinquency balances in both portfolios also reflected higher levels of personal bankruptcy filings.

Motor vehicle finance

In the vehicle finance portfolio, two months or more delinquencies declined from 5.0 per cent at 31 December 2008 to 4.6 per cent at 31 December 2009, despite the reduction in loan balances, as delinquencies fell at a faster pace.

Other personal lending

In dollar terms, delinquencies in the Consumer Lending unsecured portfolio remained lower, despite the weakened economic conditions, due to a higher number of personal bankruptcy filings which resulted in accounts moving to write-off more quickly, portfolio seasoning as the portfolio ran off, and the actions taken previously to tighten underwriting criteria in order to reduce the risk profile of the portfolio.

US personal lending loan delinquency

The table below sets out the trends in two months and over contractual delinquencies in the US:

Two months and over contractual delinquency
(Unaudited)

			Quarter ended						
	As reported 31 Dec 2009 US$m	**Ex. period change 31 Dec 2009 US$m**	**30 Sep 2009 US$m**	**30 Jun 2009 US$m**	**31 Mar 2009 US$m**	31 Dec 2008 US$m	30 Sep 2008 US$m	30 Jun 2008 US$m	31 Mar 2008 US$m
In Personal Financial Services in the US									
Residential mortgages	**9,551**	**11,519**	**10,834**	**10,070**	**9,892**	9,236	7,061	5,984	5,757
	1,194	**1,628**	**1,631**	**1,676**	**1,772**	1,790	1,616	1,585	1,638

Second lien mortgage lending									
Vehicle finance	**267**	**267**	**295**	**310**	**269**	541	512	445	370
Credit card	**1,798**	**1,798**	**1,834**	**1,864**	**1,992**	2,029	1,871	1,700	1,782
Private label	**622**	**622**	**639**	**636**	**659**	679	606	590	591
Personal non-credit card	**1,548**	**2,619**	**2,680**	**2,709**	**2,855**	3,020	2,763	2,606	2,650
Total	**14,980**	**18,453**	**17,913**	**17,265**	**17,439**	17,295	14,429	12,910	12,788
	%[18]	%[18]	%[18]	%[18]	%[18]	%[18]	%[18]	%[18]	%[18]
Residential mortgages	**14.54**	**17.03**	**15.39**	**13.89**	**12.82**	11.42	8.23	6.65	5.96
Second lien mortgage lending	**10.14**	**13.35**	**12.71**	**12.35**	**12.59**	12.26	10.59	9.83	9.76
Vehicle finance	**4.63**	**4.63**	**4.61**	**3.97**	**2.79**	4.98	4.27	3.48	2.83
Credit card	**7.38**	**7.38**	**7.28**	**7.25**	**7.14**	6.76	6.18	5.57	5.81
Private label	**4.12**	**4.12**	**4.38**	**4.08**	**4.28**	3.99	3.72	3.65	3.66
Personal non-credit card	**12.55**	**19.77**	**18.73**	**18.02**	**18.30**	17.83	15.41	14.00	13.71
Total	**11.09**	**13.34**	**12.47**	**11.49**	**10.92**	10.16	8.13	7.01	6.64

223

	Quarter ended								
	As reported 31 Dec 2009 US$m	**Ex. period change 31 Dec 2009 US$m**	**30 Sep 2009 US$m**	**30 Jun 2009 US$m**	**31 Mar 2009 US$m**	31 Dec 2008 US$m	30 Sep 2008 US$m	30 Jun 2008 US$m	31 Mar 2008 US$m
In Mortgage Services and Consumer Lending									
Mortgage Services:	**3,477**	**4,456**	**4,250**	**4,257**	**4,535**	4,699	4,227	4,260	4,484
first lien	**3,093**	**3,900**	**3,688**	**3,642**	**3,824**	3,912	3,420	3,363	3,456
second lien	**384**	**556**	**562**	**615**	**711**	787	807	897	1,028
Consumer Lending:	**6,022**	**7,445**	**7,131**	**6,514**	**6,203**	5,577	3,866	2,777	2,484
first lien	**5,380**	**6,541**	**6,241**	**5,640**	**5,322**	4,724	3,176	2,194	1,954
second lien	**642**	**904**	**890**	**874**	**881**	853	690	583	530
	%[18]	*%*[18]	*%*[18]	*%*[18]	*%*[18]	*%*[18]	*%*[18]	*%*[18]	*%*[18]
Mortgage Services:									
first lien	**16.53**	**20.00**	**18.09**	**17.13**	**17.24**	16.87	14.16	12.91	12.41
second lien	**12.57**	**17.25**	**16.36**	**16.35**	**17.44**	17.72	16.62	16.63	16.99
total	**15.98**	**19.61**	**17.84**	**17.01**	**17.27**	17.01	14.57	13.55	13.22
Consumer Lending:									
first lien	**15.41**	**18.15**	**16.75**	**14.72**	**13.52**	11.71	7.72	5.15	4.52
second lien	**13.98**	**18.64**	**17.49**	**16.17**	**15.43**	14.54	11.27	9.04	7.96
total	**15.24**	**18.21**	**16.84**	**14.90**	**13.76**	12.07	8.18	5.66	4.98

For footnote, see page 291.

Renegotiated loans

(Audited)

Restructuring activity is designed to manage customer relationships, maximise collection opportunities and, wherever possible, avoid foreclosure or repossession. Such activities include re-ageing, extended payment arrangements, approved external debt management plans, deferred foreclosure, modification, loan rewrites and/or deferral of payments in the event of a change in circumstances. Restructuring is most commonly applied to real estate loans within consumer finance portfolios. Following restructuring, an overdue consumer account is normally reset from delinquent to current status. Restructuring policies and practices are based on indicators or criteria which, in the judgement of local management, indicate that repayment is likely to continue. These policies are kept under continual review and their application varies according to the nature of the market, the product, and the availability of empirical data. Criteria vary between products, but typically include receipt of two or more qualifying payments within a certain period (or, in the case of HSBC Finance, one or more), a minimum lapse of time from origination before restructuring may occur, and restrictions on the number and/or frequency of successive restructurings. Renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment, to reflect their risk profile. When empirical evidence indicates an increased propensity to default on restructured accounts, the use of roll rate methodology ensures this factor is taken into account when calculating impairment allowances. Interest is recorded on renegotiated loans taking into account the new contractual terms following renegotiation.

Renegotiated loans that would otherwise have been past due or impaired totalled US$39 billion at 31 December 2009 (2008: US$35 billion). The largest concentration was in the US and amounted to US$33 billion (2008: US$31 billion) or 86 per cent (2008: 89 per cent) of the Group s total renegotiated loans. The increase was attributable to the deterioration in credit quality highlighted above.

HSBC Finance loan modifications and re-ageing

(Unaudited)

HSBC Finance continued to offer a variety of account management policies and practices. Modification occurs when the terms of a loan are modified, either temporarily or permanently, including changes to the rate and/or the payment. Modification may also lead to a re-ageing of the account. In 2009, HSBC Finance modified over 104,000 loans in Consumer Lending and Mortgage Services through the Foreclosure Avoidance and Account Modification programmes, with an aggregate balance of US$14.6 billion.

The total outstanding balances of real estate secured accounts which have been either re-aged or modified was US$30.2 billion, compared with US$26.2 billion at the end of 2008. Two months and over contractual delinquencies on re-aged or modified loans was 26 per cent, broadly consistent with the end of 2008.

224

Table of Contents

HSBC Finance also supports a variety of initiatives to help preserve home ownership and avoid foreclosure. A quarterly breakdown of foreclosure data is provided below:

HSBC Finance foreclosed properties in the US
(Unaudited)

			Quarter ended			
	2009	2008	**31 Dec 2009**	**30 Sep 2009**	**30 Jun 2009**	**31 Mar 2009**
Number of foreclosed properties at end of period	**6,188**	9,589	**6,188**	**6,428**	**7,286**	**8,866**
Number of properties added to foreclosed inventory in the year/quarter	**14,845**	20,051	**3,496**	**3,546**	**3,550**	**4,253**
Average loss on sale of foreclosed properties (US$000)[19]	**12**	14	**5**	**8**	**13**	**18**
Average total loss on foreclosed properties[20]	**51%**	42%	**50%**	**52%**	**53%**	**52%**
Average time to sell foreclosed properties (days)	**193**	177	**172**	**184**	**194**	**201**

For footnotes, see page 291.

Credit quality of financial instruments

(Audited)

The five credit quality classifications set out and defined below describe the credit quality of HSBC s lending, debt securities portfolios and derivatives. Since 2008, the medium classification has been subdivided into medium-good and medium-satisfactory to provide further granularity. These five classifications 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 granular level, except to the extent each falls within a single quality classification.

Credit quality of HSBC s debt securities and other bills

	External credit rating
Quality classification	
Strong	A and above
Medium-good	BBB+ to BBB
Medium-satisfactory	

	BB+ to B+ and unrated
Sub-standard	B and below
Impaired	Impaired

Credit quality of HSBC s wholesale lending and derivatives

Quality classification	Internal credit rating	Probability of default %	
Strong	CRR1 to CRR2	0	0.169
Medium-good	CRR3	0.170	0.740
Medium-satisfactory	CRR4 to CRR5	0.741	4.914
Sub-standard	CRR6 to CRR8	4.915	99.999
Impaired	CRR9 to CRR10		100

Credit quality of HSBC s retail lending

Quality classification	Internal credit rating[21]	Expected loss %	
Strong	EL1 to EL2	0	0.999
Medium-good	EL3	1.000	4.999
Medium-satisfactory	EL4 to EL5	5.000- 19.999	
Sub-standard	EL6 to EL8	20.000	99.999
Impaired	EL9 to EL10	100+ or defaulted[22]	

For footnotes, see page 291.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Credit quality > Risk ratings / Financial instruments by credit quality

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.

Medium-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.

Medium-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.

Risk rating scales

The Customer Risk Rating (CRR) 10-grade scale above summarises a more granular underlying 22-grade scale of obligor probability of default (PD). All distinct HSBC customers are rated using one of these two PD scales, 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 HSBC s consolidated holdings of ABSs and assets held in consolidated SIVs and conduits is provided on pages 160 to 161 and 182 to 183, respectively.

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 separately classified as past due but not impaired.

The following tables set out the Group s distribution of financial instruments by measures of credit quality:

Table of Contents

Distribution of financial instruments by credit quality
(Audited)

	Neither past due nor impaired				Past due		Impair-	
		Medium		Sub	but not		ment	
	Strong	Good	Satisfactory	standard	impaired	Impaired	allowances[23]	Total
	US$m	US$m	US$m	US$m	US$m	US$m	US$m	US$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 deposit	**17,463**							**17,463**
Trading assets[24]	**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[24]	**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[24]	**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[8,25]	**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**

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Credit quality > Risk ratings / 2009 / Past due but not impaired

Distribution of financial instruments by credit quality (continued)

	Neither past due nor impaired				Past due but not impaired	Impaired	Impairment allowances[23]	Total
	Strong	Good	Medium Satisfactory	Sub standard				
	US$m	US$m	US$m	US$m	US$m	US$m	US$m	US$m
At 31 December 2008								
Cash and balances at central banks	50,070	206	1,831	289				52,396
Items in the course of collection from other banks	4,541	4	1,392		66			6,003
Hong Kong Government certificates of indebtedness	15,358							15,358
Trading assets[24]	303,307	37,349	61,628	3,167				405,451
treasury and other eligible bills	32,314	75	17	52				32,458
debt securities	175,681	5,294	17,547	1,097				199,619
loans and advances to banks	60,400	7,501	5,013	141				73,055
loans and advances to customers	34,912	24,479	39,051	1,877				100,319
Financial assets designated at fair value[24]	5,288	4,141	7,293	818				17,540
treasury and other eligible bills	204		31					235
debt securities	4,129	4,140	7,262	818				16,349
loans and advances to banks	230							230
loans and advances to customers	725	1						726
Derivatives[24]	383,393	79,243	27,105	5,135				494,876
	565,542	231,966	195,822	43,432	48,422	25,422	(23,972)	1,086,634

Loans and advances held at amortised cost								
loans and advances to banks	118,684	23,753	10,013	1,268	41	70	(63)	153,766
loans and advances to customers[25]	446,858	208,213	185,809	42,164	48,381	25,352	(23,909)	932,868
Financial investments	257,435	16,170	16,719	1,382	32	1,246		292,984
treasury and other similar bills	37,932	1,904	1,023	168				41,027
debt securities	219,503	14,266	15,696	1,214	32	1,246		251,957
Other assets	11,959	9,491	17,026	1,747	219	417		40,859
endorsements and acceptances	1,851	4,333	3,460	805	30	3		10,482
accrued income and other	10,108	5,158	13,566	942	189	414		30,377

For footnotes, see page 291.

2009 compared with 2008

Financial instruments on which credit quality has been assessed declined by 8 per cent to US$2,216 billion at 31 December 2009, of which US$1,466 billion was classified as strong , representing 66 per cent (2008: 66 per cent) of the total of such financial instruments. This percentage held constant in 2009 as management actions to mitigate the Group s exposure to credit risk offset the effects on credit quality of the global economic slowdown. The proportion of financial instruments classified as medium-good increased by nearly one percentage point to 16.4 per cent. The proportion of medium-satisfactory declined by one percentage point to 12.5 per cent. The proportion of sub-standard rose marginally.

Factors contributing to the relative improvement in credit quality included the run-off of the consumer finance exit portfolios in the US, while factors contributing to relative deterioration in credit quality included higher delinquency levels in personal and commercial lending.

Derivative assets on which credit quality has been assessed decreased to US$251 billion at the end of 2009 and led to a reduction in balances in each of the credit risk categories. The decline in the overall balance was driven mainly by a reduction in foreign exchange, interest rate and credit derivatives as lower levels of volatility within the financial markets, steepening yield curves and narrowing credit spreads led to a fall in the fair value of outstanding derivative contracts.

Financial investments on which credit quality has been assessed increased by 23 per cent to US$360 billion, with a significant increase in the balance classified as strong . This reflected the investment of surplus funds in government-guaranteed, agency, supranational and government debt securities in line with the bank s risk appetite.

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[7] US$m	Middle East[7] US$m	North America US$m	Latin America US$m	Gross loans and advances past due not impaired US$m
At 31 December 2009	**3,759**	**1,165**	**1,996**	**1,661**	**27,989**	**3,508**	**40,078**
At 31 December 2008	3,800	1,805	1,863	2,457	35,247	3,250	48,422

For footnote, see page 291.

Past due but not impaired loans and advances to customers and banks by industry sector
(Audited)

	At 31 December 2009 US$m	At 31 December 2008 US$m
Banks	**12**	41
Customers	**40,066**	48,381
Personal	**34,306**	39,592
Corporate and commercial	**5,522**	8,603
Financial	**238**	186
	40,078	48,422

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 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**
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**

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Credit quality > Past due but not impaired // Impaired loans and advances / Impairment allowances

	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 2008						
Items in the course of collection from other banks	66					66
Loans and advances held at amortised cost	31,034	10,814	5,493	621	460	48,422
loans and advances to banks	41					41
loans and advances to customers	30,993	10,814	5,493	621	460	48,381
Financial investments debt securities	32					32
Other assets	45	22	118	7	27	219
endorsements and acceptances	21	6	1	2		30
other	24	16	117	5	27	189
	31,177	10,836	5,611	628	487	48,739

Impaired loans and advances
Impaired loans and advances to customers and banks by industry sector (Audited)

	Impaired loans and advances at 31 December 2009			Impaired loans and advances at 31 December 2008		
	Individually assessed US$m	**Collectively assessed US$m**	**Total US$m**	Individually assessed[26] US$m	Collectively assessed[26] US$m	Total US$m
Banks	**239**		**239**	70		70
Customers	**14,767**	**15,839**	**30,606**	7,922	17,430	25,352

Personal[8]	**1,977**	**15,451**	**17,428**	1,538	17,071	18,609
Corporate and commercial	**11,839**	**387**	**12,226**	6,086	357	6,443
Financial	**951**	**1**	**952**	298	2	300
	15,006	**15,839**	**30,845**	7,992	17,430	25,422

For footnote, see page 291.

Collateral and other credit enhancements obtained

(Audited)

HSBC obtained assets by taking possession of collateral held as security, or calling upon other credit enhancements, as follows:

	Carrying amount obtained in:	
	2009	2008
	US$m	US$m
Nature of assets		
Residential property	**1,587**	2,562
Commercial and industrial property	**93**	21
Other	**355**	382
	2,035	2,965

Repossessed properties are made 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. HSBC does not generally occupy repossessed properties for its business use.

Impairment allowances and charges on loans and advances to customers and banks

(Audited)

The tables below analyse by geographical region the impairment allowances recognised for impaired loans and advances that are either individually assessed or collectively assessed, and collective impairment allowances on loans and advances classified as not impaired.

Impairment allowances on loans and advances to customers by geographical region (Audited)

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[7] US$m	Middle East[7] US$m	North America US$m	Latin America US$m	Total US$m
At 31 December 2009							
Gross loans and advances							
Individually assessed impaired loans[27]	**8,800**	**823**	**1,006**	**1,310**	**1,990**	**838**	**14,767**
Collectively assessed[28]	**436,816**	**99,362**	**80,033**	**22,912**	**218,539**	**49,344**	**907,006**
Impaired loans[8,27]	**1,922**	**18**	**194**	**336**	**11,256**	**2,113**	**15,839**
Non-impaired loans[29]	**434,894**	**99,344**	**79,839**	**22,576**	**207,283**	**47,231**	**891,167**
Total gross loans and advances[8]	**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[8]	**2,393**	**314**	**488**	**690**	**13,026**	**2,137**	**19,048**
Total impairment allowances[8]	**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**
	1.4	**0.8**	**1.2**	**5.7**	**6.2**	**5.1**	**2.8**

Total allowances as a percentage of total gross loans and advances

	US$m	US$m	US$m	US$m	US$m	US$m	US$m
At 31 December 2008							
Gross loans and advances							
Individually assessed impaired loans[26,27]	4,817	813	705	160	832	595	7,922
Collectively assessed[28]	425,233	100,140	80,769	27,549	271,472	43,692	948,855
Impaired loans[26,27]	1,957	39	130	119	13,453	1,732	17,430
Non-impaired loans[29]	423,276	100,101	80,639	27,430	258,019	41,960	931,425
Total gross loans and advances	430,050	100,953	81,474	27,709	272,304	44,287	956,777
Impairment allowances							
Individually assessed	2,005	411	316	132	192	228	3,284
Collectively assessed	1,854	322	497	282	15,898	1,772	20,625
Total impairment allowances	3,859	733	813	414	16,090	2,000	23,909
Net loans and advances	426,191	100,220	80,661	27,295	256,214	42,287	932,868
	%	%	%	%	%	%	%
Individually assessed allowances as a percentage of individually assessed loans and advances	41.6	50.6	44.8	82.5	23.1	38.3	41.5
Collectively assessed allowances as a percentage of collectively assessed loans and advances	0.4	0.3	0.6	1.0	5.9	4.1	2.2
Total allowances as a percentage of total gross loans and advances	0.9	0.7	1.0	1.5	5.9	4.5	2.5

For footnotes, see page 291.

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Impairment allowances > Movements

Impairment allowances on loans and advances to customers and banks by industry sector
(Audited)

	At 31 December 2009			At 31 December 2008		
	Individually assessed allowances US$m	**Collectively assessed allowances US$m**	**Total allowances US$m**	Individually assessed allowances US$m	Collectively assessed allowances US$m	Total allowances US$m
Banks[30]	**107**		**107**	63		63
Customers	**6,494**	**19,048**	**25,542**	3,284	20,625	23,909
Personal[8]	**572**	**16,517**	**17,089**	312	18,657	18,969
Corporate and commercial	**5,528**	**2,354**	**7,882**	2,845	1,795	4,640
Financial	**394**	**177**	**571**	127	173	300
	6,601	**19,048**	**25,649**	3,347	20,625	23,972

For footnotes, see page 291.

Impairment allowances as a percentage of loans and advances[31]
(Unaudited)

	At 31 December	
	2009	2008
	%	%
Banks		
Individually assessed impairment allowances[32]	**0.09**	0.06
Customers[32]	**2.96**	2.63
Individually assessed impairment allowances[32]	**0.75**	0.36
Collectively assessed impairment allowances[32]	**2.21**	2.27

For footnotes, see page 291.

Movement in impairment allowances on loans and advances
(Audited)

	Banks individually assessed US$m	Customers Individually assessed US$m	Customers Collectively assessed US$m	Total US$m
At 1 January 2009	**63**	**3,284**	**20,625**	**23,972**
Amounts written off [8]	**(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 2009	**107**	**6,494**	**19,048**	**25,649**
At 1 January 2008	7	2,699	16,506	19,212
Amounts written off		(824)	(17,131)	(17,955)
Recoveries of loans and advances written off in previous years		113	721	834
Charge to income statement	54	2,010	22,067	24,131
Exchange and other movements	2	(714)	(1,538)	(2,250)
At 31 December 2008	63	3,284	20,625	23,972

For footnote, see page 291.

Table of Contents

Movement in impairment allowances by industry sector (Audited)

	2009 US$m	2008 US$m	2007 US$m	2006 US$m	2005 US$m
Impairment allowances at 1 January	**23,972**	19,212	13,585	11,366	12,559
Amounts written off	**(24,840)**	(17,955)	(12,844)	(9,473)	(9,043)
Personal[2]	**(22,703)**	(16,625)	(11,670)	(8,281)	(8,046)
residential mortgages[2]	**(4,704)**	(2,110)	(930)	(628)	(508)
other personal[2]	**(17,999)**	(14,515)	(10,740)	(7,653)	(7,538)
Corporate and commercial	**(1,984)**	(1,294)	(1,163)	(1,153)	(984)
commercial, industrial and international trade	**(1,093)**	(789)	(897)	(782)	(673)
commercial real estate and other property-related	**(327)**	(115)	(98)	(111)	(117)
other commercial	**(564)**	(390)	(168)	(260)	(194)
Financial[33]	**(153)**	(36)	(11)	(39)	(13)
Recoveries of amounts written off in previous years	**890**	834	1,005	779	494
Personal	**712**	686	837	605	320
residential mortgages	**61**	19	19	19	18
other personal	**651**	667	818	586	302
Corporate and commercial	**170**	142	157	163	174
commercial, industrial and international trade	**123**	76	74	88	76
commercial real estate and other property-related	**9**	6	29	21	9
other commercial	**38**	60	54	54	89
Financial[33]	**8**	6	11	11	
Charge to income statement[34]	**24,942**	24,131	17,177	10,547	7,860
Personal	**19,781**	20,950	15,968	9,929	7,249
residential mortgages	**4,185**	5,000	1,840	1,096	605
other personal	**15,596**	15,950	14,128	8,833	6,644

Corporate and commercial	**4,711**	2,879	1,176	664	618
commercial, industrial and international trade	**2,392**	1,573	897	503	588
commercial real estate and other property-related	**1,492**	755	152	75	56
other commercial	**827**	551	127	86	(26)
Financial[33]	**450**	302	36	(9)	(13)
Governments			(3)	(37)	6
Exchange and other movements	**685**	(2,250)	289	366	(504)
Impairment allowances at 31 December[8]	**25,649**	23,972	19,212	13,585	11,366
Impairment allowances against banks:					
individually assessed	**107**	63	7	7	9
Impairment allowances against customers:					
individually assessed	**6,494**	3,284	2,699	2,565	2,683
collectively assessed[8]	**19,048**	20,625	16,506	11,013	8,674
Impairment allowances at 31 December[8]	**25,649**	23,972	19,212	13,585	11,366
	%	*%*	*%*	*%*	*%*
Impairment allowances against customers as a percentage of loans and advances to customers:					
individually assessed	**0.70**	0.34	0.27	0.29	0.36
collectively assessed	**2.07**	2.16	1.65	1.25	1.16
At 31 December	**2.77**	2.50	1.92	1.54	1.52

For footnotes, see page 291.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Impairment allowances > Movements

Movement in impairment allowances by industry sector and by geographical region (Audited)

	2009						
	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[7] US$m	Middle East[7] US$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[2]	**(1,876)**	**(240)**	**(787)**	**(376)**	**(17,204)**	**(2,220)**	**(22,703)**
residential mortgages[2]	**(41)**	**(1)**	**(9)**		**(4,610)**	**(43)**	**(4,704)**
other personal[2]	**(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[33]	**(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[33]	**8**						**8**
Charge to income statement[34]	**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[33]	**251**			**34**	**164**	**1**	**450**
Exchange and other movements	**412**	**(56)**	**27**	**3**	**(87)**	**386**	**685**
Impairment allowances at 31 December[8]	**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[8,35]	**2,393**	**314**	**488**	**690**	**13,026**	**2,137**	**19,048**
Impairment allowances at 31 December[8]	**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[35]	**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**

	2008						
	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[7] US$m	Middle East[7] US$m	North America US$m	Latin America US$m	Total US$m
Impairment allowances at 1 January	3,938	376	650	276	11,980	1,992	19,212
Amounts written off	(2,483)	(219)	(674)	(164)	(12,215)	(2,200)	(17,955)
Personal	(1,947)	(179)	(646)	(153)	(11,989)	(1,711)	(16,625)
residential mortgages	(3)	(1)	(6)		(2,030)	(70)	(2,110)
other personal	(1,944)	(178)	(640)	(153)	(9,959)	(1,641)	(14,515)
Corporate and commercial	(515)	(38)	(28)	(11)	(214)	(488)	(1,294)
commercial, industrial and international trade	(367)	(33)	(16)	(6)	(153)	(214)	(789)
commercial real estate and other property-related	(77)	(2)	(1)	(3)	(12)	(20)	(115)
other commercial	(71)	(3)	(11)	(2)	(49)	(254)	(390)
Financial[33]	(21)	(2)			(12)	(1)	(36)
Recoveries of amounts written off in previous years	294	39	107	30	100	264	834
Personal	275	36	97	27	54	197	686
residential mortgages		7	1			11	19
other personal	275	29	96	27	54	186	667
Corporate and commercial	19	3	6	2	45	67	142
commercial, industrial and international trade	19	1	5	1	27	23	76
commercial real estate and other property-related			1		5		6
other commercial		2		1	13	44	60

Financial[33]			4	1	1		6
Charge to income statement[34]	3,411	556	815	274	16,589	2,486	24,131
Personal	1,961	160	641	219	16,006	1,963	20,950
residential mortgages	18		9	20	4,943	10	5,000
other personal	1,943	160	632	199	11,063	1,953	15,950
Corporate and commercial	1,304	363	173	47	472	520	2,879
commercial, industrial and international trade	537	316	132	39	213	336	1,573
commercial real estate and other property-related	540	28	17	4	132	34	755
other commercial	227	19	24	4	127	150	551
Financial[33]	146	33	1	8	111	3	302
Exchange and other movements	(1,238)	(19)	(80)	(7)	(364)	(542)	(2,250)
Impairment allowances at 31 December	3,922	733	813	414	16,090	2,000	23,972
Impairment allowances against banks:							
individually assessed	63						63
Impairment allowances against customers:							
individually assessed	2,005	411	316	132	192	228	3,284
collectively assessed[35]	1,854	322	497	282	15,898	1,772	20,625
Impairment allowances at 31 December	3,922	733	813	414	16,090	2,000	23,972
	%	%	%	%	%	%	%
Impairment allowances against customers as a percentage of loans and advances to customers:							
individually assessed	0.47	0.41	0.39	0.48	0.07	0.51	0.34
collectively assessed[35]	0.43	0.32	0.61	1.02	5.84	4.00	2.16

At 31 December	0.90	0.73	1.00	1.50	5.91	4.51	2.50

For footnotes, see page 291.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Impairment allowances > Net loan impairment charge

Individually and collectively assessed impairment charge to income statement by industry segment (Unaudited)

	2009			2008		
	Individually assessed US$m	**Collectively assessed US$m**	**Total US$m**	Individually assessed US$m	Collectively assessed US$m	Total US$m
Banks	**70**		**70**	54		54
Personal	**316**	**19,465**	**19,781**	110	20,840	20,950
Residential mortgages	**171**	**4,014**	**4,185**	26	4,974	5,000
Other personal	**145**	**15,451**	**15,596**	84	15,866	15,950
Corporate and commercial	**3,699**	**1,012**	**4,711**	1,782	1,097	2,879
Commercial, industrial and international trade	**1,681**	**711**	**2,392**	912	661	1,573
Commercial real estate and other property-related	**1,330**	**162**	**1,492**	613	142	755
Other commercial	**688**	**139**	**827**	257	294	551
Financial	**373**	**7**	**380**	118	130	248
Total charge to income statement	**4,458**	**20,484**	**24,942**	2,064	22,067	24,131

Net loan impairment charge to the income statement (Unaudited)

	2009 US$m	2008 US$m	2007 US$m	2006 US$m	2005 US$m
Individually assessed impairment allowances					
New allowances	**5,173**	2,742	1,533	1,297	1,715
Release of allowances no longer required	**(581)**	(565)	(608)	(711)	(998)
Recoveries of amounts previously written off	**(134)**	(113)	(129)	(128)	(199)
	4,458	2,064	796	458	518

Collectively assessed impairment allowances					
New allowances net of allowance releases	**21,240**	22,788	17,257	10,740	8,425
Release of allowances no longer required					(788)
Recoveries of amounts previously written off	**(756)**	(721)	(876)	(651)	(295)
	20,484	22,067	16,381	10,089	7,342
Total charge for impairment losses	**24,942**	24,131	17,177	10,547	7,860
Banks	**70**	54		(3)	(7)
Customers	**24,872**	24,077	17,177	10,550	7,867
	%	%	%	%	%
Charge for impairment losses as a percentage of closing gross loans and advances	**2.26**	2.17	1.39	0.99	0.90
	US$m	US$m	US$m	US$m	US$m
At 31 December					
Impaired loans[8]	**30,845**	25,422	19,594	15,086	12,360
Impairment allowances[8]	**25,649**	23,972	19,212	13,585	11,366

For footnote, see page 291.

Table of Contents

Net loan impairment charge to the income statement by geographical region (Unaudited)

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[7] US$m	Middle East[7] US$m	North America US$m	Latin America US$m	Total US$m
2009							
Individually assessed impairment allowances							
New allowances	**2,573**	**315**	**341**	**598**	**1,052**	**294**	**5,173**
Release of allowances no longer required	**(255)**	**(64)**	**(82)**	**(16)**	**(112)**	**(52)**	**(581)**
Recoveries of amounts previously written off	**(70)**	**(9)**	**(15)**	**(2)**	**(24)**	**(14)**	**(134)**
	2,248	**242**	**244**	**580**	**916**	**228**	**4,458**
Collectively assessed impairment allowances							
New allowances net of allowance releases	**2,356**	**233**	**747**	**778**	**14,525**	**2,601**	**21,240**
Recoveries of amounts previously written off	**(195)**	**(25)**	**(117)**	**(25)**	**(69)**	**(325)**	**(756)**
	2,161	**208**	**630**	**753**	**14,456**	**2,276**	**20,484**
Total charge for impairment losses	**4,409**	**450**	**874**	**1,333**	**15,372**	**2,504**	**24,942**
Banks	**55**			**15**			**70**
Customers	**4,354**	**450**	**874**	**1,318**	**15,372**	**2,504**	**24,872**
	%	**%**	**%**	**%**	**%**	**%**	**%**
Charge for impairment losses as a percentage of closing gross loans and advances	**0.86**	**0.33**	**0.75**	**4.08**	**6.52**	**3.64**	**2.26**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**

At 31 December 2009							
Impaired loans[8]	**10,873**	**846**	**1,201**	**1,666**	**13,308**	**2,951**	**30,845**
Impairment allowances[8]	**6,227**	**804**	**996**	**1,393**	**13,676**	**2,553**	**25,649**
2008							
Individually assessed impairment allowances							
New allowances	1,567	365	223	30	397	160	2,742
Release of allowances no longer required	(340)	(25)	(53)	(36)	(80)	(31)	(565)
Recoveries of amounts previously written off	(38)	(10)	(17)	(3)	(40)	(5)	(113)
	1,189	330	153	(9)	277	124	2,064
Collectively assessed impairment allowances							
New allowances net of allowance releases	2,478	255	752	310	16,372	2,621	22,788
Recoveries of amounts previously written off	(256)	(29)	(90)	(27)	(60)	(259)	(721)
	2,222	226	662	283	16,312	2,362	22,067
Total charge for impairment losses	3,411	556	815	274	16,589	2,486	24,131
Banks	54						54
Customers	3,357	556	815	274	16,589	2,486	24,077
	%	%	%	%	%	%	%
Charge for impairment losses as a percentage of closing gross loans and advances	0.68	0.43	0.74	0.78	5.85	4.22	2.17
	US$m	US$m	US$m	US$m	US$m	US$m	US$m
At 31 December 2008							
Impaired loans	6,844	852	835	279	14,285	2,327	25,422
Impairment allowances	3,922	733	813	414	16,090	2,000	23,972

For footnotes, see page 291.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Credit risk > Impairment allowances > Charge // Impaired loans > 2009

Charge for impairment losses as a percentage of average gross loans and advances to customers[8]
(Unaudited)

	2009 %	2008 %	2007 %	2006 %	2005 %
New allowances net of allowance releases	**2.92**	2.54	2.09	1.49	1.25
Recoveries	**(0.10)**	(0.09)	(0.12)	(0.10)	(0.09)
Total charge for impairment losses	**2.82**	2.45	1.97	1.39	1.16
Amount written off net of recoveries	**2.71**	1.75	1.36	1.15	1.26

For footnote, see page 291.

Charge for impairment losses as a percentage of average gross loans and advances to customers by geographical region[8]
(Unaudited)

	Europe %	**Hong Kong** %	**Rest of Asia-Pacific**[7] %	**Middle East**[7] %	**North America** %	**Latin America** %	**Total** %
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**
2008							
New allowances net of allowance releases	0.86	0.63	1.04	1.12	5.73	5.32	2.54
Recoveries	(0.07)	(0.04)	(0.12)	(0.11)	(0.03)	(0.51)	(0.09)

Total charge for impairment losses	0.79	0.59	0.92	1.01	5.70	4.81	2.45
Amount written off net of recoveries	0.52	0.19	0.64	0.50	4.16	3.73	1.75

For footnotes, see page 291.

Impaired loans and new loan impairment allowances

2009 compared with 2008

(Unaudited)

Loan impairment charges increased by 3 per cent to US$24.9 billion from US$24.1 billion 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 per cent compared with 2008 to US$26.4 billion. Releases and recoveries of allowances increased by 17 per cent to US$1.5 billion. Total impaired loans to customers at 31 December 2009 were US$31 billion, an increase of 21 per cent compared with the end of 2008. Impaired loans remained at 3 per cent of customer loans and advances at 31 December 2009.

In **Europe**, new loan impairment allowances increased by 37 per cent to US$4.9 billion in 2009, driven by credit quality deterioration in individually impaired loans. Impaired loans increased by 59 per cent to US$10.9 billion 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. HSBC s exposure to this market remained well secured with typical loan-to-value ratios of below 60 per cent.

In Europe, releases and recoveries were US$520 million, a decrease of 5 per cent compared with 31 December 2008.

In **Hong Kong**, new loan impairment allowances were US$548 million, a decline of 12 per cent 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$846 million.

In **Rest of Asia-Pacific**, new loan impairment allowances rose by 18 per cent to US$1.1 billion, 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 per cent to US$1.2 billion.

Releases and recoveries in the Rest of Asia-Pacific region rose by 42 per cent to US$214 million at 31 December 2009.

New loan impairment allowances in the **Middle East** increased significantly from a low base, to US$1.4 billion. 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$1.4 billion to US$1.7 billion.

New loan impairment allowances rose by 7 per cent to US$26.4 billion despite falls of 12 per cent in Hong Kong and 7 per cent in North America.

In **North America,** new loan impairment allowances declined by 7 per cent to US$15.6 billion 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 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, higher new loan impairment allowances were primarily against exposures in the commercial real estate, manufacturing and trade sectors.

In North America, releases and recoveries increased by 14 per cent to US$205 million 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 per cent to US$13.3 billion at 31 December 2009.

New loan impairment allowances in **Latin America** increased by 18 per cent to US$2.9 billion, while impaired loans rose by 27 per cent to US$3.0 billion. 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 per cent to US$391 million at 31 December 2009.

For an analysis of loan impairment charges and other credit risk provisions by customer group, see page 35.

2008 compared with 2007

(Unaudited)

Loan impairment charges increased by 40 per cent to US$24.1 billion from US$17.2 billion in 2007. The commentary that follows is on a constant currency basis.

New allowances for loan impairment charges rose by 37 per cent compared with 2007. Releases and recoveries of allowances declined by 10 per cent to US$1.4 billion. Impaired loans were 3 per cent of customer loans and advances at 31 December 2008, compared with 2 per cent at 31 December 2007.

In **Europe**, new loan impairment charges were US$4.0 billion, a rise of 24 per cent compared with 2007. Impaired loans increased by 32 per cent to US$6.8 billion at 31 December 2008.

Loan impairment charges increased in Global Banking and Markets following a significant charge against a single European commercial real estate corporate customer. Impairment charges against banks rose in the UK due to exposure to the Icelandic banks in 2008. New loan impairment charges rose in Turkey as delinquency rates increased across credit cards, personal loans and corporate lending in light of the deteriorating economic environment. Elsewhere, impairment charges on the commercial portfolio rose in the UK, particularly in the final quarter of 2008 as the weakening property market led to higher impairment charges against construction companies and businesses dependent upon the real estate sector. In France, the impact of declining commercial credit quality more than offset lower balances. Impairment allowances against firms in the financial sector rose due to exposure to a single asset management firm in the UK. Credit quality in the UK personal lending portfolio remained broadly stable, reflecting the strength of HSBC s loan book in a period of significant economic uncertainty. Mortgage lending in the UK remained well secured as actions taken since 2006 reduced risk exposure. Credit quality in the unsecured portfolios of M&S Money, HSBC Bank and Partnership Cards deteriorated slightly in 2008, particularly in the second half of the year, due to the weakening UK economy.

Releases and recoveries in Europe declined by 27 per cent, driven by the deterioration in economic conditions.

In **Hong Kong**, new loan impairment charges more than doubled from a low base, driven by deterioration in credit quality in the commercial portfolio in the second half of the year as the economy and trade flows weakened. Residential mortgage lending continued to be well secured, as regulatory restrictions constrained origination loan-to-value ratios to below 70 per cent. Impaired loans increased from a low base to US$852 million at 31 December 2008.

In **Rest of Asia-Pacific**, new loan impairment charges rose to US$975 million, primarily in India due to a combination of rising delinquency rates in consumer lending as credit conditions deteriorated, and increased lending.

In the **Middle East**, new loan impairment charges rose from a low base to US$340 million, due to rising delinquencies as growth rates declined and the property market slowed as economic conditions weakened because of lower oil and gas prices.

New loan impairment charges in **North America** rose by 37 per cent to US$16.8 billion, driven by the continued deterioration in credit quality in the HSBC Finance loan portfolio and, to a lesser extent, in HSBC USA. Impaired loans increased by 49 per cent to US$14.3 billion at 31 December 2008.

US credit quality showed significant deterioration across the portfolio, driven by the continued weakness of the US economy. The reasons behind the deterioration in US credit quality, the effects on the US personal lending portfolio and actions taken as a result are discussed in more detail on page 221. Partly offsetting the effect of the deterioration was a reduction in overall lending as HSBC continued to reduce its exposure in the US.

In Commercial Banking, impairment charges rose from a low base driven by deterioration in the commercial real estate loan book in the US, and higher impairment charges against firms in the manufacturing, export and commercial real estate sectors in Canada. Higher impairment charges in Global Banking and Markets reflected weaker credit fundamentals in the US in 2008. Impairment allowances against firms in the financial sector rose due to rising delinquencies, despite government intervention.

Releases and recoveries in North America rose by 55 per cent to US$180 million.

In **Latin America**, new loan impairment charges rose by 37 per cent to US$2.8 billion.

Impaired loans increased by 37 per cent to US$2.3 billion at 31 December 2008.

The most significant increase was in Mexico, reflecting higher impairment charges in the credit card portfolio due to a combination of higher average balances from organic expansion and growing delinquency rates driven by a deterioration in credit quality as the 2006 and 2007 vintages continued to season and move into later stages of delinquency. Management action to improve the quality of new business included tightened underwriting, enhanced collection strategies and better managed customer acquisition channels. The commercial portfolio in Mexico also experienced higher impairment charges due to credit quality deterioration among small and medium sized enterprises as the economy weakened. In Brazil, higher impairment charges were driven by a combination of balance growth and credit quality deterioration in the vehicle finance and payroll loan portfolios.

HSBC Holdings

(Audited)

Credit risk primarily arises in HSBC Holdings 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 the HSBC Global Risk function, which provides high-level centralised oversight and management of HSBC s credit risks worldwide.

No collateral or other credit enhancements were held by HSBC Holdings in respect of its transactions with subsidiaries.

HSBC Holdings maximum exposure to credit risk at 31 December 2009 is shown below. Its financial assets principally represent claims on Group subsidiaries in Europe and North America.

HSBC Holdings maximum exposure to credit risk

(Audited)

	Maximum exposure	
	2009	2008
	US$m	US$m
Derivatives	**2,981**	3,682
Loans and advances to HSBC undertakings	**23,212**	11,804
Financial investments	**2,455**	2,629
Financial guarantees and similar contracts	**35,073**	47,341
Loan and other credit-related commitments	**3,240**	3,241
	66,961	68,697

All of the derivative transactions are with HSBC undertakings which are banking counterparties (2008: 100 per cent).

The credit quality of the loans and advances to HSBC undertakings is assessed as satisfactory risk, with 100 per cent of the exposure being neither past due nor impaired (2008: 100 per cent).

The long-term debt ratings of the HSBC Group issuers of the financial investments are within the Standard & Poor s ratings range of A+ to A (2008: AA to A).

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;
- 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, HSBC presents information on its impaired loans and advances in accordance with the classification approach described on page 225.

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, HSBC recognises 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 the Group expects to recover the contractual cash flows in full.

Troubled debt restructurings

The SEC requires separate disclosure of any loans whose terms have been modified by the lender because of the borrower s financial difficulties, as a concession that the lender would not otherwise consider. These are classified as troubled debt restructurings (TDR s). The definition of TDRs differs from the definition of renegotiated loans as disclosed under IFRSs, see page 224, as follows. After restructuring, TDRs may continue to be classified as impaired, as past due but not impaired or, where appropriate, as neither past due nor impaired. Under IFRSs, disclosure is required of loans that would otherwise have been classified as past due or impaired whose terms have been renegotiated.

Furthermore, a loan is no longer classified as a TDR after the end of the first year following the restructuring if the loan performs in accordance with the new terms, and the interest rate at the time of restructuring was a market rate for a loan with comparable risk.

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 214. 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 231, 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 203.

Analysis of risk elements in the loan portfolio by geographical region (Unaudited)

	At 31 December				
	2009	2008	2007	2006	2005
	US$m	US$m	US$m	US$m	US$m
Impaired loans					
Europe	**10,873**	6,844	6,266	5,858	5,081
Hong Kong	**846**	852	433	454	506
Rest of Asia-Pacific[7]	**1,201**	835	779	807	596
Middle East[7]	**1,666**	279	309	381	349
North America[8]	**13,308**	14,285	9,662	6,108	4,602
Latin America	**2,951**	2,327	2,145	1,478	1,226
	30,845	25,422	19,594	15,086	12,360
Unimpaired loans contractually past due 90 days or more as to principal or interest					
Europe	**57**	635	202	237	592
Hong Kong	**4**	43	49	79	74
Rest of Asia-Pacific[7]	**36**	84	94	75	40
Middle East[7]	**215**	190	62	3	
North America	**217**	108	24	78	32
Latin America	**40**	21	421	165	4
	569	1,081	852	637	742
Troubled debt restructurings (not included in the classifications above)					
Europe	**436**	366	648	360	239
Hong Kong	**236**	165	146	189	198
Rest of Asia-Pacific[7]	**135**	90	23	56	96
Middle East[7]	**103**	29	11	17	25
North America	**9,613**	5,618	3,322	1,712	1,417
Latin America	**1,518**	1,067	848	915	878
	12,041	7,335	4,998	3,249	2,853
Trading loans classified as in default					
North America	**798**	561	675	127	11
Risk elements on loans					
Europe	**11,366**	7,845	7,116	6,455	5,912
Hong Kong	**1,086**	1,060	628	722	778
Rest of Asia-Pacific[7]	**1,372**	1,009	896	938	732
Middle East[7]	**1,984**	498	382	401	374

North America	**23,936**	20,572	13,683	8,025	6,062
Latin America	**4,509**	3,415	3,414	2,558	2,108
	44,253	34,399	26,119	19,099	15,966
Assets held for resale					
Europe	**52**	81	59	30	205
Hong Kong	**10**	26	29	42	49
Rest of Asia-Pacific[7]	**8**	11	5	15	29
Middle East[7]	**2**	2	2	2	2
North America	**707**	1,758	1,172	999	582
Latin America	**153**	113	101	91	103
	932	1,991	1,368	1,179	970
Total risk elements					
Europe	**11,418**	7,926	7,175	6,485	6,117
Hong Kong	**1,096**	1,086	657	764	827
Rest of Asia-Pacific[7]	**1,380**	1,020	901	953	761
Middle East[7]	**1,986**	500	384	403	376
North America	**24,643**	22,330	14,855	9,024	6,644
Latin America	**4,662**	3,528	3,515	2,649	2,211
	45,185	36,390	27,487	20,278	16,936
	%	%	%	%	%
Loan impairment allowances as a percentage of risk elements on loans[36]	**58.8**	70.8	75.5	71.6	71.2

For footnotes, see page 291.

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Liquidity and funding > Policies and procedures / Primary sources of funding / Liquidity risk management

Liquidity and funding

(Audited)
Liquidity risk is 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. Funding risk (a form of liquidity risk) arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The objective of HSBC s 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, HSBC maintains a diversified funding base comprising core retail and corporate customer deposits and institutional balances. This is augmented with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity which are held to enable HSBC to respond quickly and smoothly to unforeseen liquidity requirements.

HSBC requires its operating entities 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 appropriately and that all their anticipated obligations can be met when due.

HSBC adapts its liquidity and funding risk management framework in response to changes in the mix of business that it undertakes, and to changes in the nature of the markets in which it operates. The Group has continuously monitored the impact of recent market events on its liquidity positions and has changed customer behavioural assumptions and assumed asset liquidity characteristics where justified. The liquidity and funding risk management framework will continue to evolve as the Group assimilates knowledge from the recent market events, the effects of which are discussed more fully below.

Policies and procedures
(Audited)
The management of liquidity and funding is primarily undertaken locally in HSBC s operating entities in compliance with practices and limits set by the Risk Management Meeting (RMM). These limits vary according to the depth and liquidity of the market in which the entities operate. It is HSBC s general 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 HSBC s largest banking operations and within clearly defined internal and regulatory guidelines and limits. The limits place formal restrictions on the transfer of resources between HSBC entities and reflect the broad range of currencies, markets and time zones within which HSBC operates.

HSBC s liquidity and funding management process includes:

- 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 deposits 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.

Primary sources of funding

(Audited)

Current accounts and savings deposits payable on demand or at short notice form a significant part of HSBC s funding, and the Group places considerable importance on maintaining their stability. For deposits, stability depends upon preserving depositor confidence in HSBC s capital strength and liquidity, and on competitive and transparent pricing.

HSBC also accesses professional markets in order to provide funding for non-banking subsidiaries that do not accept deposits, to maintain a presence in local money markets and to optimise the funding of asset maturities not naturally matched by core deposit funding. In aggregate, HSBC s banking entities are liquidity providers to the interbank market, placing significantly more funds with other banks than they themselves borrow.

Table of Contents

The 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 2009, US$82 billion (2008: US$111 billion) of HSBC Finance s liabilities were drawn from professional markets, utilising a range of products, maturities and currencies. As the loan portfolios within HSBC Finance are in run off it has not accessed the term debt markets for more than 2 years.

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 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	**221,191**	**87,044**	**101,289**	**107,379**	**41,147**
Financial guarantees and similar contracts	**6,111**	**15,288**	**17,072**	**10,749**	**4,031**
	1,609,437	**541,772**	**262,704**	**284,196**	**198,047**
At 31 December 2008					
Deposits by banks	45,884	82,514	8,734	4,875	2,356
Customer accounts	698,187	332,207	69,721	34,537	5,798
Trading liabilities	247,652				
Financial liabilities designated at fair value	5,365	2,713	6,969	34,855	64,853
Derivatives	482,039	373	1,479	2,634	1,003
Debt securities in issue	481	56,590	53,174	68,169	22,920
Subordinated liabilities	92	686	1,646	9,718	41,701
Other financial liabilities	19,474	26,180	5,473	1,472	1,022
	1,499,174	501,263	147,196	156,260	139,653

Loan and other credit-related commitments	239,753	105,952	153,774	72,111	32,432
Financial guarantees and similar contracts	5,749	13,429	17,756	9,807	5,577
	1,744,676	620,644	318,726	238,178	177,662

The balances in the above table will not agree directly with the balances in the 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 the balance sheet. Trading liabilities and trading derivatives have been included in the On demand time bucket, and not by contractual maturity, because trading liabilities are typically held for short periods of time. The undiscounted cash flows payable under hedging derivative liabilities are classified according to their contractual maturity. 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)

The Group uses three principal measures to manage liquidity risk, as described below.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Liquidity and funding > Liquidity risk management / Contingent liquidity risk

Advances to deposits ratio
HSBC emphasises the importance of core current accounts and savings accounts as a source of funds to finance lending to customers, and discourages reliance on short-term professional funding. This is achieved by placing limits on Group banking entities which restrict their ability to increase loans and advances to customers without corresponding growth in current accounts and savings accounts. This measure is referred to as the advances to deposits ratio.

Advances to deposits ratio limits are set by the RMM and monitored by Group Finance. The ratio describes loans and advances to customers as a percentage of the total of core customer current and savings accounts 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 HSBC receives securities which are deemed to be liquid, are excluded from the advances to deposits ratio. The classification of a deposit as core includes consideration of the size of the customer s total deposit balances, the pricing and the deposit s behavioural characteristics.

The three principal banking entities listed in the table below represented 70 per cent of HSBC s total core deposits at 31 December 2009 (2008: 70 per cent). The table shows that loans and advances to customers in HSBC s principal banking entities are overwhelmingly financed by reliable and stable sources of funding. HSBC would meet any unexpected net cash outflows by selling securities and accessing additional funding sources such as interbank or collateralised lending markets. The distinction between core and non-core deposits generally means that the Group s measure of advances to deposits is more restrictive than that which could be inferred from the published financial statements. For example, HSBC s consolidated advances to deposits measure at 31 December 2009 based only on published balance sheet information was 77.3 per cent (2008: 83.6 per cent).

Ratio of net liquid assets to customer liabilities
Net liquid assets are the aggregated liquid assets less all funds maturing in the next 30 days from wholesale market sources and from customers who are deemed to be professional. For this purpose, HSBC defines liquid assets as cash balances, short-term interbank deposits and highly-rated debt securities available for immediate sale and for which a deep and liquid market exists. Contingent liquidity risk associated with committed loan facilities is not reflected in the ratios. The Group s framework for monitoring this risk is described in Contingent liquidity risk below.

Limits for the ratio of net liquid assets to customer liabilities are set for each bank operating entity, but not for HSBC Finance. As HSBC Finance does not accept customer deposits, it is not appropriate to manage its liquidity using standard liquidity ratios. See HSBC Finance below.

Ratios of net liquid assets to customer liabilities are provided in the following table, along with the US dollar equivalents of net liquid assets.

HSBC s principal banking entities the management of liquidity risk
(Audited)

	Advances to deposits ratios		Ratio of net liquid assets to customer liabilities		Net liquid assets	
	2009	2008	**2009**	2008	**2009**	2008

	%	%	**%**	%	**US$bn**	US$bn
HSBC Bank (UK operations)						
Year-end	**102.3**	106.0	**8.8**	7.1	**29.2**	21.3
Maximum	**107.7**	106.7	**13.6**	14.1	**46.2**	52.5
Minimum	**101.7**	97.5	**6.5**	6.9	**19.5**	21.3
Average	**105.1**	101.5	**10.2**	10.0	**32.6**	35.8
The Hongkong and Shanghai Banking Corporation						
Year-end	**70.9**	77.4	**30.0**	25.0	**84.9**	64.6
Maximum	**77.4**	82.9	**35.0**	25.0	**97.8**	64.6
Minimum	**68.6**	76.7	**25.0**	19.9	**64.6**	51.1
Average	**71.5**	80.6	**30.7**	21.9	**85.1**	56.5
HSBC Bank USA						
Year-end	**98.1**	103.7	**17.8**	31.5	**14.1**	27.4
Maximum	**110.6**	117.3	**31.5**	31.5	**27.4**	27.4
Minimum	**98.1**	103.7	**16.7**	15.8	**13.2**	17.1
Average	**105.4**	111.8	**22.2**	22.6	**18.9**	21.5

Table of Contents

	Advances to deposits ratios		Ratio of net liquid assets to customer liabilities		Net liquid assets	
	2009	2008	**2009**	2008	**2009**	2008
	%	%	**%**	%	**US$bn**	US$bn
Total of HSBC s other principal banking entities[37]						
Year-end	**80.8**	85.2	**29.4**	26.5	**94.7**	83.5
Maximum	**85.2**	92.3	**29.4**	26.5	**94.7**	83.5
Minimum	**80.8**	82.7	**24.7**	19.4	**73.2**	66.1
Average	**82.2**	88.1	**27.3**	22.5	**84.8**	73.9

For footnote, see page 291.

The reduction in the quantum of net liquid assets in HSBC Bank USA between 2008 and 2009 reflects the temporary high level of net liquid assets maintained at the end of 2008 in anticipation of funding requirements for the credit card portfolios transferred to HSBC Bank USA from HSBC Finance in early 2009.

Projected cash flow scenario analysis

The Group uses a number of standard projected cash flow scenarios designed to model 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 Group banking entities and by HSBC Finance. The appropriateness of the assumptions under each scenario is regularly reviewed. In addition to the Group s 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 RMM.

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 CP programmes.

HSBC Finance funding
(Audited)

	At 31 December	
	2009	2008
	US$bn	US$bn
Maximum amounts of unsecured term funding maturing in any rolling:		
3 month period	**5.2**	6.0
12 month period	**12.3**	17.4
Unused committed sources of secured funding[38]	**0.4**	2.4

Committed backstop lines from non-Group entities in support of CP programmes	**5.3**	7.3

For footnote, see page 291.

The need for HSBC Finance to refinance maturing term funding is mitigated by the continued run-down of its balance sheet.

Contingent liquidity risk

(Audited)

In the normal course of business, Group entities provide customers with committed facilities, including committed backstop lines to conduit vehicles sponsored by the Group and standby facilities to corporate customers. These facilities increase the funding requirements of the Group 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 RMM 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.

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Liquidity and funding > Contingent liquidity risk / Impact of market turmoil / HSBC Holdings

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	
	2009	2008	**2009**	2008	**2009**	2008	**2009**	2008
	US$bn	US$bn	**US$bn**	US$bn	**US$bn**	US$bn	**US$bn**	US$bn
Conduits								
Client-originated assets[39]								
total lines	**7.4**	5.6	**6.4**	11.2	**0.3**	0.3	**0.3**	
largest individual lines	**0.8**	1.0	**0.4**	0.4	**0.1**	0.2	**0.3**	
HSBC-managed assets[40]	**29.1**	34.8						
Other conduits[41]			**1.3**	1.1				
Single-issuer liquidity facilities								
five largest[42]	**4.3**	6.0	**6.1**	5.0	**2.0**	1.5	**1.2**	1.0
largest market sector[43]	**7.9**	7.3	**4.7**	3.5	**2.9**	2.4	**1.5**	1.7

For footnotes, see page 291.

In times of market stress, the Group may choose to provide non-contractual liquidity support to certain HSBC-sponsored vehicles or HSBC-promoted products. This support would only be provided after careful consideration of the potential funding requirement and the impact on the entity s overall liquidity.

The impact of market turmoil on the Group s liquidity risk position

(Audited)

Market turmoil continued to have significant adverse effects on the liquidity and funding risk profile of the banking system in 2009, although the effects gradually moderated during the year:

interbank funding costs remained above pre-market turmoil levels, although they declined significantly from the peaks observed in the latter part of 2008;

many asset classes continued to suffer from reduced liquidity;

the ability of many market participants to issue either unsecured or secured debt continued to be restricted, although the effect was mitigated in part by the support provided by some central bank and government programmes; and

many special purpose entities with investments linked to US sub-prime mortgages, or to ABSs where the underlying credit exposures were not fully transparent, continued to experience difficulties in raising wholesale funding.

In general terms, the strains arising from the credit crisis were concentrated in the wholesale market. The retail market, the market from which HSBC derives its core current and savings accounts, (the importance of which as a source of funding for the Group is discussed under Advances to deposits ratio above) was relatively unaffected. The Group s limited dependence on wholesale markets for funding has been a significant competitive advantage to HSBC through the recent period of dislocation in the financial markets.
As a net provider of funds to the interbank market, HSBC has not been significantly affected by the scarcity of interbank funding.

HSBC s customer deposit base grew between 30 June 2007, the reporting date closest to the onset of the market turmoil, and 31 December 2009 by US$178 billion. This growth in US dollar equivalent terms was diluted by the strengthening of the US dollar against other major currencies between these two reporting dates, and therefore understates the growth in customer deposits on an underlying currency basis.

A number of central banks and governments have taken action to alleviate the effects of the market turmoil, including making available government guaranteed term funding facilities. In the US, bank issuance under such programmes became normal market practice during 2008, although many market participants successfully issued non-government guaranteed debt in the latter half of 2009. HSBC s US-based operations participated modestly at the outset in the US government guaranteed term debt issuance scheme. At 31 December 2009, US$2.67 billion had been issued by HSBC USA, Inc. under the Federal Deposit Insurance Corporation Temporary Liquidity Guarantee Programme. This debt was issued in 2008.

The deterioration of the US sub-prime credit market reduced the availability of term financing to entities with exposures to the US sub-prime market. However, HSBC Finance, by virtue of its position within the Group, continued to enjoy committed financing facilities, albeit at a lower level, and access to CP markets at competitive interest rates. By reducing the size of its balance sheet, issuing cost-effective retail debt, receiving capital infusions from the HSBC Group and utilising alternative sources of funding, including from other members of the HSBC Group, HSBC Finance eliminated the need to issue institutional term debt in 2008 and 2009. Funding plans are in place which would enable HSBC Finance to deal with a recurrence of stress in the credit markets. As part of liquidity management, asset portfolios totalling US$15.3 billion were transferred from HSBC Finance to HSBC Bank USA in January 2009, resulting in US$8.0 billion of net funding benefit to HSBC Finance.

The scheme set up by the US Federal Reserve in 2008 to provide support to US issuers in the CP market was extended to 1 February 2010. Under this scheme, HSBC Finance was eligible to issue a maximum of US$12.0 billion. At 31 December 2009, HSBC Finance did not have any outstanding CP under this programme (31 December 2008: US$520 million).

The effect of the market turmoil on liquidity and funding elsewhere in HSBC was largely restricted to the Group s activities that historically depended upon the asset-backed CP markets for funding, specifically SIVs and conduits, and certain money market funds. This is discussed in detail on page 182.

HSBC Holdings

(Audited)

HSBC Holdings primary sources of cash are the receipt of dividends from subsidiaries, interest on and repayment of, intra-group loans, and interest earned on its own liquid funds. HSBC Holdings also received cash from its rights issue in April 2009 and, on an ongoing basis, raises ancillary funds in the debt capital markets through subordinated and senior debt issuance. Primary uses of cash are investments in 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 its 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 HSBC s activities means that HSBC Holdings is not dependent on a single source of profits to fund its dividend payments to shareholders. During 2009 HSBC Holdings continued to have full access to debt capital markets at market rates and issued US$5.3 billion of capital instruments and senior debt (2008: US$8.8 billion).

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Liquidity and funding > HSBC Holdings // Market risk > Sensitivity analysis

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 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**
At 31 December 2008					
Amounts owed to HSBC undertakings		133	539	3,590	
Financial liabilities designated at fair value		587	1,762	5,977	25,571
Derivatives	1,324				
Subordinated liabilities		235	706	3,764	32,214
Other financial liabilities		1,805			
	1,324	2,760	3,007	13,331	57,785
Loan commitments	3,241				
Financial guarantees and similar contracts	47,341				
	51,906	2,760	3,007	13,331	57,785

The balances in the above table will not agree directly with the balances 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.

Market risk

(Audited)

The objective of HSBC s market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the Group s status as one of the world s largest banking and financial services organisations.

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 HSBC s income or the value of its portfolios.

HSBC separates exposures to market risk into trading and non-trading portfolios. Trading portfolios include those positions arising from market-making, position-taking and other marked-to-market positions so designated.

Non-trading portfolios include positions that arise from the interest rate management of HSBC s retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from HSBC s insurance operations.

Market risk arising in HSBC s insurance businesses is discussed in Risk management of insurance operations on pages 265 to 285.

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 principal factor in determining the level of limits set. Group Risk, an independent unit within Group Management Office, develops the Group s 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 which arise on each product in its business and to transfer these risks 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). The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to manage such risks professionally. In certain cases where the market risks cannot be adequately captured by the transfer process, simulation modelling is used to identify the impact of varying scenarios on valuations and net interest income.

HSBC uses 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)

Sensitivity measures are used to monitor the market risk positions within each risk type, for example, 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 that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence.

The VAR models used by HSBC are based predominantly on historical simulation. These models derive plausible future scenarios from past series of recorded market rates and prices, taking account of 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.

The historical simulation models used by HSBC incorporate the following features:

- potential market movements are calculated with reference to data from the past two years;
- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities; and
- VAR is calculated to a 99 per cent confidence level and for a one-day holding period.

HSBC routinely validates the accuracy of its 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, HSBC would expect to see losses in excess of VAR only 1 per cent 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.

Although a valuable guide to risk, VAR should always be viewed in the context of its limitations. For example:

- 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 per cent 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.

Stress testing

In recognition of the limitations of VAR, HSBC augments 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. This coordinates the Group s stress testing scenarios in conjunction with regional risk managers, considering actual market risk exposures and market events in determining the scenarios to be applied at portfolio and consolidated levels, as follows:

- sensitivity scenarios, which 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, which consider the largest move in each risk factor, without consideration of any underlying market correlation;

- hypothetical scenarios, which consider potential macro economic events, for example, a global flu pandemic; and

- historical scenarios, which 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 impact such events would have on HSBC s profit. The daily losses experienced during 2009 were within the stress loss scenarios reported to senior management.

The following table provides an overview of the reporting of risks within this section:

	Portfolio	
	Trading	**Non-trading**
Risk type		
Foreign exchange and commodity	VAR	VAR[44]
Interest rate	VAR	VAR[45]
Equity	VAR	Sensitivity
Credit spread	VAR	VAR[46]

For footnotes, see page 291.

The impact of market turmoil on market risk

(Audited)

The market turmoil that began in 2007 and accelerated through 2008 was characterised by extreme market volatility and, as a consequence, increased levels of VAR notwithstanding reduced underlying risk positions. High levels of market volatility across all asset classes continued into early
2009. However, the overall impact was limited as a result of further managing down the market risk exposures in all asset classes during this period.

Continued high levels of volatility in interest rates in 2009 caused a small increase in VAR.

Central banks monetary easing has led to the progressive stabilisation of financial markets during the second half of 2009. Credit spreads and volatility levels have generally continued to decrease as liquidity improved throughout the period. Additionally, this period was characterised by high levels of government borrowing, uncertainty around the robustness of economic recovery in major economies and concerns over the effect of any developing inflationary pressures. As a result, this led to the continuation of high levels of volatility in interest rates which, together with the extension of the asset profile in the non-trading books, caused a small increase in the total VAR.

Value at risk of the trading and non-trading portfolios

The VAR, both trading and non-trading, for the Group was as follows:

Value at risk
(Audited)

	2009	2008
	US$m	US$m
At 31 December	**204.5**	191.2
Average	**156.1**	158.9
Minimum	**105.7**	59.8
Maximum	**204.5**	287.1

The daily VAR, both trading and non-trading, for the Group was as follows:

Daily VAR (trading and non-trading) (US$m)
(Unaudited)

The major contributor to the trading and non-trading VAR for the Group was Global Markets.

The histogram on page 253 illustrates the frequency of daily revenue arising from Global Markets trading, balance sheet management and other trading activities.

The average daily revenue earned from Global Markets trading, balance sheet management and other trading activities in 2009 was US$59.9 million, compared with US$21.7 million in the same period ended 31 December 2008. The standard deviation of these daily revenues was US$38.4 million compared with US$53.4 million in 2008. The standard deviation measures the variation of daily revenues about the mean value of those revenues.

An analysis of the frequency distribution of daily revenue shows that there were 11 days with negative revenue during 2009 compared with 66 days in 2008. The most frequent result was daily revenue of between US$30 million and US$40 million and US$40 million and US$50 million with 29 occurrences each, compared with between US$40 million and US$50 million with 28 occurrences in 2008.

11 days of negative revenue compared with 66 in 2008.

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.

Trading revenues generated by Global Markets and Balance Sheet Management improved considerably in 2009 compared with 2008 due to strong client business and favourable positioning against the backdrop of a low interest rate environment. The histogram of daily revenues for 2009 below therefore shows the majority of trading days closely concentrated around the average daily revenues of US$59.9 million, with relatively few loss days recorded during the year.

By contrast, in 2008, trading revenues were more volatile, particularly across the Credit businesses, which experienced significant losses on legacy Credit Trading positions and monoline exposures. The graph of daily revenues for 2008 shows a flatter profile and greater distribution of revenues around the average daily revenue of US$21.7 million, as the turmoil in the credit markets caused volatile trading days where large daily profits and losses were reported.

Daily distribution of Global Markets trading, balance sheet management and other trading revenues[47]
(Unaudited)

2009

2008

For footnote, see page 291.

For a description of HSBC s fair value and price verification controls, see page 166.

Trading portfolios

(Audited)

HSBC s control of market risk 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.

Market making and position taking is undertaken within Global Markets. The VAR for such trading activity at 31 December 2009 was US$45.3 million (2008: US$72.5 million). This is analysed below by risk type:

Market risk > Trading portfolios / Non-trading portfolios

VAR by risk type for the trading activities (excluding credit spread VAR)
(Audited)

	Foreign exchange and commodity US$m	**Interest rate US$m**	**Equity US$m**	**Total[48] US$m**
At 31 December 2009	**19.5**	**42.6**	**17.5**	**45.3**
At 31 December 2008	29.8	63.4	13.9	72.5
Average				
2009	**20.6**	**51.3**	**11.3**	**53.8**
2008	19.0	50.7	15.2	53.1
Minimum				
2009	**11.1**	**35.6**	**4.9**	**35.6**
2008	8.7	21.4	8.2	22.6
Maximum				
2009	**46.7**	**78.0**	**21.2**	**86.6**
2008	54.9	147.4	39.0	104.4

For footnote, see page 291.

The VAR for overall trading activity as at 31 December 2009 was lower than in 2008 and remained within a narrower band. The decrease was driven primarily by the interest rate component due to reduced levels of underlying exposure in the trading book.

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. The Group has introduced credit spread as a separate risk type within its VAR models on a global basis. The VAR shows the effect on trading income from a one-day movement in credit spreads over a two-year period, calculated to a 99 per cent confidence level.

Increased market liquidity helped dampen volatility of credit spreads and decrease credit VAR in 2009.

At 31 December 2009, the credit VAR for trading activities was US$72.7 million (2008: US$218.4 million, calculated on a comparable basis). The decrease in the credit VAR in 2009 was due to the effect of a reduction in the volatility of credit spreads observed during the year, in part reflecting increased market liquidity. Also, the actual positions within the trading portfolios exposed to credit spread risk were lower on 31 December 2009 than on 31 December 2008. In addition to the above measure, certain portfolios are also managed using default risk measures where appropriate.

Credit spread risk also arises on credit derivative transactions entered into by Global Banking in order to manage the risk concentrations within the corporate loan portfolio and so enhance capital

efficiency. The mark-to-market of these transactions is reflected in the income statement.

At 31 December 2009, the credit VAR on the credit derivatives transactions entered into by Global Banking was US$13.8 million (2008: US$23.0 million).

Gap risk

For certain transactions that are structured so that the risk to HSBC is 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 change in market price from one level to another with no accompanying trading opportunity, where the price change breaches the threshold beyond which the risk profile changes from having no open risk to having full exposure to the underlying structure. Such movements may occur, for example, when there are adverse news announcements and the market for a specific investment becomes illiquid, making hedging impossible.

Given the characteristics of these transactions, they will make little or no contribution to VAR or to traditional market risk sensitivity measures. HSBC captures the risks of such transactions within its stress testing scenarios and monitors gap risk arising on an ongoing basis. HSBC regularly considers the probability of gap loss and fair value adjustments are booked against this risk. HSBC has not incurred any material gap loss in respect of such transactions in the 12 months ended 31 December 2009.

ABSs/MBSs positions

The ABSs/MBSs exposures within the trading portfolios are managed within sensitivity and VAR limits, as described on page 251, and are included within the stress testing scenarios as described on page 252.

Non-trading portfolios

(Audited)

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. The prospective change in future net interest income from non-trading portfolios will be reflected in the current realisable value of these positions, should they be sold or closed prior to maturity.

In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Markets or to separate books managed under the supervision of the local ALCO. This transfer is usually achieved by a series of internal deals between the business units and these books. When the behavioural characteristics of a product differ from its contractual characteristics, the former are assessed to determine the true underlying interest rate risk. Local ALCOs are required to regularly monitor all such behavioural assumptions and interest rate risk positions to ensure they comply with interest rate risk limits established by GMB.

In certain cases, the non-linear characteristics of products cannot be adequately captured by the risk transfer process. For example, both the flow from customer deposit accounts to alternative investment products and the precise prepayment speeds of mortgages will vary at different interest rate levels, and where expectations about future moves in interest rates change. In such circumstances, simulation modelling is used to identify the impact of varying scenarios on valuations and net interest income.

Once market risk has been consolidated in Global Markets or ALCO-managed books, 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 above).

Credit spread risk

At 31 December 2009, the sensitivity of equity to the effect of movements in credit spreads, based on credit spread VAR, on the Group s available-for-sale debt securities was US$535 million (2008: US$1,013 million). The sensitivity was calculated on the same basis as applied to the trading portfolio. Including the gross exposure for the SICs consolidated within HSBC s balance sheet at 31 December 2009, the sensitivity increased to US$549 million. This sensitivity is struck, however, before taking account of any losses which would be absorbed by the capital note holders. At 31 December 2009, the capital note holders would have absorbed the first US$2.2 billion (2008: US$2.2 billion) of any losses incurred by the SICs prior to HSBC incurring any equity losses.

The notable decrease in this sensitivity at 31 December 2009, compared with 31 December 2008, was due to the effect of lower volatility in credit spreads observed during 2009. The overall credit spread positions within the available-for-sale portfolios were lower on 31 December 2009 compared with 31 December 2008.

Equity securities classified as available for sale

Market risk arises on equity securities classified as available for sale. The fair value of these securities at 31 December 2009 was US$9.1 billion (2008: US$7.3 billion) and included private equity holdings of US$4.0 billion (2008: US$2.5 billion). 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. Funds typically invested for short-term cash management represented US$0.8 billion (2008: US$0.9 billion). Investments held to facilitate ongoing business, such as holdings in government-sponsored enterprises and local stock exchanges, represented US$1.2 billion (2008: US$1.0 billion). Other strategic investments represented US$3.1 billion (2008: US$2.4 billion). The fair value of the constituents of equity securities classified as available for sale can fluctuate considerably. A 10 per cent reduction in the value of the available-for-sale equities at 31 December 2009 would have reduced equity by US$0.9 billion (2008:

US$0.7 billion). For details of the impairment incurred on available-for-sale equity securities, see

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Market risk > Sensitivity of NII / Structural FX exposure

Summary of significant accounting policies on page 369.

Sensitivity of net interest income

(Unaudited)

A principal part of HSBC s management of market risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). HSBC aims, through its management of market risk in non-trading portfolios, 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, businesses use a combination of scenarios relevant to local businesses and local markets and standard scenarios which are required throughout HSBC. The standard scenarios are consolidated to illustrate the combined pro forma
effect on HSBC s consolidated portfolio valuations and net interest income.

The table below sets out the effect on future net interest income of an incremental 25 basis points parallel fall or rise in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 January 2010. Assuming no management actions, a sequence of such rises would increase planned net interest income for 2010 by US$695 million (2009: US$463 million decrease), while a sequence of such falls would decrease planned net interest income by US$1,563 million (2009: US$284 million decrease). These figures incorporate the effect of any option features in the underlying exposures.

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. The sensitivity of projected net interest income, on this basis, is as follows:

Sensitivity of projected net interest income
(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 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)**
Change in 2009 projected net interest income arising from a shift in yield curves of:							
+25 basis points at the beginning of each quarter	(243)	42	(45)	100	28	(345)	(463)
25 basis points at the beginning of each quarter	41	(42)	(285)	(114)	(235)	351	(284)

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 the Group s current interest rate risk profile. This effect, however, does not incorporate actions that would be taken by Global Markets or in the business units to mitigate the impact of this interest rate risk; in reality, Global Markets 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. HSBC s exposure to the effect of movements in interest rates on its net interest income arises in two main areas, core deposit franchises and Global Markets:

- core deposit franchises: these 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 Global Markets, under the Group s policy of transferring interest rate risk to Global Markets to be managed within defined limits and with flexibility as to the instruments used.

The main drivers of the year on year movements in the sensitivity of the Group s net interest income to the changes in interest rates tabulated above were:

- decreases in interest rates, particularly in US dollar, Hong Kong dollar and sterling which have restricted the Group s ability to pass on to depositors further rate reductions, thereby increasing exposures to further rate falls; and

- Global Markets decreased net trading asset positions, particularly in euros and US dollars. The funding of net trading assets is recorded in Net interest income whereas the income from such assets is recorded in Net trading income .

HSBC monitors the sensitivity of reported reserves to interest rate movements on a monthly basis by 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 HSBC s reported reserves to these movements at the end of 2009 and 2008 and the maximum and minimum month-end figures during these years:

Sensitivity of reported reserves to interest rate movements
(Unaudited)

	US$m	Maximum impact US$m	Minimum impact US$m
At 31 December 2009			
+ 100 basis point parallel move in all yield curves	**(3,096)**	**(3,438)**	**(2,715)**
As a percentage of total shareholders equity	**(2.4%)**	**(2.7%)**	**(2.1%)**
100 basis point parallel move in all yield curves	**3,108**	**3,380**	**2,477**
As a percentage of total shareholders equity	**2.4%**	**2.6%**	**1.9%**
At 31 December 2008			
+ 100 basis point parallel move in all yield curves	(2,740)	(2,740)	(1,737)
As a percentage of total shareholders equity	(2.9%)	(2.9%)	(1.9%)
100 basis point parallel move in all yield curves	2,477	2,609	1,944
As a percentage of total shareholders equity	2.6%	2.8%	2.1%

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 the Group s overall interest rate exposures. The accounting treatment under IFRSs of the Group s remaining interest rate exposures, while economically largely offsetting the exposures shown in the above table, does not require revaluation movements to go to reserves.

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. The main functional currencies in which HSBC s operations transact business are the US dollar, the Hong Kong dollar, pound sterling, the euro, the Mexican peso, the Brazilian real and the Chinese renminbi. 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 operations 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. HSBC s consolidated balance sheet is, therefore, affected by exchange differences between the US dollar and all the non-US dollar functional currencies of underlying subsidiaries.

HSBC hedges structural foreign exchange exposures only in limited circumstances. HSBC s structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that HSBC s 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.

HSBC may also transact hedges where a currency in which it has 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 2009 or at the end of 2008.

Defined benefit pension schemes

(Audited)

Market risk arises within HSBC s 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.

HSBC s defined benefit pension schemes

(Audited)

	2009	2008
	US$bn	US$bn
Liabilities (present value)	**30.6**	24.0
	%	%
Assets:		
Equity investments	**21**	20
Debt securities	**67**	68
Other (including property)	**12**	12

100 100

Lower corporate bond yields in the UK in 2009 resulted in a decrease of 160 basis points in the real discount rate (net of the increase in expected inflation) used to value the accrued benefits payable under the HSBC Bank (UK) Pension Scheme, the Group s largest plan. There was an increase in the liabilities of the scheme which was partially offset by an increase in the fair values of the scheme s plan assets. As a consequence, the deficit on the HSBC Bank (UK) Pension Scheme increased to US$3,822 million from US$392 million. For details of the latest actuarial valuation of the HSBC Bank (UK) pension scheme, see Note 8 on the Financial Statements.

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 the Group s businesses; earning dividend and interest income on its investments in the Group s businesses; providing dividend payments to HSBC Holding s 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 its Structural Positions Review Group.

A number of cross-currency interest rate swaps entered into as part of HSBC Holdings

Table of Contents

management of interest rate risk arising on certain long-term debt capital issues do not qualify for hedge accounting treatment. 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.

Net interest income sensitivity

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 an incremental 25 basis point parallel fall or rise in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 January 2010.

Assuming no management action, a sequence of such rises would increase HSBC Holdings planned net interest income for 2010 by US$16 million (2009: decrease of US$60 million) and decrease cumulative net interest income by US$116 million over a 5-year period from 1 January 2010 (2009: decrease of US$554 million), while a sequence of such falls would decrease planned net interest income for 2010 by US$17 million (2009: increase of US$60 million) and increase cumulative net interest income by US$115 million over a 5-year period from 1 January 2010 (2009: increase of US$554 million). These figures incorporate the effect of any option features in the underlying exposures.

Instead of assuming that all interest rates move together, HSBC groups its interest rate exposures into currency blocs whose interest rates are considered likely to move together. The sensitivity of projected net interest income, on this basis, is described as follows:

Sensitivity of HSBC Holdings net interest income to interest rate movements
(Unaudited)

	US dollar bloc US$m	Sterling bloc US$m	Euro bloc US$m	Total US$m
Change in projected net interest income as at 31 December 2009 arising from a shift in yield curves 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)**
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**

Change in projected net interest income as at 31 December 2008 arising from a shift in yield curves of:

+ 25 basis points at the beginning of each quarter				
0-1 year	(81)	10	11	(60)
2-3 years	(351)	20	77	(254)
4-5 years	(358)	54	64	(240)
25 basis points at the beginning of each quarter				
0-1 year	81	(10)	(11)	60
2-3 years	351	(20)	(77)	254
4-5 years	358	(54)	(64)	240

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Market risk > HSBC Holdings // Residual value risk

HSBC Holdings principal exposure to changes in its net interest income from movements in interest rates arises on short-term cash balances, floating rate loans advanced to subsidiaries and fixed rate debt capital securities in issue which have been swapped to floating rate.

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 the 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.

The projected decrease in HSBC Holdings sensitivity to moves in interest rates is mainly due to the placing of funds received as a result of the rights issue at short tenors.

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 decrease in the negative net interest rate gap in the up to 1 year time bucket is due to funds received as a result of the rights issue being invested in short-term liquid assets.

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 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)	

Table of Contents

	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 2008						
Cash at bank and in hand: balances with HSBC undertakings	443	443				
Derivatives	3,682					3,682
Loans and advances to HSBC undertakings	11,804	8,995	511		1,222	1,076
Financial investments	2,629			300	1,885	444
Investments in subsidiaries	81,993	1,459	1,094		875	78,565
Other assets	131					131
Total assets	100,682	10,897	1,605	300	3,982	83,898
Amounts owed to HSBC undertakings	(4,042)	(3,389)				(653)
Financial liabilities designated at fair values	(16,389)	(4,210)	(4,410)	(5,290)	(3,448)	969
Derivatives	(1,324)					(1,324)
Other liabilities	(1,816)					(1,816)
Subordinated liabilities	(14,017)	(1,500)	(2,187)	(2,962)	(7,152)	(216)
Total equity	(62,587)				(3,650)	(58,937)
Other non-interest bearing liabilities	(507)					(507)
Total liabilities and equity	(100,682)	(9,099)	(6,597)	(8,252)	(14,250)	(62,484)
Off-balance sheet items attracting interest rate sensitivity		(12,353)	4,410	5,046	3,760	(863)
Net interest rate risk gap		(10,555)	(582)	(2,906)	(6,508)	20,551
Cumulative interest rate gap		(10,555)	(11,137)	(14,043)	(20,551)	

Value at risk

Total foreign exchange VAR arising within HSBC Holdings in 2009 and 2008 was as follows:

HSBC Holdings value at risk
(Audited)

	Foreign exchange	
	2009	2008
	US$m	US$m
At 31 December	**83.2**	55.2
Average	**76.6**	40.3
Minimum	**55.2**	29.2
Maximum	**190.8**	56.1

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 the income statement. These loans, and the associated foreign exchange exposures, are eliminated on a Group consolidated basis.

The increased maximum VAR in 2009 related to a portion of the proceeds of the Group s rights issue that was held in sterling.

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 business regularly monitors residual value exposure by reviewing the recoverability of the residual value projected at lease inception. This entails considering the potential of re-letting of operating lease assets and their projected disposal proceeds at the end of their lease terms. Provision is made to the extent that the carrying values of leased assets are impaired through residual values not being fully recoverable.

The net carrying amount of equipment leased to customers on operating leases by the Group takes into account projected residual values at the end of current lease terms, to be recovered through re-letting or disposal in the following periods:

Residual values
(Unaudited)

	2009	2008
	US$m	US$m
Within 1 year	**21**	108
Between 1-2 years	**233**	59
Between 2-5 years	**1,347**	530
More than 5 years	**792**	1,549
Total exposure	**2,393**	2,246

Operational risk

(Unaudited)
Operational risk is relevant to every aspect of the Group s 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 HSBC s operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with the Group s risk appetite, as defined by 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 the Group s operational risk management framework.

In each of HSBC s 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 the business unit. 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 the HSBC approach to Operational Risk Management can be found in the Group pillar 3 disclosures.

Legal risk
(Unaudited)
Each operating company is required to implement procedures to manage legal risk that conform to HSBC 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 is made up 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.

HSBC has a global legal function to assist management in controlling legal risk. The function provides legal advice and support in managing claims against HSBC 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 a Group General Manager. There are legal departments in 58 of the countries in which HSBC operates. There are also regional legal functions in each of Europe, North America, Latin America, the Middle East, and Asia-Pacific.

Operating companies must notify the appropriate legal department immediately any litigation is either threatened or commenced against HSBC or an employee. The appropriate regional legal department must 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 the Group s reputation. Further, any claims which exceed US$1.5 million or equivalent must also be advised to the appropriate regional legal department and the regional legal department must immediately advise the GMO Legal department if any such claim exceeds US$5 million. All such matters are then reported to the Risk Management Meeting of the GMB in a monthly paper.

An exception report must be made to the local compliance function and escalated to the Head of Group Compliance in respect of any breach which has given rise to a fine and/or costs levied by a court of law or regulatory body where the amount is US$1,500 or more, and material or significant issues are reported to the Risk Management Meeting of GMB and/or the Group Audit Committee.

In addition, operating companies are required to submit quarterly returns detailing outstanding claims where the claim (or group of similar claims) exceeds US$10 million, where the action is by a regulatory authority, where the proceedings are criminal, where the claim might materially affect the Group s reputation, or, where the GMO Legal department has requested returns be completed for a particular claim. These returns are used for reporting to the Group Audit Committee and the Board, and disclosure in the *Interim Report* and *Annual Report and Accounts,* 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 the Group to identify and mitigate the permutations of these and other non-financial risks to its business lines across the jurisdictions in which it operates.

Pension risk

(Unaudited)

HSBC operates a number of pension plans throughout the world, as described in Note 8 on the Financial Statements. Some of them are defined benefit plans, of which the largest is the HSBC Bank (UK) Pension Scheme.

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 the cash flow of the Group 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 HSBC Bank (UK) Pension Scheme 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).

The 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.

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 HSBC Bank (UK) Pension Scheme, which accounts for approximately 70 per cent of the obligations of the Group s defined benefit pension plans, is overseen by a corporate trustee who regularly monitors the market risks inherent in the scheme.

Reputational risk

(Unaudited)

The safeguarding of HSBC s reputation is of paramount importance to its continued prosperity and is the responsibility of every member of staff.

HSBC regularly reviews its 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.

263

HSBC has always aspired to the highest standards of conduct and, as a matter of routine, takes account of reputational risks to its business. Reputational risks can arise from a wide variety of causes, including ESG issues and 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 whom it provides financial services, conduct themselves. The training of Directors on appointment includes reputational matters.

A Group Reputational Risk Committee (GRRC) was established in 2008 at which Group functions with responsibility for activities that attract reputational risk are represented. 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 GMB for policy or procedural changes to mitigate such risk. With effect from 2010, Reputational Risk Committees have been established in each of the Group s regions. These committees will ensure that reputational risks are considered at a regional as well as Group level. Minutes from the regional committees will be 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, GMB, the Risk Management Meeting, subsidiary company boards, board committees and senior management during the formulation of policy and the establishment of HSBC standards. These policies, which form an integral part of the internal control system (see page 313), 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 HSBC s risk management system and its sustainability practices.

Sustainability risk

(Unaudited)

Assessing the environmental and social impacts of providing finance to the Group s customers has been firmly embedded into HSBC s 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 HSBC s 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 HSBC s 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 HSBC s

lending and investment activities on sustainable development; and

providing training and capacity building within HSBC s operating companies to ensure sustainability risks are identified and mitigated consistently to either HSBC s own standards, international standards or local regulations, whichever is the higher.

Risk management of insurance operations

(Audited)

HSBC operates a bancassurance model which provides insurance products for customers with whom the Group has a banking relationship. Insurance products are sold to all customer groups, mainly utilising retail branches, the internet and phone centres. Personal Financial Services customers attract the majority of sales and comprise the majority of policyholders.

HSBC offers its customers a wide range of insurance and investment products, many of which complement other bank and consumer finance products.

Many of these insurance products are manufactured by HSBC subsidiaries. The Group underwrites the insurance risk and retains the risks and rewards associated with writing insurance contracts, retaining both the underwriting profit and the commission paid by the manufacturer to the bank distribution channel within the Group. When the Group chooses to manage its exposure to insurance risk through the use of third-party reinsurers, the associated revenue and manufacturing profit is ceded to them. HSBC s exposure to risks associated with manufacturing insurance contracts in its subsidiaries and its management of these risks are discussed below.

Where the Group considers it operationally more effective, third parties are engaged to manufacture insurance products for sale through HSBC s banking network. The Group works with a limited number of market-leading partners to provide the products. These arrangements earn HSBC a commission.

HSBC s bancassurance business operates in all six of the Group s geographical regions with over 30 legal entities, the majority of which are subsidiaries of banking legal entities, manufacturing insurance products. Management of these insurance manufacturers set their own control procedures in addition to complying with guidelines issued by the Group Insurance Head Office. This is headed by HSBC s Managing Director of Insurance, supported by a Chief Operating Officer, Chief Financial Officer and Chief Risk Officer. The role of Group Insurance Head Office includes forming and communicating the strategy for insurance, setting the control framework for monitoring and measuring insurance risk in line with Group practices, and drawing up insurance-specific policies and guidelines for inclusion in the Group Instruction Manuals. 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 report to the Committee, focusing on products and pricing, market and liquidity risk, credit risk, operational and insurance risk.

All insurance products, whether manufactured internally or by a third-party, are subjected to a detailed 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 process consists of an analysis of the inherent risks of a product, including but not limited to market risk, credit risk, insurance and pricing risk and regulatory risk. Certain products, for example those of a particularly complex nature or those providing a guarantee, are reviewed by the Product and Pricing Committee as part of the approval process. The committee comprises the heads of the relevant risk functions within insurance and sits at both regional and Group Insurance levels.

The processes and controls employed to monitor each risk are described under their respective headings below.

The main contracts manufactured by HSBC are as follows:

Life insurance business

(Audited)

Life insurance contracts with discretionary participation features (DPF) allow policyholders to participate in the profits generated from such business, which may take the form of annual bonuses and a final bonus, in addition to providing cover on death. Certain minimum return levels are also guaranteed. The largest portfolio is in Hong Kong.

Credit life insurance business is written to underpin banking and finance products. The policy pays a claim if the holder of the loan is unable to make repayments due to early death or unemployment.

Annuities are contracts providing regular payments of income from capital investment for either a fixed period or during the annuitant s lifetime. Payments to the annuitant either begin on inception of the policy (immediate annuities) or at a designated future date (deferred annuities).

Term assurance and critical illness policies provide cover in the event of death (term assurance) and serious illness.

Linked life insurance contracts pay benefits to policyholders which are typically determined by reference to the value of the investments supporting the policies.

Investment contracts with DPF allow policyholders to participate in the profits generated by such business. The largest portfolio is written in France. Policyholders are guaranteed to receive a return on their investment plus any discretionary bonuses. In addition, certain minimum return levels are guaranteed.

Unit-linked investment contracts are those where the principal benefit payable is the value of assigned assets. Any benefits payable to policyholders related to insurance risk are not significant on these contracts.

Other investment contracts include pension contracts written in Hong Kong.

Non-life insurance business

(Audited)

Non-life insurance contracts include motor, fire and other damage to property, accident and health, repayment protection and commercial insurances.

Motor insurance business covers vehicle damage and liability for personal injury. For fire and other damage to property, the main focus in most markets is providing individuals with home and contents insurance. Cover is also provided for selected commercial customers, largely written in Asia and Latin America.

A very limited portfolio of liability business is written, other than that included in the motor book.

Credit non-life insurance is concentrated in North America, and is originated in conjunction with the provision of loans. Following a decision taken to close the Consumer Lending business in the US, insurance products written in conjunction with this business will now be run off. In December 2007, the group decided to cease 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 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. HSBC has 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 continues to consult on whether a ban on firms selling PPI at the point of sale of the credit product is an appropriate and justified remedy for the deficiencies it identified in the PPI market.

Given the nature of the contracts written by the Group, the risks to which HSBC s insurance operations are exposed fall into two principal categories: insurance risk and financial risk. The following section describes the nature and extent of these risks and HSBC s approach to managing them. The majority of the risk in the insurance business derives from manufacturing activities, and consequently the following sections focus on how the Group manages risk arising in the manufacturing subsidiaries.

Insurance risk

(Audited)

Insurance risk is a risk, other than financial risk, transferred from the holder of a contract to the issuer, in this case HSBC.

The principal insurance risk faced by HSBC is that, over time, the combined cost of claims, benefits, administration and acquisition of the contract 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. Performance of the underlying assets is affected by changes in both interest rates and equity prices (see page 274).

During 2009, Group Insurance agreed to a global risk appetite statement in relation to insurance risks, encompassing limits on the largest exposures the business will write in normal circumstances. In addition to the global statement, local businesses continue to propose their own risk appetites that are authorised centrally.

Life and non-life business insurance risks are controlled by high-level policies and procedures set centrally, supplemented as appropriate with measures which take account of specific local market conditions and regulatory requirements.

Specifically, the Group manages its exposure to insurance risk by applying formal underwriting, reinsurance and claims-handling procedures designed to ensure compliance with regulations. This is supplemented with stress testing. In addition, manufacturing entities are required to obtain authorisation from Group Insurance Head Office to write certain classes of business, with restrictions applying to commercial and liability non-life insurance, in particular.

Local ALCOs and Risk Management Committees are required to monitor certain risk exposures, mainly for life business where the focus is on reviewing the risks associated with the duration and cash flow matching of insurance assets and liabilities.

Reinsurance is also used as a means of mitigating exposure, in particular to aggregations of catastrophe risk. Specific examples are as follows:

Accident and health insurance. Potential exposure to concentrations of claims arising from isolated events such as earthquakes are mitigated by the purchase of catastrophe reinsurance.

Motor insurance. Reinsurance protection is arranged to avoid excessive exposure to larger losses, particularly from personal injury claims.

Fire and other damage to property. Portfolios at risk from catastrophic losses are protected by reinsurance in accordance with information obtained from professional risk-modelling organisations.

Although reinsurance provides a means of managing insurance risk, such contracts expose the Group to counterparty risk, the risk of default by the reinsurer (see page 277).

The following tables provide an analysis of HSBC s insurance risk exposures by geographical region and by type of business. By definition, HSBC is not exposed to insurance risk on investment contracts, so they are not included in the insurance risk management analysis.

Insurance contracts sold by HSBC primarily relate to core underlying banking activities, such as savings and investment products, and credit life products. The Group s manufacturing focuses on personal lines, e.g. contracts written for individuals, which tend to be of higher value than commercial lines. The focus on the higher volume, lower individual value personal lines contributes to diversifying insurance risk.

Life business tends to be longer-term in nature than non-life business and frequently involves an element of savings and investment in the contract. Accordingly, separate tables are provided for life and non-life businesses, reflecting their distinctive risk characteristics. The life insurance risk table provides an analysis of insurance liabilities as the best available overall measure of insurance exposure, because provisions for life contracts are typically set by reference to expected future cash outflows relating to the underlying policies. The table for non-life business uses written premiums as the best available measure of risk exposure because policies are typically priced by reference to the risk being underwritten.

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Insurance operations > Insurance risk

Analysis of life insurance risk liabilities to policyholders[49]
(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 2009						
Life (non-linked)	**2,998**	**14,456**	**526**	**1,026**	**1,973**	**20,979**
Insurance contracts with DPF[50]	**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[50,51]	**20,979**		**35**			**21,014**
Insurance liabilities to policyholders	**26,102**	**17,352**	**998**	**1,026**	**5,501**	**50,979**
At 31 December 2008						
Life (non-linked)	2,962	11,320	343	1,006	1,739	17,370
Insurance contracts with DPF[50]	1,015	11,213	216			12,444
Credit life	252			65		317
Annuities	379		28	805	1,363	2,575
Term assurance and other long-term contracts	1,316	107	99	136	376	2,034
Life (linked)	1,548	2,276	310		1,933	6,067
Investment contracts with DPF[50,51]	17,732		34			17,766

Insurance liabilities to policyholders	22,242	13,596	687	1,006	3,672	41,203

For footnotes, see page 291.

(Audited)

The above table of liabilities to life insurance policyholders highlights that the most significant 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 Europe.

The liabilities for long-term contracts are set by reference to a range of assumptions which include lapse and surrender rates, mortality and expense levels. These assumptions typically reflect each entity s own experience. Economic assumptions, such as investment returns and interest rates, are usually based on market observable data. Changes in underlying assumptions affect the liabilities. The sensitivity of profit after tax and shareholders equity to changes in both economic and non-economic assumptions are considered below in Sensitivity of HSBC s insurance subsidiaries to risk factors and Sensitivity analysis .

Insurance risk arising from life insurance depends on the type of business, and varies considerably. The principal risks are mortality, morbidity, lapse, surrender and expense levels.

The main contracts which generate exposure to mortality and morbidity risks are term assurance contracts and annuities. These risks are monitored on a regular basis, and are primarily mitigated by medical underwriting and by retaining the ability in certain cases to amend premiums in the light of experience. The risk associated with lapses and surrenders is generally mitigated by the application of surrender charges, though other management actions, such as managing the level of bonus payments to policyholders, may be taken. Expense risk is generally managed through pricing. The level of expenses in the contract will be one of the factors considered when setting premiums.

Table of Contents

Analysis of non-life insurance risk net written insurance premiums[49,52]
(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
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)
2007						
Accident and health	27	132	5		25	189
Motor	369	15	10		224	618

Fire and other damage	178	23	7	2	19	229
Liability		12	3	8	34	57
Credit (non-life)	76			157		233
Marine, aviation and transport		12	4		18	34
Other non-life insurance contracts	30	24		30	24	108
Total net written insurance premiums	680	218	29	197	344	1,468
Net insurance claims incurred and movement in liabilities to policyholders	(598)	(90)	(10)	(79)	(151)	(928)

For footnotes, see page 291.

(Audited)

The above table of non-life net written insurance premiums provides an overall summary of the non-life insurance activity of the Group. Motor business is written predominantly in Europe and Latin America and represented the largest class of non-life business in 2009. However, following a decision to close to new business in the second half of 2009, the UK motor book is now in run-off. Fire and other damage to property business is written 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 risk and claims experience risk. Underwriting risk is the risk that HSBC does not charge premiums appropriate to the cover provided and claims experience risk is the risk that portfolio experience differs from expectations. HSBC manages 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 non-life insurance contracts are renewable annually and the underwriters have the right to refuse renewal or to change the terms and conditions of the contract at that time. Management may decide to withdraw a product from the market when it is no longer considered commercially viable, such as the closure of the UK motor book to new business in 2009.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Insurance operations > Insurance risk

Balance sheet of insurance manufacturing subsidiaries by type of contract
(Audited)

A principal tool used by HSBC to manage its exposure to insurance risk, in particular for life insurance contracts, is asset and liability matching.

Models are used 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. In addition to assessing the actual cash inflow required to meet cash outflows, of particular importance is the need to match the expected pattern of cash inflows with the benefits payable on the underlying contracts, which can extend for many years. The table below shows the composition of assets and liabilities and demonstrates that there were sufficient assets to cover the liabilities to policyholders at the end of 2009.

Balance sheet of insurance manufacturing subsidiaries by type of contract
(Audited)

	Insurance contracts					Investment contracts				
	With DPF US$m	**Unit-linked US$m**	**Annuities US$m**	**Term assurance[53] US$m**	**Non-life US$m**	**With DPF[51] US$m**	**Unit-linked US$m**	**Other US$m**	**Other assets[52] US$m**	**Total US$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[55]									**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 liabilities[53]	**15,456**	**8,986**	**2,833**	**2,719**	**2,735**	**21,015**	**7,347**	**3,937**	**11,701**	**76,729**

For footnotes, see page 291.

	Insurance contracts					Investment contracts				
	With DPF US$m	Unit-linked US$m	Annu-ities US$m	Term assur-ance[53] US$m	Non-life US$m	With DPF[51] US$m	Unit-linked US$m	Other US$m	Other assets[52] US$m	Total US$m
At 31 December 2008										
Financial assets	12,336	5,141	2,378	2,209	2,053	17,312	6,138	3,739	6,684	57,990
trading assets					35				4	39
financial assets designated at fair value	959	4,738	457	496	52	4,597	5,525	1,481	1,970	20,275
derivatives	27	3		26		60	170	91	24	401
financial investments	9,383		1,282	399	860	12,482		1,482	2,576	28,464
other financial assets	1,967	400	639	1,288	1,106	173	443	685	2,110	8,811
Reinsurance assets	6	956	311	320	430				60	2,083
PVIF[55]									2,033	2,033
Other assets and investment properties	121	3	32	71	257	459	55	54	935	1,987
Total assets	12,463	6,100	2,721	2,600	2,740	17,771	6,193	3,793	9,712	64,093
Liabilities under investment contracts:										
designated at fair value							6,012	3,271		9,283
carried at amortised cost								284		284
Liabilities under insurance contracts	12,444	6,067	2,575	2,351	2,480	17,766				43,683
Deferred tax	8	7	22	30	1	1		3	515	587
Other liabilities									2,679	2,679
Total liabilities	12,452	6,074	2,597	2,381	2,481	17,767	6,012	3,558	3,194	56,516
Total equity									7,577	7,577

Total equity and liabilities[56]	12,452	6,074	2,597	2,381	2,481	17,767	6,012	3,558	10,771	64,093

For footnotes, see page 291.

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. In an environment where interest rates and yield curves are falling, insurance operations are exposed to re-investment risk as higher yielding assets held in the portfolio mature and are replaced with lower yielding assets. Given the objective to hold rather than trade investments, the 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, the current yield of the debt securities exceeds that which may be obtained on current issues. Management action was taken in relation to certain participating contracts to reduce short-term bonus rates paid to policyholders to manage the immediate strain on the business. Should interest rates and yield curves return to lower levels for prolonged periods, further management actions may be needed.

The table below shows the composition of assets and liabilities by region and demonstrates that there were sufficient assets to cover the liabilities to policyholders for each region at the end of 2009.

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Insurance operations > Financial risks

Balance sheet of insurance manufacturing subsidiaries by geographical region[49]
(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 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[55]	**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 liabilities[56]	**39,206**	**24,932**	**1,491**	**2,779**	**8,321**	**76,729**

At 31 December 2008						
Financial assets	31,246	17,865	961	2,625	5,293	57,990
trading assets					39	39
financial assets designated at fair value	12,605	4,153	581		2,936	20,275
derivatives	258	117			26	401
financial investments	14,240	10,689	91	2,040	1,404	28,464
other financial assets	4,143	2,906	289	585	888	8,811
Reinsurance assets	920	1,004	20	13	126	2,083
PVIF[55]	845	905	81		202	2,033
Other assets and investment properties	933	400	9	354	291	1,987
Total assets	33,944	20,174	1,071	2,992	5,912	64,093
Liabilities under investment contracts:						
designated at fair value	5,310	3,895	78			9,283
carried at amortised cost					284	284
Liabilities under insurance contracts	23,752	13,873	745	1,237	4,076	43,683
Deferred tax	304	161	19		103	587
Other liabilities	2,184	190	42	11	252	2,679
Total liabilities	31,550	18,119	884	1,248	4,715	56,516
Total equity	2,394	2,055	187	1,744	1,197	7,577
Total equity and liabilities[56]	33,944	20,174	1,071	2,992	5,912	64,093

For footnotes, see page 291.

Financial risks

(Audited)

HSBC s 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, for example, when the proceeds from financial assets are not sufficient to fund the obligations arising from non-linked insurance and investment contracts. Certain insurance-related activities undertaken by HSBC subsidiaries such as insurance broking, insurance management (including captive management) and the administration and intermediation of insurance, pensions and annuities are exposed to financial risks, but not to a significant extent.

Risk management procedures which reflect local market conditions and regulatory requirements may be implemented by HSBC s insurance manufacturing subsidiaries in addition to policies provided for Group-wide application through the Group Instruction Manuals. In many jurisdictions, local regulatory requirements prescribe the type, quality and concentration of assets that these subsidiaries must maintain to meet insurance liabilities. Within each subsidiary, ALCOs are responsible for ensuring that exposures to financial risks remain within local requirements and risk mandates (as agreed with Group Insurance Head Office), and ensure compliance with the control framework established centrally through the Group Instruction Manuals.

The following table analyses the assets held in HSBC s insurance manufacturing subsidiaries at 31 December 2009 by type of contract, and provides a view of the exposure to financial risk:

Financial assets held by insurance manufacturing subsidiaries
(Audited)

	Life linked contracts[57] US$m	Life non-linked contracts[58] US$m	Non-life insurance[59] US$m	Other assets[54] US$m	Total[60] US$m
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[61]	**861**	**4,473**	**1,475**	**1,263**	**8,072**
	15,570	**44,451**	**2,290**	**7,252**	**69,563**

At 31 December 2008					
Trading assets					
Debt securities			35	4	39
Financial assets designated at fair value	10,263	7,990	52	1,970	20,275
Treasury bills	31	197		8	236
Debt securities	4,091	3,109	52	1,625	8,877
Equity securities	6,141	4,684		337	11,162
Financial investments					
Held-to-maturity:					
debt securities		10,411	170	510	11,091
Available-for-sale		14,617	690	2,066	17,373
Treasury bills		4	130	128	262
other eligible bills			272	126	398
debt securities		14,602	254	1,596	16,452
equity securities		11	34	216	261
Derivatives	173	204		24	401
Other financial assets[61]	843	4,752	1,106	2,110	8,811
	11,279	37,974	2,053	6,684	57,990

For footnotes, see page 291.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Insurance operations > Financial risks > Market risk

The table demonstrates that for linked contracts, HSBC typically designates assets at fair value. For non-linked contracts, the classification of the assets is driven by the nature of the underlying contract.

The table also shows that approximately 64.4 per cent of financial assets were invested in debt securities at 31 December 2009 (2008: 62.9 per cent) with 22.2 per cent (2008: 19.7 per cent) invested in equity securities.

In life linked insurance, premium income less charges levied is invested in a portfolio of assets. HSBC manages 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. Typically, HSBC retains some exposure to market risk as the market value of the linked assets influences the fees charged by HSBC and thereby affects the recoverability of expenses incurred by the Group in managing the product. The assets held to support life linked liabilities represented 22.4 per cent of the total financial assets of HSBC s insurance manufacturing subsidiaries at the end of 2009 (2008: 19.4 per cent).

Market risk

(Audited)

Insurance and investment products manufactured by HSBC s insurance manufacturing subsidiaries typically comprise features or combinations of features which may not be easily or exactly replicated by investments. 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 HSBC s insurance manufacturing subsidiaries which generate market risk, and the market risk to which these features expose the subsidiaries, are discussed below.

Long-term insurance or investment products may incorporate either one investment return guarantee or a combination thereof, divided into the following categories:

- annuities in payment;

- deferred 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;

- capital: policyholders are guaranteed to receive no less than the premiums paid plus declared bonuses less expenses; and

- market performance: policyholders receive an investment return which is guaranteed to be within a prescribed range of average investment returns earned by predetermined market participants on the specified product.

Subsidiaries manufacturing products with guarantees usually retain exposures to falls in market interest rates as they result in lower available yields on the assets bought to support guaranteed investment returns payable to policyholders.

The table below shows, in respect of each category of guarantee, the total liabilities to policyholders established for guaranteed products, the range of investment returns (net of operating costs) implied by the guarantees, and the range of current yields of the investment portfolios supporting the guarantees.

Liabilities to policyholders[62]
(Audited)

	2009									
	Amount of reserve US$m	**Investment returns implied by guarantee**[63] **%**		**Current yields %**		Amount of reserve US$m	2008 Investment returns implied by guarantee[63] %		Current yields %	
Annuities in payment	**925**	**0.0**	**7.5**	**1.3**	**16.7**	744	0.0	11.5	6.5	28.0
Deferred annuities	**943**	**0.0**	**6.0**	**0.9**	**15.1**	120	0.0	6.0	3.9	7.4
Immediate annuities	**553**	**6.0**	**9.0**	**5.4**	**5.4**	576	6.0	9.0	5.4	5.4
Annual return	**17,147**	**0.0**	**4.5**	**0.8**	**6.2**	13,717	0.0	4.5	2.2	4.9
Annual return	**497**	**4.5**	**6.0**	**5.1**	**6.5**	302	4.5	6.0	3.4	7.3
Capital	**15,866**			**2.4**	**4.3**	13,346			2.0	4.3

For footnotes, see page 291.

A certain number of these products have been discontinued, including the US$553 million immediate annuity portfolio in HSBC Finance where, as highlighted in the above table, the current portfolio yield is less than the guarantee. On acquisition of this block of business by HSBC Finance, a provision was established to mitigate the shortfall in yields. There has been no further deterioration in the shortfall since acquisition. There are a limited number of additional contracts where the current portfolio yield is less than the guarantee implied by the contract.

The proceeds from insurance and investment products with DPF are primarily invested in bonds with a proportion allocated to equity securities 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 the market price of equity securities when they 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.

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 HSBC typically remains exposed to market risk as the market value of the linked assets influences the fees HSBC earns for managing them.

How the risks are managed

(Audited)

HSBC s insurance manufacturing subsidiaries manage market risk by using some or all of the following techniques, depending on the nature of the contracts they write:

- for products with DPF, adjusting bonus rates to manage the liabilities to policyholders. Bonus rates are managed by regularly evaluating their sustainability. The effect is that a significant portion of the market risk is borne by the policyholder;
- as far as possible, matching assets to liabilities. For example, for products with annual return or capital guarantees, HSBC seeks to invest in bonds which produce returns at least equal to the investment returns implied by the guarantees while remaining attentive to the overall portfolio credit quality;
- using derivatives in a limited number of instances;
- when designing new products with investment guarantees, evaluating the cost of the guarantee and considering this cost when determining the level of premiums or the price structure;
- periodically reviewing products identified as higher risk, which contain guarantees and embedded optionality features linked to savings and investment products. The scope of the review would include pricing, risk management and profitability (a control introduced during 2008). Guaranteed products which expose the Group to risk beyond the levels deemed acceptable in any of these categories are either altered or are no longer offered to customers;
- 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 for example, by implementing asset reallocation strategies in order to manage risk exposures.

The product approval process includes the identification and assessment of the risk embedded in new products.

Group Insurance Head Office includes a Chief Market and Liquidity Risk Officer reporting to the Chief Risk Officer. Each regional insurance unit

includes an individual responsible for market and liquidity risk.

As described above, the product approval process includes an identification and assessment of the risk embedded in new products, for example, those including options and guarantees within the contract. When such product features are identified, the product proposal is reviewed by Group Insurance Head Office to ensure that the key risks are identified and appropriate risk management procedures are in place. Management reviews certain exposures more frequently when markets demonstrate increased volatility to ensure that any matters arising are dealt with in a timely fashion.

Each insurance manufacturing subsidiary is required to have a market risk mandate which specifies the investment instruments in which it is permitted to invest and the maximum quantum of market risk which it is permitted to retain. It is the responsibility of the subsidiary s ALCO and the Market and Liquidity Risk Committee (sub-committee to the Group Insurance Risk Committee) to ensure that each mandate is consistent with local regulations. All mandates are reviewed and agreed annually by Group Insurance Head Office, and aggregate limits are approved by the Risk Management Meeting of GMB. All market risk mandates include management action loss limits designed to control risk.

How the exposures to risks are measured

(Audited)

HSBC s insurance manufacturing subsidiaries monitor exposures against mandated limits regularly and report these quarterly to Group Insurance Head Office. Exposures are aggregated and reported 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.

The standard measures used to quantify the market risks are as follows:

- 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.

Although these measures are relatively straightforward to calculate and aggregate, there are limitations with them. The most significant limitation 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 return guarantees and certain product features such as the ability of policyholders to surrender their policies. If the yields on investments held to support contracts with guarantees are less than the investment returns implied by the guarantees, shortfalls will be to the account of HSBC.

HSBC recognises these limitations and augments its 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 the insurance manufacturing subsidiaries. HSBC s insurance manufacturing subsidiaries report the results of their stress tests every quarter to Group Insurance Head Office, where the reports are consolidated and reviewed by the Group Insurance Market and Liquidity Risk Meeting and the Group Stress Test Review Group.

HSBC s insurance manufacturing subsidiaries identify the assets and liabilities in their financial statements whose values are sensitive to each category of market risk and revalue them at various market rates. The outcome of the exercise is expressed in terms of the effect on profit for the year and total equity under the stress-tested assumptions, after taking into consideration tax and accounting treatments where material and relevant.

Table of Contents

Sensitivity of HSBC s insurance manufacturing subsidiaries to risk factors
(Audited)

	2009		2008	
	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	**68**	**(82)**	94	(13)
100 basis points parallel shift in yield curves	**(69)**	**92**	(82)	24
10 per cent increase in equity prices	**19**	**19**	10	10
10 per cent decrease in equity prices	**(20)**	**(20)**	(12)	(12)
10 per cent increase in US dollar exchange rate compared to all currencies	**20**	**20**	28	29
10 per cent decrease in US dollar exchange rate compared to all currencies	**(20)**	**(20)**	(28)	(29)
Sensitivity to credit spread increases	**(36)**	**(91)**	(73)	(134)

The above table illustrates the effect on the aggregated profit for the year and total equity under various interest rate, equity price, foreign exchange rate and credit spread scenarios. Where appropriate, the impact of the stress on the PVIF is included 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.

The sensitivity of the net profit after tax of HSBC s insurance subsidiaries to the effects of increases in credit spreads is a fall of US$36 million (2008: US$73 million fall). The sensitivity is calculated using simplified assumptions based on a one-day movement in credit spreads over a two-year period. A confidence level of 99 per cent, consistent with the Group s VAR, has been applied. Credit spreads experienced some volatility during 2009 but generally improved from the high level at the end of 2008.

Credit risk

(Audited)

Credit risk can give rise to losses through default and can lead to volatility in income statement and balance sheet figures through movements in credit spreads, principally on the US$40.5 billion (2008: US$33.2 billion) non-linked bond portfolio. The exposure of the income statement to the effect of changes in credit spreads is small (see the table above). 52 per cent of the financial assets held by 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.

The exposure of the income statement to the effect of changes in credit spread is small.

HSBC sells certain unit-linked life insurance contracts which are reinsured with a third-party. These insurance contracts include market return guarantees which are underwritten by the third-party. HSBC is exposed to credit risk to the extent that the third-party (the counterparty) is unable to meet the terms of the guarantees. As highlighted in Market Risk above, the cost to the Group 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. As a consequence of the improved market conditions in 2009, there has been a reduction in these costs, and hence the Group s counterparty exposure to the guarantees under the reinsurance agreement at 31 December 2009 was lower than at 31 December 2008. The sale of these contracts ceased in 2008, reflecting the adjusted risk appetite of the business.

Group Insurance Head Office includes a Chief Credit Risk Officer reporting to the Chief Risk Officer. Each regional insurance unit includes an individual responsible for credit risk.

The exposure to credit risk products and the management of the risks associated with credit protection products are included in the description of life and non-life insurance risk on pages 266 to 269. HSBC s insurance manufacturing subsidiaries are responsible for the credit risk, quality and performance of their investment portfolios. Investment credit mandates and limits are set by the subsidiaries and approved by their local insurance ALCOs and Credit Risk functions before being

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Insurance operations > Financial risks > Credit risk

submitted to Group Credit Risk for concurrence. The form and content of the mandates must accord with centrally set investment credit risk guidance regarding credit quality, industry sector concentration and liquidity restrictions, but allow for the inclusion of local regulatory and country-specific conditions. The 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 the 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.

As noted above, under certain circumstances, the Group is able to dilute the effect of investment losses by sharing them with policyholders. However, when, for example, a contract includes a guarantee, losses which would result in a breach of the guaranteed benefits due to the policyholder are borne by the Group.

A number of tools are used to manage and monitor credit risk. These include an Early Warning Report which is produced on a weekly basis to identify investments which may be at risk of future impairment. This report is circulated to senior management in Group Insurance Head Office and the Regional Chief Risk Officers, and risk reduction strategies are implemented when considered appropriate. Similarly, a watch list of investments with current credit concerns is circulated weekly.

Credit quality

(Audited)

The following table presents an analysis of treasury bills, other eligible bills and debt securities within HSBC s insurance business by measures of credit quality. The definitions of the five credit quality classifications are included on page 225. 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. 90.9 per cent (2008: 93.7 per cent) 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					
	Strong US$m	Medium-good US$m	Medium-Satisfactory US$m	Sub-standard US$m	Impaired[64] US$m	Total US$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**
	32,946	**1,589**	**836**	**217**		**35,588**
Supporting shareholders funds[65]						
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**
	3,862	**818**	**196**	**16**		**4,892**
Total[66]						

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**
	36,808	**2,407**	**1,032**	**233**	**40,480**

For footnotes, see page 291.

Table of Contents

HSBC HOLDINGS PLC
Report of the Directors: Risk (continued)

Insurance operations > Financial risks > Credit risk / Liquidity risk

Treasury bills, other eligible bills and debt securities in HSBC s insurance manufacturing subsidiaries (continued)

	Neither past due nor impaired					
	Strong US$m	Medium-good US$m	Medium-satisfactory US$m	Sub-standard US$m	Impaired[64] US$m	Total US$m
At 31 December 2008						
Supporting liabilities under non-linked insurance and investment contracts						
Trading assets debt securities	27	8				35
Financial assets designated at fair value	2,704	335	319			3,358
treasury and other eligible bills	197					197