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FONT size=2 face="serif">) (1) (3) (20) Other commercial (209) (33) (42) (29) (185) (498) Residential mortgages (10) (52) (8) (463) (28) (561) Other personal (770) (125) (171) (5,566) (404) (7,036) Recoveries of amounts written off in previous years 136 47 70 504 156 913 Commercial, industrial and international trade 27 10 4 38 39 118 Real estate 3 □ 10 4 □ 17 Non-bank financial institutions 3 □ □ □ □ 3 Other commercial 5 3 14 18 45 85 Residential mortgages 1 12 1 8 9 31 Other personal 97 22 41 436 63 659 Net charge to profit and loss account[3] 1,023 (220) 102 5,018 272 6,195 Banks (7) □ (1) □ (2) (10) Commercial, industrial and international trade 180 (56) 52 (9) 12 179 Real estate 21 (15) (28) (1) 1 (22) Non-bank financial institutions 18 (3) (1) 1 □ 15 Governments □ □ □ 1 □ 1 Other commercial (65) (29) (18) (21) (35) (168) Residential mortgages 3 (14) 4 494 (5) 482 Other personal 1,035 120 142 4,616 303 6,216 General provisions (162) (223) (48) (63) (2) (498) Foreign exchange and other movements 551 (24) 14 150 (53) 638

Provisions at 31 December 4,812 522 943 5,212 1,070 12,559

Provisions against banks: □ specific provisions 14 □ 3 □ □ 17 Provisions against customers: □ specific provisions 4,036 320 785 4,106 770 10,017 □ general provisions[2] 762 202 155 1,106 300 2,525

Provisions at 31 December	4,812	522	943	5,212	1,070	12,559

	%	%	%	%	%	%
Provisions against customers as a percentage of loans and advances to customers						
specific provisions	1.43	0.40	1.27	1.67	4.58	1.46
general provisions	0.27	0.25	0.25	0.45	1.79	0.37
At 31 December	1.70	0.65	1.52	2.12	6.37	1.83

For footnotes, see page 234.

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Report of the Directors: The Management of Risk (continued)

Credit risk > Provisions / Loan impairment charge

Movement in provisions by industry segment and by geographical region *(continued)*
(Unaudited)

	2003					
	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	North America US$m	Latin America US$m	Total US$m
Provisions at 1 January	3,668	1,143	1,496	642	2,191	9,140
Amounts written off	(902)	(584)	(445)	(4,469)	(1,056)	(7,456)
Commercial, industrial and international trade	(338)	(71)	(201)	(102)	(304)	(1,016)
Real estate	(31)	(12)	(18)	(3)	(115)	(179)
Non-bank financial institutions	(3)	(13)	(21)	—	(30)	(67)
Other commercial	(54)	(65)	(42)	(80)	(54)	(295)
Residential mortgages	(4)	(121)	(16)	(292)	(242)	(675)
Other personal	(472)	(302)	(147)	(3,992)	(311)	(5,224)
Recoveries of amounts written off in previous years	142	42	74	330	22	610
Commercial, industrial and international trade	25	16	18	20	3	82
Real estate	3	—	4	2	—	9
Non-bank financial institutions	2	—	5	4	—	11
Other commercial	49	4	11	10	7	81
Residential mortgages	1	6	1	2	3	13
Other personal	62	16	35	292	9	414
Net charge to profit and loss account[3]	874	400	85	4,557	177	6,093
Banks	(6)	—	3	—	—	(3)
Commercial, industrial and international trade	286	(3)	(45)	77	61	376
Real estate	15	(18)	(8)	(1)	1	(11)
Non-bank financial institutions	(1)	1	(17)	(5)	(1)	(23)
Governments	—	—	1	—	—	1
Other commercial	216	78	(4)	55	(6)	339
Residential mortgages	—	102	23	422	5	552
Other personal	482	271	116	3,950	164	4,983
General Provisions	(118)	(31)	16	59	(47)	(121)
Foreign exchange and other movements[4]	653	54	(29)	4,605	45	5,328
Provisions at 31 December	4,435	1,055	1,181	5,665	1,379	13,715

Provisions against banks:

specific provisions	20		4			24
Provisions against customers:						
specific provisions	3,554	629	981	4,660	1,054	10,878
general provisions[3]	861	426	196	1,005	325	2,813
Provisions at 31 December	4,435	1,055	1,181	5,665	1,379	13,715
	%	%	%	%	%	%
Provisions against customers as a percentage of loans and advances to customers						
specific provisions	1.65	0.84	1.99	2.47	6.97	2.00
general provisions	0.40	0.57	0.40	0.53	2.15	0.52
At 31 December	2.05	1.41	2.39	3.00	9.12	2.52

1 *See table below Net impairment charge to income statement by geographical region.*
2 *Collectively assessed impairment allowances (2004 and 2003: general provisions) are allocated to geographical segments based on the location of the office booking the provision. Consequently, the general provisions booked in Hong Kong may cover assets booked in branches located outside Hong Kong, principally in Rest of Asia-Pacific, as well as those booked in Hong Kong.*
3 *See table below Net charge to the profit and loss account for bad and doubtful debts by geographical region.*
4 *Other movements include amounts of US$129 million in Europe and US$4,524 million in North America transferred in on the acquisition of HSBC Finance Corporation, and of US$116 million in Latin America transferred in on the acquisition of Lloyds TSB Groups Brazilian businesses and assets.*

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Net loan impairment charge to the income statement by geographical region
(Unaudited)

	Year ended 31 December 2007					
	Europe	**Hong Kong**	**Rest of Asia-Pacific**	**North America**	**Latin America**	**Total**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**
Individually assessed impairment allowances						
New allowances	**781**	**103**	**211**	**228**	**210**	**1,533**
Release of allowances no longer required	**(388)**	**(32)**	**(96)**	**(54)**	**(38)**	**(608)**
Recoveries of amounts previously written off	**(38)**	**(14)**	**(32)**	**(26)**	**(19)**	**(129)**
	355	**57**	**83**	**148**	**153**	**796**
Collectively assessed impairment allowances						
New allowances net of allowance releases	**2,692**	**184**	**623**	**11,999**	**1,759**	**17,257**
Recoveries of amounts previously written off	**(504)**	**(29)**	**(92)**	**(36)**	**(215)**	**(876)**
	2,188	**155**	**531**	**11,963**	**1,544**	**16,381**
Total charge for impairment losses	**2,543**	**212**	**614**	**12,111**	**1,697**	**17,177**
Banks	–	–	–	–	–	–
Customers	**2,543**	**212**	**614**	**12,111**	**1,697**	**17,177**
	%	**%**	**%**	**%**	**%**	**%**
Charge for impairment losses as a percentage of closing gross loans and advances	**0.45**	**0.14**	**0.43**	**3.80**	**2.71**	**1.39**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**
31 December 2007						
Impaired loans	**6,266**	**433**	**1,088**	**8,384**	**2,145**	**18,316**
Impairment allowances	**3,938**	**376**	**926**	**11,980**	**1,992**	**19,212**

	Year ended 31 December 2006					
	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	North America US$m	Latin America US$m	Total US$m
Individually assessed impairment allowances						
New allowances	715	93	138	229	122	1,297
Release of allowances no longer required	(439)	(45)	(130)	(61)	(36)	(711)
Recoveries of amounts previously written off	(33)	(14)	(28)	(39)	(14)	(128)

	243	34	(20)	129	72	458
Collectively assessed impairment allowances						
New allowances net of allowance releases	2,285	150	599	6,715	991	10,740
Recoveries of amounts previously written off	(388)	(27)	(67)	(46)	(123)	(651)
	1,897	123	532	6,669	868	10,089
Total charge for impairment losses	2,140	157	512	6,798	940	10,547
Banks	—	—	(1)	—	(2)	(3)
Customers	2,140	157	513	6,798	942	10,550
	%	%	%	%	%	%
Charge for impairment losses as a percentage of closing gross loans and advances	0.45	0.12	0.48	2.24	1.89	0.99
	US$m	US$m	US$m	US$m	US$m	US$m
31 December 2006						
Impaired loans	5,858	454	1,188	4,822	1,478	13,800
Impairment allowances	3,683	365	901	7,247	1,389	13,585

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Report of the Directors: The Management of Risk (continued)

Credit risk > Loan impairment charge > 2007

Net loan impairment charge to the income statement by geographical region *(continued)*
(Unaudited)

	Year ended 31 December 2005					
	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	North America US$m	Latin America US$m	Total US$m
Individually assessed impairment allowances						
New allowances	1,029	200	131	299	56	1,715
Release of allowances no longer required	(648)	(123)	(166)	(42)	(19)	(998)
Recoveries of amounts previously written off	(21)	(18)	(34)	(101)	(25)	(199)
	360	59	(69)	156	12	518
Collectively assessed impairment allowances						
New allowances	2,013	159	339	5,072	842	8,425
Release of allowances no longer required	(326)	(45)	(86)	(264)	(67)	(788)
Recoveries of amounts previously written off	(63)	(27)	(48)	(45)	(112)	(295)
	1,624	87	205	4,763	663	7,342
Total charge for impairment losses	1,984	146	136	4,919	675	7,860
Banks	(5)	–	(2)	–	–	(7)
Customers	1,989	146	138	4,919	675	7,867
	%	%	%	%	%	%
Charge for impairment losses as a percentage of closing gross loans and advances	0.55	0.12	0.15	1.83	2.11	0.90
	US$m	US$m	US$m	US$m	US$m	US$m
31 December 2005						
Impaired loans	5,081	506	945	3,710	1,226	11,468
Impairment allowances	3,499	398	837	5,349	1,283	11,366

Net charge to the income statement for bad and doubtful debts by geographical region
(Unaudited)

	Year ended 31 December 2004				
		Hong	Rest of Asia-	North	Latin

	Europe	Kong	Pacific	America	America	Total
	US$m	US$m	US$m	US$m	US$m	US$m
Specific provisions						
New provisions	2,047	237	419	5,690	479	8,872
Release of provisions no longer required	(726)	(187)	(199)	(105)	(49)	(1,266)
Recoveries of amounts previously written off	(136)	(47)	(70)	(504)	(156)	(913)
	1,185	3	150	5,081	274	6,693
General provisions	(162)	(223)	(48)	(63)	(2)	(498)
Total bad and doubtful debt charge	1,023	(220)	102	5,018	272	6,195
Banks	(7)	—	(1)	—	(2)	(10)
Customers	1,030	(220)	103	5,018	274	6,205
	%	%	%	%	%	%
Bad and doubtful debt charge as a percentage of closing gross loans and advances	0.36	(0.28)	0.17	1.88	1.20	0.91
	US$m	US$m	US$m	US$m	US$m	US$m
31 December 2004						
Non-performing loans	6,039	696	1,160	3,555	977	12,427
Provisions	4,798	522	940	5,212	1,070	12,542

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(Unaudited)

	Year ended 31 December 2003					
	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	North America US$m	Latin America US$m	Total US$m
Specific provisions						
New provisions	1,485	655	412	4,907	318	7,777
Release of provisions no longer required	(351)	(182)	(269)	(80)	(71)	(953)
Recoveries of amounts previously written off	(142)	(42)	(74)	(329)	(23)	(610)
	992	431	69	4,498	224	6,214
General provisions	(118)	(31)	16	59	(47)	(121)
Total bad and doubtful debt charge	874	400	85	4,557	177	6,093
Banks	(6)	—	3	—	—	(3)
Customers	880	400	82	4,557	177	6,096
	%	%	%	%	%	%
Bad and doubtful debt charge as a percentage of closing gross loans and advances	0.41	0.53	0.17	2.33	0.79	1.12
	US$m	US$m	US$m	US$m	US$m	US$m
31 December 2003						
Non-performing loans	5,701	1,671	1,538	4,889	1,251	15,050
Provisions	4,415	1,055	1,177	5, 665	1,379	13,691

Impairment allowances as a percentage of loans and advances to customers

(Unaudited)

	At 31 December	
	2007	2006
	%	%
Total impairment allowances to gross lending[1]		
Individually assessed impairment allowances	**0.28**	0.30
Collectively assessed impairment allowances	**1.73**	1.28
	2.01	1.58

1 *Net of reverse repo transactions, settlement accounts and stock borrowings*.

Year ended 31 December 2007 compared with year ended 31 December 2006

(Unaudited)

Loan impairment charges rose by 63 per cent to US$17.2 billion from US$10.5 billion in 2006. The commentary that follows is on a constant currency basis:

New allowances for loan impairment charges rose by 52 per cent, compared with 2006. Releases and recoveries of allowances increased by 1 per cent to US$1.6 billion.

In **Europe**, new loan impairment charges were US$3.5 billion, a rise of 8 per cent compared with 2006. This partly reflected growth in commercial lending, where charges remained low compared with historical amounts but rose from the exceptionally low levels experienced in 2005 and 2006. Increased charges also reflected growth in credit card lending in Turkey. In the UK, refinements to the methodology used to calculate roll rate percentages resulted in a higher charge in the consumer finance

operations in the first half of the year. Excluding this, loan impairment charges were marginally lower than in 2006.

Releases and recoveries in Europe were broadly in line with 2006.

In **Hong Kong,** new loan impairment charges of US$287 million were recorded, an increase of 19 per cent, due to the growth in credit card balances and new corporate loan charges.

Releases and recoveries in Hong Kong decreased to US$75 million, primarily in the corporate sector. This reflected the low level of allowances added in recent years.

In **Rest of Asia-Pacific**, new loan impairment charges rose by 10 per cent to US$834 million, with higher loan impairment charges arising in the commercial loan books in Thailand and Malaysia. This was offset by a decline in loan impairment charges for personal lending, particularly in Taiwan and Indonesia, where charges returned to more

Report of the Directors: The Management of Risk (continued)

Credit risk > Loan impairment charge > 2007 / 2006

regular levels after an upsurge in 2006 due to regulatory changes which affected collection activity and minimum payments.

With corporate and commercial loan impairment charges low in recent years, releases and recoveries decreased by 6 per cent to US$220 million.

New loan impairment charges in **North America** rose by 76 per cent to US$12.2 billion, driven by the continued deterioration in credit quality in the US consumer finance loan portfolio.

US credit quality deteriorated as mortgage delinquencies rose, house prices declined, refinancing credit became less available in the market and the macroeconomic outlook worsened. 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 217.

Other factors affecting the rise in US loan impairment charges included normal seasoning of the portfolio, a higher proportion of unsecured personal lending and a return to historical norms from the unusually low levels of bankruptcy filings experienced in 2006, following changes enacted to US bankruptcy law in 2005.

Delinquency rates rose across all parts of the HSBC Finance personal lending portfolio, with mortgage services and consumer lending experiencing significant rises in delinquency which flowed through subsequent stages through to foreclosure. As the housing downturn began to have more effect on the broader economy, delinquency rates in credit cards and vehicle finance rose in the final quarter of 2007. A change in product mix in the cards portfolio towards higher yielding products also contributed to higher impairment charges as this segment of the portfolio seasoned.

Releases and recoveries in North America decreased to US$116 million. In the US consumer finance business, collection staff increased in all lending portfolios as part of the response to the deteriorating credit environment.

In **Latin America**, new loan impairment charges rose by 63 per cent to US$2.0 billion. The most significant increase was registered in Mexico, reflecting strong growth in balances, normal portfolio seasoning and a rise in delinquency rates in credit cards. Charges for commercial lending in Mexico fell as increased delinquency rates in the small and medium-sized business portfolios were offset by impairment allowance releases. Products with high credit losses were discontinued or restructured. Loan impairment charges in Brazil rose

marginally, due to growth in store loans and credit cards.

Releases and recoveries in Latin America increased to US$272 million. In Brazil, credit models were changed during 2007 to align with credit behaviour in underlying portfolios.

Year ended 31 December 2006 compared with year ended 31 December 2005
(Unaudited)

Loan impairment charges increased by US$2.7 billion, or 34 per cent, compared with 2005. Acquisitions accounted for US$309 million of the rise, mainly Metris in the US. On an underlying basis, the increase was 30 per cent. Personal Financial Services continued to dominate loan impairments, representing 94 per cent of the

Group□s charge. On a constant currency basis, the key trends were as follows.

New allowances for loan impairment charges of US$12.0 billion increased by 27 per cent compared with 2005. Releases and recoveries of allowances were broadly in line with 2005.

In **Europe**, new loan impairment charges rose by 9 per cent compared with 2005 to US$3.0 billion. A challenging credit environment in UK unsecured lending, which began to deteriorate in the middle of 2005, was the primary cause of the increase, although this was partly mitigated by continued benign corporate and commercial impairment experience. Personal bankruptcies and the use of IVAs have been on a rising trend since the introduction of legislation in 2004 that eased filing requirements, and this was further exacerbated by the recent active marketing of bankruptcy and IVA relief through the media by debt advisors. Additionally, a rise in unemployment, which began in the middle of 2005, and modest rises in interest rates added to the strain on some personal customers. In response, HSBC tightened underwriting controls in the second half of 2005, reduced its market share of unsecured personal lending and changed the product mix of new business towards lower-risk customers. In 2006, there were early signs of improvement in more recent unsecured lending. New loan impairment charges also rose in Turkey, by 30 per cent, mainly due to growth in unsecured credit card and personal lending as overall credit quality remained stable. In France, new charges fell, reflecting a stable credit environment and the reduction in charges following the sale of a consumer finance business in the second half of 2005.

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Releases and recoveries in Europe of US$860 million were 17 per cent higher than in 2005. Increases in the UK were partially offset by a decline in France. In the UK, increased resources deployed on collection activities, combined with a rise in sales of delinquent debt, were reflected in significantly higher recoveries. The non-recurrence of several significant recoveries in 2005 led to a large fall in France.

In **Hong Kong,** new loan impairment charges declined by 22 per cent to US$243 million, reflecting the non-recurrence of an individual charge in 2005 for a large commercial customer. This was partly offset by a rise in credit card impairments as a result of a rise in balances. Overall, credit quality remained stable as strong economic growth and low levels of unemployment continued.

Releases and recoveries fell by 49 per cent to US$86 million, again mainly as a result of fewer individual impairment releases in the corporate and commercial sector and the non-recurrence of mortgage lending recoveries in 2005, following improvement in the property market since 2004.

In **Rest of Asia-Pacific**, there was an 88 per cent rise in new impairment allowances toUS$737 million. This was an improvement on the situation in the first half of 2006, when new impairment charges were 111 per cent higher than in the first half of 2005. The year-on-year increase was largely due to Taiwan and, to a lesser extent, Indonesia. During the first half of 2006, new government regulations placing restrictions on collection activity, combined with the popularity of renegotiation schemes offering the opportunity to waive interest and postpone principal payments, led to a sharp rise in credit card defaults, for which a full-year charge of US$200 million was recorded. In the second half of 2006, this problem had begun to moderate and new impairment charges were 31 per cent lower than in the first half. In Indonesia, increased loan impairment charges in the personal sector reflected legislation which introduced higher minimum payment rules and a reduction in fuel subsidies. There were further rises in the Middle East, largely due to loan growth. Elsewhere in the region, credit quality was stable.

Releases and recoveries in the region fell by 11 per cent to US$225 million. The fall was mainly in Malaysia and was partly offset by a rise in commercial releases and recoveries in the Middle East.

In **North America**, new loan impairment charges rose by 36 per cent. Excluding Metris, new charges increased by 30 per cent. Credit

deterioration, mainly in second lien, some portions of first lien and adjustable-rate mortgages acquired from third party correspondents through HSBC□s mortgage services business, were the primary cause of the rise in new charges. As the housing market in the US slowed through 2006 and interest rates rose, delinquency trends on both second lien and portions of first lien mortgages originated in 2005 and 2006 were higher than for loans made in previous years. In addition, the extra payment obligations arising from the repricing of adjustable-rate mortgages to higher rates added to the assessed impairment of the correspondent portfolio, in particular in respect of second lien mortgages ranking behind adjustable-rate first lien mortgages.

As interest rate adjustments will be occurring in an environment of lower home value appreciation and tightening credit, it is estimated that the probability of default on adjustable-rate first mortgages subject to repricing, and on any second lien mortgage loans that are subordinate to an adjustable-rate first lien, will be greater than has been experienced in the past. As a result, loan impairment charges relating to the mortgage services portfolio have increased significantly.

In the second half of 2006, HSBC took action to tighten credit criteria in the mortgage services operation as detailed on page 217. As a consequence, balances in mortgage services declined compared with 30 June 2006.

Notwithstanding the credit weakness witnessed in the mortgage services business, credit delinquency in the majority of the other portfolios, including mortgage balances originated through the branch-based consumer lending business, rose modestly, driven by portfolio ageing and an increased proportion of credit card loans following the Metris acquisition. Partially offsetting factors included the effects of a decline in bankruptcy filings, especially in the first half of 2006 following the spike in the fourth quarter of 2005, low unemployment and the non-recurrence of charges relating to hurricane Katrina.

HSBC in the US closely monitors the two-month-and-over contractual delinquency ratio (being the ratio of two or more months delinquent accounts to gross loans and advances), as management views this as an important indicator of future write-offs. Details are disclosed below. The rise in the total ratio was chiefly as a result of the mortgage services business.

The increase in the US was partly offset by a small decline in new loan impairment charges in

Report of the Directors: The Management of Risk (continued)

Credit risk > Loan impairment charge / HSBC Holdings / Risk elements

Canada, as the strong economy continued to underpin good credit quality.

Releases and recoveries in North America decreased by 23 per cent to US$146 million due to the non-recurrence of recoveries in the US.

In **Latin America**, new impairment charges rose by 24 per cent to US$1.1 billion in 2006. This increase was chiefly attributable to Mexico and, to a lesser extent, Brazil. Strong growth in personal and

commercial lending in Mexico resulted in higher new charges. In Brazil, new charges rose by 11 per cent, a significant reduction from the 52 per cent rise reported in 2005, as credit quality improved following enhancements made to underwriting procedures during 2005 and 2006.

Latin American releases and recoveries went up by 7 per cent, largely in Mexico as a result of more stable political and economic conditions.

Charge for impairment losses as a percentage of average gross loans and advances to customers
(Unaudited)

	Europe %	Hong Kong %	Rest of Asia-Pacific %	North America %	Latin America %	Total %
Year ended 31 December 2007						
New allowances net of allowance releases	**0.86**	**0.29**	**0.83**	**4.20**	**4.55**	**2.09**
Recoveries	**(0.15)**	**(0.05)**	**(0.14)**	**(0.02)**	**(0.55)**	**(0.12)**
Total charge for impairment losses	**0.71**	**0.24**	**0.69**	**4.18**	**4.00**	**1.97**
Amount written off net of recoveries	**0.67**	**0.23**	**0.67**	**2.55**	**2.95**	**1.36**
Year ended 31 December 2006	0.87	0.23	0.80	2.52	3.95	1.49

New allowances net of allowance releases						
Recoveries	(0.14)	(0.05)	(0.13)	(0.03)	(0.50)	(0.10)
Total charge for impairment losses	0.73	0.18	0.67	2.49	3.45	1.39
Amount written off net of recoveries	0.77	0.20	0.62	1.77	3.36	1.15
Year ended 31 December 2005						
New allowances net of allowance releases	0.76	0.24	0.33	2.15	3.97	1.25
Recoveries	(0.03)	(0.06)	(0.13)	(0.07)	(0.68)	(0.09)
Total charge for impairment losses	0.73	0.18	0.20	2.08	3.29	1.16
Amount written off net of recoveries	1.00	0.31	0.37	2. 02	2.77	1.26
Year ended 31 December 2004						
New provisions	0.78	0.31	0.77	2.61	3.09	1.41
Releases and recoveries	(0.33)	(0.30)	(0.49)	(0.28)	(1.32)	(0.35)
Net charge for specific provisions	0.45	0.01	0.28	2.33	1.77	1.06
Total provisions charged	0.39	(0.29)	0.19	2.31	1.64	0.99
Amount written off net of recoveries	0.46	0.33	0.61	2. 57	3.41	1.26
Year ended 31 December 2003						
New provisions	0.76	0.89	0.96	3.06	2.22	1.60
Releases and recoveries	(0.25)	(0.30)	(0.80)	(0.25)	(0.65)	(0.32)
Net charge for specific provisions	0.51	0.59	0.16	2.81	1.57	1.28
Total provisions charged	0.45	0.54	0.20	2.84	1.23	1.25
Amount written off net of recoveries	0.39	0.73	0.86	2. 58	7.20	1.40

HSBC Holdings
(Audited)

Credit risk arises in HSBC Holdings primarily as a result of transactions with Group subsidiaries as well as guarantees issued in support of obligations incurred by some Group businesses in the normal conduct of their business.

These risks are reviewed and managed, within regulatory and internal limits for exposures, by the HSBC Group Risk function, which provides high-level, centralised oversight and management ofHSBC s credit risks world-wide, reporting to the Group Chief Risk Officer.

No collateral or other credit enhancements were held by HSBC Holdings in respect of its transactions with subsidiary undertakings.

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HSBC Holdings’ maximum exposure to credit risk at 31 December 2007 is shown below. HSBC Holdings’ financial assets represent claims on Group

subsidiaries, principally located in Europe and North America.

	2007			2006 (restated)[1]		
	Carrying value US$m	**Off-balance sheet exposure US$m**	**Maximum exposure US$m**	Carrying value US$m	Off-balance sheet exposure US$m	Maximum exposure US$m
Derivatives	**2,660**	—	**2,660**	1,599	—	1,599
Loans and advances to HSBC undertakings	**17,242**	**3,638**	**20,880**	14,456	3,967	18,423
Financial investments	**3,022**	—	**3,022**	3,614	—	3,614
Guarantees	—	**38,457**	**38,457**	—	17,605	17,605
	22,924	**42,095**	**65,019**	19,669	21,572	41,241

1 *Comparative figures have been restated to include US$298 million of available-for-sale assets within the total for financial investments held by HSBC Holdings.*

All of the derivative transactions are with HSBC undertakings which are banking counterparties (2006: 100 per cent).

The credit quality of loans and advances to HSBC undertakings is assessed as satisfactory risk, with 100 per cent of the exposure being neither past due nor impaired (2006: 100 per cent).

The long-term debt rating of issuers of financial investments is within the Standard & Poor’s ratings range of AA− to AA+ (2006: AA− to AA+).

Risk elements in the loan portfolio
(This section all unaudited)

The disclosure of credit risk elements under the following headings reflects US accounting practice and classifications for publicly traded bank holding companies:

- loans accounted for on a non-accrual basis;
- accruing loans contractually past due 90 days or more as to interest or principal; and
- troubled debt restructurings not included in the above.

Troubled debt restructurings

The SEC requires separate disclosure of any loans whose terms have been modified because of problems with the borrower to grant concessions other than are warranted by market conditions. These are classified as ‘troubled debt restructurings’ and are distinct from the normal restructure activities in personal loan portfolios described in ‘Renegotiated loans’ on page 227. Disclosure of troubled debt restructurings may be discontinued after the first year if the debt performs in accordance with the new terms.

Troubled debt restructurings increased by 54 per cent in 2007, reflecting measures taken to mitigate risk in the US consumer finance business in response to the deterioration in mortgage loans.

Unimpaired loans past due 90 days or more

Unimpaired loans contractually past due 90 days or more increased by 11 per cent. The rise was largely attributable to the US consumer finance business, where credit quality deteriorated throughout the year. The rise in overdue balances on credit cards in Mexico also contributed.

Impaired loans

In accordance with IFRSs, HSBC recognises interest income on assets after they have been written down as a result of an impairment loss. In the following tables, HSBC represents information on its impaired loans and advances which are designated in accordance with the policy described above.

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 above, including ARMs and stated-income products.

Risk elements

The following table provides an analysis of risk elements in the loan portfolios at 31 December for the past five years:

Report of the Directors: The Management of Risk (continued)

Credit risk > Risk elements / Liquidity and funding > Policies / Primary sources of funding

	At 31 December				
	2007 US$m	2006 US$m	2005 US$m	2004 US$m	2003 US$m
Impaired loans					
Europe	**6,266**	5,858	5,081	6,053	5,680
Hong Kong	**433**	454	506	696	1,670
Rest of Asia-Pacific	**1,088**	1,188	945	1,172	1,519
North America	**8,384**	4,822	3,710	3,600	4,177
Latin America	**2,145**	1,478	1,226	932	1,170
	18,316	13,800	11,468	12,453	14,216
Troubled debt restructurings					
Europe	**648**	360	239	213	335
Hong Kong	**146**	189	198	436	571
Rest of Asia-Pacific	**34**	73	121	56	68
North America	**3,322**	1,712	1,417	1,600	1,569
Latin America	**848**	915	878	830	1,041
	4,998	3,249	2,853	3,135	3,584
Unimpaired loans contractually past due 90 days or more as to principal or interest					
Europe	**202**	237	592	68	34
Hong Kong	**49**	79	74	67	205
Rest of Asia-Pacific	**156**	78	40	56	45
North America	**1,302**	1,364	924	1,171	1,252
Latin America	**421**	165	4	–	2
	2,130	1,923	1,634	1,362	1,538
Trading loans classified as grades 6 and 7					
North America	**675**	127	11	–	–
Risk elements on loans					
Europe	**7,116**	6,455	5,912	6,334	6,049
Hong Kong	**628**	722	778	1,199	2,446
Rest of Asia-Pacific	**1,278**	1,339	1,106	1,284	1,632
North America	**13,683**	8,025	6,062	6,371	6,998
Latin America	**3,414**	2,558	2,108	1,762	2,213
	26,119	19,099	15,966	16,950	19,338

Assets held for resale					
Europe	**59**	30	205	27	32
Hong Kong	**29**	42	49	75	2
Rest of Asia-Pacific	**7**	17	31	21	30
North America	**1,172**	999	582	664	720
Latin America	**101**	91	103	44	74
	1,368	1,179	970	831	858
Total risk elements					
Europe	**7,175**	6,485	6,117	6,361	6,081
Hong Kong	**657**	764	827	1,274	2,448
Rest of Asia-Pacific	**1,285**	1,356	1,137	1,305	1,662
North America	**14,855**	9,024	6,644	7,035	7,718
Latin America	**3,515**	2,649	2,211	1,806	2,287
	27,487	20,278	16,936	17,781	20,196
	%	%	%	%	%
Loan impairment allowances as a percentage of risk elements on loans[1]	**75.5**	71.6	71.2	74.1	70.9

1 *Ratio excludes trading loans classified as grades 6 and 7.*

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Liquidity and funding management
(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 necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The objective of HSBCs liquidity and funding management is to ensure that all foreseeable funding commitments, including deposit withdrawals, can be met when due, and that access to the wholesale markets is co-ordinated and cost-effective. It is HSBCs objective to maintain a diversified and stable funding base comprising core retail and corporate customer deposits and institutional balances. This is augmented by wholesale funding and maintaining portfolios of highly liquid assets which are diversified by currency and maturity, with the objective of enabling HSBC to respond quickly and smoothly to unforeseen liquidity requirements.

HSBC requires its operating entities to maintain a strong liquidity position and to manage the liquidity profile of their assets, liabilities and commitments with the objective of ensuring that cash flows are appropriately balanced and all obligations can be met when due.

Policies and procedures
(Audited)

The management of liquidity and funding is primarily carried out locally in the operating entities of HSBC in accordance with practices and limits set by the Group Management Board. These limits vary by entity to take account of the depth and liquidity of the market in which the entity operates. It is HSBCs general policy that each banking entity should be self-sufficient with regards to funding its own operations. Exceptions are permitted to facilitate the efficient funding of certain short-term treasury requirements and start-up operations or branches which do not have access to local deposit markets, all of which are funded under clearly defined internal and regulatory guidelines and limits from HSBCs largest banking operations. These internal and regulatory limits and guidelines serve to place formal limitations on the transfer of resources between HSBC entities and are necessary to reflect the broad range of currencies, markets and time zones within which HSBC operates.

The Groups 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 ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate 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 ensuring 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 HSBCs funding. HSBC places considerable importance on maintaining the stability of these deposits.

The stability of deposits, which are a primary source of funding, depends upon preserving depositor confidence in HSBCs capital strength and liquidity, and on competitive and transparent deposit-pricing strategies.

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, HSBCs banking entities are liquidity providers to the inter-bank market, placing significantly more funds with other banks than they themselves borrow.

The main operating subsidiary that does not accept deposits is HSBC Finance, which funds itself principally by taking term funding in the professional markets and by securitising assets.

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Report of the Directors: The Management of Risk (continued)

Liquidity and funding > Primary sources of funding

At 31 December 2007, US$142 billion (2006: US$150 billion) of HSBC Finance’s liabilities were drawn from professional markets, utilising a

range of products, maturities and currencies to avoid undue reliance on any particular funding source.

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 2007					
Deposits by banks	**42,793**	**78,429**	**11,445**	**4,208**	**5,199**
Customer accounts	**629,227**	**391,659**	**56,294**	**29,445**	**6,614**
Trading liabilities	**314,580**	–	–	–	–
Financial liabilities designated at fair value	**11,730**	**2,083**	**8,286**	**43,147**	**68,726**
Derivatives	**181,009**	**113**	**873**	**1,663**	**613**
Debt securities in issue	**635**	**90,718**	**59,626**	**109,054**	**38,782**
Subordinated liabilities	**3**	**277**	**1,951**	**10,181**	**34,841**
Other financial liabilities	**20,516**	**29,812**	**5,177**	**977**	**1,273**
	1,200,493	**593,091**	**143,652**	**198,675**	**156,048**
Loan commitments	**312,146**	**155,142**	**155,565**	**113,072**	**28,532**
	1,512,639	**748,233**	**299,217**	**311,747**	**184,580**
At 31 December 2006					
Deposits by banks	29,609	55,239	8, 462	6,356	4,893
Customer accounts	535,695	301,847	47,560	25,155	5,420
Trading liabilities	226,608	–	–	–	–
Financial liabilities designated at fair value	8,990	1,103	2, 855	36,194	52,222
Derivatives	99,790	671	884	1,337	167
Debt securities in issue	919	80,288	38,831	102,069	51,171
Subordinated liabilities	–	285	1,296	11,221	30,764
Other financial liabilities	14,809	34,838	1,094	206	711
	916,420	474,271	100,982	182,538	145,348
Loan commitments	321,075	144,38 2	125,141	89,306	34,726

	1,237,495	618,653	226,123	271,844	180,074

The balances in the above table will not agree directly to the balances in the consolidated balance sheet as the table incorporates all cash flows, on an undiscounted basis, relating to both principal and those associated with all future coupon payments (except for trading liabilities and trading derivatives). Furthermore, loan commitments 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 on hedging derivative liabilities are classified according to their contractual maturity.

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.

Advances to deposits ratio

(Audited)

HSBC emphasises the importance of current accounts and savings accounts as a source of funds to finance lending to customers, and discourages reliance on short-term professional funding. To achieve this goal, limits are placed on Group banking entities which restrict their ability to grow loans to customers without corresponding growth in core 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 compares loans and advances to customers as a percentage of core customer current and savings accounts together with term funding with a remaining term to maturity in excess of one year. Loans to customers which are part of reverse repurchase arrangements, and where the Group

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receives securities which are deemed to be liquid, are excluded from the advances to deposits ratio. Current accounts and savings accounts from customers deemed to be professional are excluded. The definition of a professional customer takes account of the size of the customers total deposit balances by applying a tiering classification. Generally, any customer with total funds deposited in excess of US$2 million is regarded as professional. Due to the distinction between core and professional depositors, the Groups measure of advances to deposits will be more restrictive than that which could be inferred from the published financial statements.

The advances to deposits ratios of the Groups principal banking entities
(Audited)

	Year ended 31 December	
	2007	2006
	%	%
HSBC Bank (UK operations)		
Year-end	**97.5**	100.7
Maximum	**101.7**	104.3
Minimum	**92.6**	98.1
Average	**97.1**	102.0
The Hongkong and Shanghai Banking Corporation		
Year-end	**76.7**	72.4
Maximum	**82.2**	77.8
Minimum	**72.4**	72.4
Average	**76.4**	75.5
HSBC Bank USA		
Year-end	**114.9**	116.8
Maximum	**116.8**	132.3
Minimum	**107.0**	115.8
Average	**112.7**	121.4
Total of Groups other principal banking entities		
Year-end	**88.4**	87.5
Maximum	**89.3**	91.6
Minimum	**86.2**	87.5
Average	**87.7**	88.8

The three major Group banking entities shown

separately in the table above represented 71 per cent of the Groups total core deposits at 31 December 2007 (2006: 73 per cent). The table demonstrates that loans to customers in the Groups principal banking entities are broadly 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. In addition to the advances to deposits ratio, the Group uses a range of other measures for managing liquidity risk. These other measures include the ratio of net liquid assets to customer liabilities and projected cash flow scenario analyses.

Ratio of net liquid assets to customer liabilities
(Audited)

Net liquid assets are liquid assets less all funds maturing in the next 30 days from wholesale market sources and from customers who are deemed to be professional. The Group defines liquid assets for the purposes of the liquidity ratio 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. As noted above, the definition of a professional customer takes account of the size of the customer□s total depositsContingent liquidity risk associated with committed loan facilities is not reflected in the ratios. The Group□s framework for monitoring this risk is outlined below.

Limits for the ratio of net liquid assets to customer liabilities are set for each bank operating entity. As HSBC Finance does not accept customer deposits, it is not appropriate to manage their liquidity using the standard liquidity ratios. The liquidity and funding risk framework of HSBC Finance is discussed below.

Ratios of net liquid assets to customer liabilities are provided in the following table. For additional information, the US dollar equivalents of net liquid assets are also provided.

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Report of the Directors: The Management of Risk (continued)

Liquidity and funding > Primary sources of funding / HSBC Holdings

Ratio of net liquid assets to customer liabilities and net liquid assets
(Audited)

	Year ended 31 December 2007		Year ended 31 December 2006	
	Ratio %	**Net liquid assets US$bn**	Ratio %	Net liquid assets US$bn
HSBC Bank (UK operations)				
Year-end	**12.1**	**44.2**	16.3	48.7
Maximum	**21.5**	**80.6**	19.1	50.1
Minimum	**12.1**	**39.9**	12.8	32.9
Average	**15.6**	**52.4**	15.1	40.1
The Hongkong and Shanghai Banking Corporation				
Year-end	**21.8**	**53.9**	21.4	46.7
Maximum	**24.1**	**56.9**	21.4	46.7
Minimum	**16.1**	**35.3**	14.2	28.4
Average	**20.8**	**48.2**	17.5	36.1
HSBC Bank USA				
Year-end	**15.8**	**17.1**	22.7	22.5
Maximum	**25.7**	**26.1**	25.5	25.5
Minimum	**15.8**	**17.1**	19.1	17.8
Average	**21.3**	**22.0**	23.7	23.1
Total of Groups other principal banking entities				
Year-end	**21.0**	**66.1**	24.5	59.4
Maximum	**26.1**	**72.7**	25.6	61.3
Minimum	**21.0**	**58.8**	20.8	43.9
Average	**24.0**	**65.3**	22.9	51.7

The Total of Groups other principal banking entities reflects the other main banking subsidiaries and, as such, includes businesses spread across a range of locations, in many of which the Group may require a higher ratio of net liquid assets to customer liabilities to reflect local market conditions.

Projected cash flow scenario analysis

(Audited)

The Group uses a number of standard projected cash flow scenarios which are designed to model both Group-specific and market-wide liquidity crises. The scenarios vary the rate and timing of deposit withdrawals and drawdowns on committed lending facilities, and restrict access to interbank funding, term debt markets and the ability to generate funds from asset portfolios. The scenarios are modelled by all Group banking entities and by HSBC Finance. The assumptions for each scenario are regularly reviewed for appropriateness. In addition to the Group□s standard projected cash flow scenarios, individual entities are required to design their own scenarios tailored 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 does not accept 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 placing caps 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. At 31 December 2007, the maximum amounts of unsecured term funding maturing in any rolling three-month and rolling 12-month periods were US$6.2 billion and US$17.7 billion, respectively (2006: US$6.1 billion and US$16.0 billion). At 31 December 2007, HSBC Finance also had in place unused committed sources of secured funding, for which eligible assets were held, of US$6.2 billion (2006: US$9.0 billion) and committed backstop lines from non-Group entities in support of CP programmes totalling US$9.3 billion (2006: US$9.3 billion).

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The deterioration of the US sub-prime credit market has reduced the willingness of financial institutions to provide committed financing to entities with exposures to the US sub-prime market, such as HSBC Finance. HSBC Finance continues to have access to term funding markets, although the price of this funding has increased to reflect the downturn in credit markets. Funding plans are in place to enable HSBC Finance to deal with continued stress in the credit markets.

Contingent liquidity risk

(Audited)

In the normal course of its business, the Group provides committed facilities to customers; these

facilities include committed backstop lines to conduit vehicles sponsored by the Group. The liquidity risk consequences of drawdowns on these committed loan facilities provided by Group entities are reflected in projected cash flow scenario analyses, in which the level of drawdown is varied under different stress scenarios. The Group also sets total notional limits by Group entity for non-cancellable contingent funding commitments. The limits are set by the RMM after due consideration of the entity's ability to fund the commitments. The limits are split according to the borrower, the liquidity of the underlying assets and the size of the committed line.

The Group's contractual exposures as 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	
	2007 US$bn	2006 US$bn	**2007 US$bn**	2006 US$bn	**2007 US$bn**	2006 US$bn	**2007 US$bn**	2006 US$bn
Conduits								
Client-originated assets[1]								
– total lines	**9.0**	6.0	**9.7**	9.0	–	–	–	–
– largest individual lines	**1.6**	1.5	**0.9**	1.0	–	–	–	–
HSBC-managed assets[2]	**25.7**	25.8	–	–	–	–	–	–
Other conduits	–	–	**2.6**	3.3	**2.5**	2.2	–	–
Single-issuer liquidity facilities								
– five largest[3]	**10.0**	10.9	**5.9**	4.2	–	–	**1.3**	1.3
– largest market sector[4]	**11.7**	9.5	**4.2**	5.2	–	–	**2.3**	2.8

1 *These vehicles provide funding to Group customers by issuing debt secured by a diversified pool of customer-originated assets.*
2 *These vehicles issue debt secured by highly rated asset-backed securities which are managed by HSBC. All of the exposures shown in the table under this category related to Solitaire.*
3 *These figures represent the five largest committed liquidity facilities provided to customers other than those facilities to conduits.*
4 *These figures represent the total of all committed liquidity facilities provided to the largest market sector.*

The Group recognises that, in times of market stress, it may choose to provide non-contractual liquidity support to certain HSBC-sponsored vehicles or HSBC-promoted products. Such potential support would not be included in the Groups liquidity risk measures until such time as the support becomes legally binding, and would only be provided after careful consideration of the potential funding requirement and the impact on the entitys overall levels of liquidity.

In the second half of 2007, HSBC provided additional funding to two SIVs sponsored by the Group (Cullinan and Asscher) in the form of repos, CP purchases and the acquisition of assets at fair value from Cullinan. In November 2007, HSBC announced its intention to provide investors in Cullinan and Asscher with the option to exchange their capital notes for notes issued by one or more new SPEs, with term funding and liquidity to be

provided by HSBC. For further information on these SIVs, see Off-balance sheet arrangements and special purpose entities on page 183.

HSBC Holdings

(Audited)

HSBC Holdings primary sources of cash are interest and capital receipts from its subsidiaries, which it deploys in short-term bank deposits or liquidity funds. HSBC Holdings primary uses of cash are investments in subsidiaries, interest payments to debt holders and dividend payments to shareholders. On an ongoing basis, HSBC Holdings replenishes its liquid resources through the receipt of interest on, and repayment of, intra-group loans, from dividends paid by subsidiaries and from interest earned on its own liquid funds. The ability of its subsidiaries to pay dividends or advance monies to HSBC Holdings depends, among other things, on their respective

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Report of the Directors: The Management of Risk (continued)

Liquidity and funding > HSBC Holdings / Market risk management > VAR

regulatory capital requirements, statutory reserves, and financial and operating performance.

HSBC actively manages the cash flows from its subsidiaries to optimise the amount of cash held at the holding company level, and expects to continue doing so in the future. The wide range of HSBC's activities means that HSBC Holdings is not dependent on a single source of profits to fund its dividends. HSBC Holdings is also subject to contingent liquidity risk by virtue of loan

commitments and guarantees given. Such commitments are only provided after due consideration of HSBC Holdings' ability to finance these commitments and the likelihood of the need arising. Together with its accumulated liquid assets, HSBC Holdings believes that planned dividends and interest from subsidiaries will enable it to meet anticipated cash obligations. Also, in usual circumstances, HSBC Holdings has full access to capital markets on normal terms.

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 2007					
Amounts owed to HSBC undertakings	–	**109**	**1,801**	**1,192**	–
Financial liabilities designated at fair value	–	**258**	**776**	**8,152**	**28,639**
Derivatives	**44**	–	–	–	–
Subordinated liabilities	–	**160**	**482**	**2,568**	**23,069**
Other financial liabilities	–	**1,398**	–	–	–
	44	**1,925**	**3,059**	**11,912**	**51,708**
Loan commitments	**3,638**	–	–	–	–
	3,682	**1,925**	**3,059**	**11,912**	**51,708**
At 31 December 2006					
Amounts owed to HSBC undertakings	109	221	88	3,025	5
Financial liabilities designated at fair value	–	177	532	4,039	21,029
Derivatives	177	–	–	–	–
Subordinated liabilities	–	158	473	2,525	23,327
Other financial liabilities	13	1,608	–	–	8

	299	2,164	1,093	9,589	44,369
Loan commitments	3,967				
	4,266	2,164	1,093	9,589	44,369

At 31 December 2007, the short-term liabilities of HSBC Holdings totalled US$3.3 billion (2006: US$1.8 billion), including US$1.4 billion in respect of the third interim dividend for 2007 (2006: US$1.5 billion) which was paid on 16 January 2008. Short-term assets of US$8.1 billion (2006: US$7.6 billion) consisted mainly of cash at bank of US$360 million (2006: US$729 million) and loans and advances to HSBC undertakings of US$7.4 billion (2006: US$6.9 billion). Derivatives have been included in the On demand time bucket, and not by contractual maturity. The undiscounted cash flows on hedging derivative liabilities are classified according to their contractual maturity.

Market risk management

(Audited)

The objective of HSBCs 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 Groups status as one of the worlds largest banking and financial services organisations.

Market risk is the risk that movements in market risk factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices will reduce HSBCs 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, proprietary position-taking and other marked-to-market positions so designated.

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Non-trading portfolios include positions that arise from the interest rate management of HSBCs retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from HSBCs insurance operations.

Market risk arising in HSBCs insurance businesses is discussed in Risk management of insurance operations on pages 272 to 275.

The management of market risk is principally undertaken in Global Markets using risk limits approved by the Group Management Board. Limits are set for portfolios, products and risk types, with market liquidity being a principal factor in determining the level of limits set. Traded Credit and Market Risk, an independent unit within the Group Management Office, develops the Groups 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 Traded Credit and Market 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 value at risk (VAR), sensitivity analysis and stress testing. The following table provides an overview of the reporting of risks within this section:

	Portfolio	
	Trading	**Non-trading**
Risk type		
Foreign exchange	VAR	VAR[1]
Interest rate	VAR	VAR[2]
Commodity	VAR	N/A
Equity	VAR	Sensitivity
Credit spread	Sensitivity	Sensitivity[3]

1 *The structural foreign exchange risk is not included within VAR. This is discussed on page 256.*
2 *The VAR for the fixed-rate securities issued by HSBC Holdings is not included within the Group VAR. This is disclosed separately on page 252.*
3 *Credit spread VAR is reported for the credit derivatives transacted by Global Banking. This is disclosed on page 251.*

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 predominantly based 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;

- VAR is calculated to a 99 per cent confidence level; and

- VAR is calculated for a one-day holding period.

HSBC routinely validates the accuracy of its VAR models by backtesting 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 hedged in one

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- 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.

HSBC recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. HSBC also applies a wide range of stress testing, both on individual portfolios and on the Group's consolidated positions.

The VAR, both trading and non-trading, for the Group was as follows:

Value at risk
(Audited)

	2007	2006[1]
	US$m	US$m
At 31 December	**95.3**	68.9
Average	**78.4**	74.5
Minimum	**55.6**	41.5
Maximum	**107.0**	128.8

1 *Restated to incorporate the VAR for HSBC Finance and mortgage servicing rights that were previously reported separately.*

Total VAR at 31 December 2007 increased, compared with 31 December 2006. The major cause of this was an increase in volatility in market rates during the latter half of 2007.

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 histograms below illustrate the frequency of daily revenue arising from Global Markets trading, balance sheet management and other trading activities.

The average daily revenue earned therefrom in 2007 was US$18.7 million, compared with US$21.3 million in 2006. The standard deviation of these daily revenues was US$25.3 million, compared with US$11.4 million in 2006. 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 35 days with negative revenue during 2007, compared with two days in 2006.

Daily distribution of Global Markets trading, balance sheet management and other trading revenues
(Unaudited)

Year ended 31 December 2007
Number of days

Year ended 31 December 2006
Number of days

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.

For a description of HSBCs fair value and price verification controls, see Note 33 on the Financial Statements.

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Trading portfolios

(Audited)

HSBCs 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 Traded Credit and Market 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.

In addition, at both portfolio and position levels, market risk in trading portfolios is monitored and

controlled using a complementary set of techniques. These include VAR and, for interest rate risk, present value of a basis point movement in interest rates, together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of defined market movements.

Market making and proprietary position taking is undertaken within Global Markets. The VAR for such trading activity at 31 December 2007 was US$48.3 million (2006: US$30.2 million). This is analysed below by risk type:

VAR by risk type for the trading activities

(Audited)

	Foreign exchange and commodity US$m	**Interest rate US$m**	**Equity US$m**	**Total US$m**
At 31 December 2007	**11.5**	**37.5**	**23.7**	**48.3**
At 31 December 2006	7.3	27.9	11.8	30.2
Average				
2007	**9.9**	**33.1**	**15.1**	**36.7**
2006	6.3	31.7	6.5	31.6
Minimum				
2007	**4.4**	**24.2**	**8.1**	**26.3**
2006	2.6	18.3	2.6	19.9
Maximum				
2007	**23.2**	**47.5**	**28.1**	**56.0**
2006	12.7	49.6	11.8	48.2

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VAR on those portfolios where VAR is calculated.

The Group is introducing credit spread as a separate risk type within the VAR models and, at 31 December 2007, credit spread VAR was calculated for the London trading and New York credit derivatives portfolios. At that date, the total VAR for the trading activities, including credit spread VAR for the above portfolios, was US$60.1 million.

The effect of movements in credit spreads on the Groups trading portfolio became more significant in 2007 as volatility in these spreads increased in the latter half of 2007. The sensitivity of trading income to the effect of movements in credit spreads on the total trading activities of the Group was US$95.4 million at 31 December 2007 (2006: US$27.3 million). This sensitivity was calculated using simplified assumptions based on one-day movements in average market credit spreads over a two-year period at a confidence level of 99 per cent.

The increase in the sensitivity at 31 December

2007, compared with 31 December 2006, was due to the effect of higher volatility in credit spreads observed in the latter half of 2007. The credit spread positions within the trading portfolios were at a similar level on 31 December 2007 compared with 31 December 2006.

Credit spread risk also arises on credit derivative transactions entered into by Global Banking. The purpose of these transactions is to manage the risk concentrations within the corporate loan portfolio and so enhance capital efficiency. The mark-to-market of these transactions is taken through the profit and loss account.

At 31 December 2007, the credit spread VAR on the credit derivatives transactions entered into by Global Banking was US$19.7 million (2006: US$8.2 million). 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.

HSBC augments its VAR measures with a series of stress scenarios to determine the potential loss arising from market moves that are outside the 99 per cent confidence level measured by VAR.

Report of the Directors: The Management of Risk (continued)

Market risk > Trading portfolios / Non-trading portfolios

The stress scenarios cover a range of potential market events, such as the hypothetical breaking of a currency peg or the historical observation of market moves during previous periods of stress which would not be captured within VAR. The scenarios provide senior management with an assessment of the financial impact such events would have on the profit and loss of HSBC. The daily losses experienced during 2007 were within the stress loss scenarios reported to senior management.

Certain transactions are structured such that the risk to HSBC is negligible under a wide range of market conditions or events, but in which there exists a remote probability that a significant gap event could lead to loss. A gap event could be seen as a change in market price from one level to another with no trading opportunity in between, and 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 for such transactions within the stress testing scenarios. Gap risk arising is monitored on an ongoing basis, and HSBC incurred no gap losses on such transactions in 2007.

Non-trading portfolios
(Audited)

The principal objective of market risk management of non-trading portfolios is to optimise net interest income.

Market 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.

The transfer of market risk to books managed by Global Markets or supervised by ALCO 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 behavioural characteristics 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 the Group Management Board.

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 above).

Fixed-rate securities
(Audited)

Market risk also arises on fixed-rate securities issued by HSBC Holdings. These securities are managed as capital instruments and include non-cumulative preference shares, non-cumulative perpetual preferred securities and fixed-rate subordinated debt. The interest rate VAR for these capital instruments, which is not included within Group VAR, was as follows:

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Capital instruments VAR
(Audited)

	VAR US$m
At 31 December 2007	**104.7**
At 31 December 2006[1]	73.7
Average	
2007	**75.8**
2006[1]	64.0
Minimum	
2007	**61.8**
2006[1]	57.0
Maximum	
2007	**105.4**
2006[1]	73.7

1 *Restated to reflect securities issued by HSBC Holdings only. All other issued fixed-rate securities are included within the VAR for the Group.*

At 31 December 2007, the sensitivity of equity to the effect of movements in credit spreads on the Groups available-for-sale debt securities was US$206.5 million (2006: US$52.0 million). The sensitivity was calculated on the same basis as applied to the trading portfolio. Including the gross exposure for the SIVs consolidated within HSBCs balance sheet at 31 December 2007, the sensitivity increased to US$279.8 million. This sensitivity is struck, however, before taking account of any losses which would be absorbed by the income note holders. At 31 December 2007, the income note holders would have absorbed the first US$1.3 billion of any losses incurred by the SIVs prior to HSBC incurring any equity losses.

The increase in this sensitivity at 31 December 2007, compared with 31 December 2006, was due to the effect of higher volatility in credit spreads observed in the latter half of 2007.

Equity securities classified as available for sale
(Audited)

Market risk arises on equity securities held as available for sale. The fair value of these securities at 31 December 2007 was US$12.6 billion (2006: US$8.3 billion) and included private equity holdings of US$3.2 billion (2006: US$0.9 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 and Group Finance is responsible for reviewing the carrying value of the investments. Funds typically invested for short-term cash management represented US$3.1 billion (2006: US$2.6 billion),

Investments held to facilitate ongoing business, such as holdings in government-sponsored enterprises and local stock exchanges, represented US$1.7 billion (2006: US$1.3 billion). Other strategic investments represented US$4.6 billion (2006: US$3.5 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 2007 would have reduced equity by US$1.3 billion (2006: US$0.8 billion).

Defined benefit pension scheme
(Audited)

Market risk also arises within HSBCs 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 are subject to change due to fluctuations in long-term interest rates as well as factors such as changes in inflation, salary increases and scheme members living longer. The pension scheme assets will include equities and debt securities, the cash flows of which will change as equity prices and interest rates vary. The risks are that market movements in equity prices and interest rates could result in assets which are insufficient over time to cover the level of projected obligations. In addition, increases in inflation and members living longer could increase the pension scheme obligations. Management, together with the trustees who act on behalf of the pension scheme beneficiaries, assess the level of this risk using reports prepared by independent external actuaries and take action, where appropriate, in terms of setting investment strategy and agreeing contribution levels. For example, in order to mitigate the risk of adverse movements in investments, interest rates and inflation, the Trustee of the HSBC Bank (UK) Pension Scheme has continued to implement a programme of initiatives proposed by HSBC, including reducing the equity content of the investment strategy and increasing the diversification of the investments, and entering into long-term interest rate and inflation swaps.

The present value of HSBCs defined benefit pension plans liabilities was US$32.4 billion at 31 December 2007, compared with US$32.2 billion at 31 December 2006. Assets of the defined benefit schemes at 31 December 2007 comprised equity investments, 26 per cent (2006: 30 per cent); debt securities, 62 per cent (2006: 56 per cent); and other (including property), 12 per cent (2006: 14 per cent) (see Note 8 on the Financial Statements).

Increased corporate bond yields in the UK over the period have resulted in an increase of 40 basis points in the real discount rate (net of the increase in expected inflation) used to value the net present value of the benefits payable of the HSBC Bank (UK) Pension Scheme, the Groups largest plan. In addition, the plan assets of the scheme have increased due to a special contribution to the scheme of US$0.6 billion. Primarily as a result of these factors, the deficit on HSBCs defined benefit plans has decreased to US$2 billion from US$4.6 billion.

Sensitivity of net interest income

(Unaudited)

A principal part of HSBCs 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 HSBCs 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 2008. Assuming no management actions, a series of such rises would decrease planned net interest income for 2008 by US$503 million (2007: US$578 million), while a series of such falls would increase planned net interest income by US$525 million (2007: US$511 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 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)

	Rest of	Rest of

	US dollar bloc US$m	Americas bloc US$m	Hong Kong dollar bloc US$m	Asia bloc US$m	Sterling bloc US$m	Euro bloc US$m	Total US$m
Change in 2008 projected net interest income arising from a shift in yield curves of:							
+25 basis points at the beginning of each quarter	**(275)**	**96**	**9**	**77**	**(140)**	**(270)**	**(503)**
25 basis points at the beginning of each quarter	**272**	**(95)**	**11**	**(65)**	**142**	**260**	**525**
Change in 2007 projected net interest income arising from a shift in yield curves of:							
+25 basis points at the beginning of each quarter	(342)	53	(32)	18	(163)	(112)	(578)
25 basis points at the beginning of each quarter	249	(53)	52	(14)	164	113	511

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 Groups 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 impact on net interest income of some rates changing while others remain unchanged. The projections take account of the anticipated net interest income impact of rate change differences

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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.

HSBCs exposure to the effect of movements in interest rates on its net interest income arise in three main areas: core deposit franchises, HSBC Finance and Global Markets.

- Core deposit franchises: these are exposed to changes in the cost of deposits raised and spreads on wholesale funds. In a low interest rate environment, 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.

- HSBC Finance reduces the sensitivity of the core deposit franchises to interest rate reductions. This arises from the fact that HSBC Finance has a substantial fixed rate, real estate secured, lending portfolio which is primarily funded with interest rate sensitive short-term liabilities.

- Residual interest rate risk is managed within Global Markets, under the Groups policy ofransferring interest rate risk to Global Markets to be managed within defined limits and with flexibility as to the instruments used.

The main drivers of change in the sensitivity of the Groups net interest income to the changes in interest rates tabulated above were:

- There has been an overall increase in benefit from rising rates and an increase in exposure to falling rates due to general growth in core deposits.

- The average life of certain US mortgage assets has increased due to a reduction in the predicted rate of refinancing, increasing the benefit from reducing US dollar rates.

- Global Markets increased euro-denominated net trading asset positions leading to increased sensitivity in this currency to both rising and falling rates. The funding of net trading assets is generally sourced from floating rate retail deposits and recorded in Net interest income whereas the income from such assets is recorded in Net trading income. Additionally, balance sheet management increased its exposure to euro-denominated assets in non-trading portfolios, adding to the increased sensitivity.

It can be seen from the above that projecting the movement in net interest income from prospective changes in interest rates is a complex interaction of structural and managed exposures.

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 HSBCs reported reserves to these movements at the end of 2007 and 2006 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 2007			
+ 100 basis point parallel move in all yield curves	**(1,737)**	**(1,738)**	**(1,519)**
As a percentage of total shareholders equity	**(1.4%)**	**(1.4%)**	**(1.2%)**
100 basis point parallel move in all yield curves	**1,977**	**2,048**	**1,430**
As a percentage of total shareholders equity	**1.5%**	**1.6%**	**1.1%**

At 31 December 2006			
+ 100 basis point parallel move in all yield curves	(1, 558)	(2,015)	(1,358)
As a percentage of total shareholders equity	(1.4%)	(1.9%)	(1.3%)
100 basis point parallel move in all yield curves	1,456	1,944	1,270
As a percentage of total shareholders equity	1.3%	1.8%	1.2%

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The sensitivities are illustrative only and are based on simplified scenarios. The table shows interest rate risk exposures arising in available-for-sale portfolios and from cash flow hedges which are marked-to-market through reserves. These particular exposures form only a part of the Groups overall interest rate exposures. The accounting treatment under IFRSs of the Groups 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 or associated undertakings, the functional currencies of which are currencies other than the US dollar.

Exchange differences on structural exposures are recorded in the consolidated statement of recognised income and expense. The main operating (or functional) currencies in which HSBCs business is transacted are the US dollar, the Hong Kong dollar, pound sterling, the euro, the Mexican peso, the Brazilian real and the Chinese renminbi. As the US dollar and currencies linked to it form the dominant currency bloc in which HSBCs operations transact business, HSBC Holdings prepares its consolidated financial statements in US dollars. HSBCs 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. HSBCs structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that HSBCs consolidated capital ratios and the capital ratios of individual banking subsidiaries are 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.

Selective hedges were in place during 2006 and 2007. 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. There was no ineffectiveness arising from these hedges in the year ended 31 December 2007.

There was no material effect from exchange differences on HSBCs capital ratios during the year.

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 Holding's market risk management strategy is to reduce exposure to these risks and minimise volatility in reported income, cash flows and distributable reserves. Market risk for HSBC Holdings is monitored by its Structural Positions Review Group.

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.

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Total VAR arising within HSBC Holdings in 2007 and 2006 was as follows:

Value at risk HSBC Holdings
(Audited)

	Foreign exchange US$m	Interest rates US$m	Total US$m
At 31 December 2007	**49.1**	**97.7**	**105.0**
At 31 December 2006	30.8	61.4	66.4
Average			
2007	**33.6**	**66.0**	**68.1**
2006	27.4	43.6	49.2
Minimum			
2007	**29.2**	**52.7**	**53.3**
2006	23.2	30.7	34.8
Maximum			
2007	**49.1**	**97.7**	**105.0**
2006	32.0	61.4	66.4

The increase in total VAR during 2007 was mainly due to the increase in volatility of interest rates and new debt capital issues made in the year.

(Unaudited)

A principal tool in the management of market risk is the projected sensitivity of HSBC Holdings net interest income to future changes in yield curves.

The table below sets out the effect on HSBC Holdings future net interest income 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 2008.

Assuming no management action, a series of such rises would decrease HSBC Holdings planned net interest income for 2008 by US$23 million (2007: increase of US$8 million) while a series of such falls would increase planned net interest income by US$23 million (2007: decrease of US$8 million). These figures incorporate the impact 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 2008 projected net interest income arising from a shift in yield curves of:				
+25 basis points at the beginning of each quarter	**(51)**	**16**	**12**	**(23)**
25 basis points at the beginning of each quarter	**51**	**(16)**	**(12)**	**23**
Change in 2007 projected net interest income arising from a shift in yield curves of:				

+25 basis points at the beginning of each quarter	(7)	6	9	8
25 basis points at the beginning of each quarter	7	(6)	(9)	(8)

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 and HSBC Holdings current interest rate risk profile. They do not take into account the effect of actions that could be taken to mitigate this interest rate risk, however.

The projected increase in HSBC Holdings sensitivity to moves in interest rates is mainly due to new interest-bearing capital issues, the funds from which have been largely invested in non-interest bearing equity investments in subsidiaries.

Areas of special interest market risk

(Audited)

In the second half of 2007, credit risk concerns emanating from the US sub-prime mortgage market led to a deterioration in the fair value of assets supported by sub-prime mortgages. However, there was a consequential impact beyond sub-prime related assets and, to a lesser degree, fair value

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deterioration occurred in US mortgage-related financial instruments generally, with financial instruments issued by non-US government sponsored entities more significantly affected than sponsored financial instruments.

The following table shows the net market risk arising from HSBCs exposure to US mortgage loans held at fair value through profit or loss, and US mortgage-backed securities (MBSs) including those represented by collateralised debt obligations (CDOs). HSBCs exposures arise from the following activities:

– purchase of sub-prime whole loans with the intention of structuring and placing securitisations into the market;

– secondary market trading activities; and

– holding of MBSs as part of investment portfolios including the HSBC consolidated SIVs and conduits.

Unrealised and realised gains and losses arising from securitisation and secondary market trading activity are recognised in the income statement, while changes in fair value of the investment portfolio and the SIV and conduit portfolios are recognised in equity. US MBSs are primarily measured at fair value; a small proportion of high grade securities are classified as held-to-maturity and measured at amortised cost. There are no significant differences between fair value and carrying amount for these US MBSs measured at amortised cost.

HSBCs principal exposure to the US mortgage market is via credit risk from loans and advances to customers, details of which are set out from page 216.

(Audited)

	Principal[1] US$m	Carrying amount US$m	Unrealised gains and losses[2] US$m	Realised gains and losses[2] US$m	Fair value movements recognised[3] US$m
Year ended 31 December 2007					
US sub-prime mortgage-related assets[4]					
Direct lending	**2,692**	**2,231**	**(383)**	**(221)**	****
MBSs[5]	**5,733**	**5,146**	**(557)**	**(69)**	**(187)**
high grade (AA or AAA rated)	**5,233**	**4,909**	**(114)**		**(187)**
rated C to A	**443**	**186**	**(275)**		****
not publicly rated	**57**	**51**	**(168)**		****
MBS CDOs[5]	**701**	**560**	**(97)**	**12**	**(43)**
high grade (AA or AAA rated)	**665**	**531**	**(95)**		**(38)**
rated C to A	**36**	**29**	**(2)**		**(5)**
not publicly rated	****	****	****		****

	9,126	**7,937**	**(1,037)**	**(278)**	**(230)**
Other US mortgage-related assets					
Direct lending	**762**	**756**	**(4)**	**41**	
MBSs[5]	**47,958**	**46,320**	**(181)**	**(38)**	**(1,051)**
high grade (AA or AAA rated)	**47,859**	**46,254**	**(147)**		**(1,051)**
rated C to A	**87**	**54**	**(34)**		
not publicly rated	**12**	**12**			
	48,720	**47,076**	**(185)**	**3**	**(1,051)**

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	Principal[1] US$m	Carrying amount US$m	Unrealised gains and losses[2] US$m	Realised gains and losses[2] US$m	Fair value movements recognised[3] US$m
Year ended 31 December 2006					
US sub-prime mortgage-related assets					
Direct lending	4,947	4,997	(11)	227	–
MBSs[5]	2,986	2,944	(41)	5	2
– high grade (AA or AAA rated)	2,640	2,641	1		2
– rated C to A	155	146	(1)		–
– not publicly rated	191	157	(41)		–
MBS CDOs[5]	326	325	–	–	–
– high grade (AA or AAA rated)	326	325	–		–
– rated C to A	–	–	–		–
– not publicly rated	–	–	–		–
	8,259	8,266	(52)	232	2
Other US mortgage-related assets					
Direct lending	1,317	1,322	2	45	–
MBSs[5]	40,001	38,691	(72)	70	(42)
– high grade (AA or AAA rated)	39,825	38,531	(59)		(42)
– rated C to A	136	132	–		–
– not publicly rated	40	28	(13)		–
	41,318	40,013	(70)	115	(42)

1 *The principal is the redemption amount on maturity or, in the case of an amortising instrument, the sum of the future redempti on amounts through the residual life of the security.*
2 *Recognised during the year in the income statement.*
3 *Fair value gains and losses recognised during the year in equity.*
4 *HSBC has primarily utilised loan counterparty credit scores as the basis for determining whether an asset is classified as sub- prime.*
5 *Mortgage-backed securities ('MBSs') and collateralised debt obligations ('CDOs').*

In addition to the exposure detailed above, HSBC also holds long positions in MBSs with a carrying value of US$1,633 million (2006: US$963 million) and MBS CDOs with a carrying value of US$349 million (2006: US$608 million) where the exposure has been matched by specific credit derivatives with monolines and other financial institutions. The counterparty credit risk arising from the derivative transactions undertaken with monolines is included in the monoline exposure analysis detailed on page 260.

HSBC's exposure to derivative transactions entered into directly with monoline insurers
(Audited)

HSBC's principal exposure to monoline insurers is through a number of OTC derivative transactions, primarily credit default swaps ('CDSs'). HSBC has entered into CDSs to purchase credit protection against securities held within the trading portfolio.

During the second half of 2007, the market value of the securities declined, with offsetting increases in the mark-to-market value of the CDS transactions, thereby increasing OTC counterparty credit risk to the monoline insurers. The table below sets out the mark-to-market value of the derivative contracts at 31 December 2007, and hence the amount at risk, based on 31 December 2007 security prices, 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 assess that risk, protection purchased is sub-divided between those monoline insurers that had external investment grade ratings at 25 February 2008, and those that did not. The Credit Risk Adjustment column indicates the valuation adjustment taken against the mark-to-market exposures, and reflects the deterioration in creditworthiness of the monoline insurers during 2007. These adjustments have been charged to the income statement.

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Report of the Directors: The Management of Risk (continued)

Residual value risk management / Operational risk management > Legal risk

HSBCs exposure to derivative transactions entered into directly with monoline insurers (Audited)

	Net exposure before credit risk adjustment[1] US$m	Credit risk adjustment[2] US$m	Net exposure after credit risk adjustment US$m
At 31 December 2007			
Derivative transactions with monoline counterparties:			
Monoline investment grade	**1,342**	**(133)**	**1,209**
Monoline below investment grade	**214**	**(214)**	****
	1,556	**(347)**	**1,209**
At 31 December 2006			
Derivative transactions with monoline counterparties:			
Monoline investment grade	9		9

1 *Net exposure after legal netting and any other relevant credit mitigation prior to deduction of credit risk adjustment.*
2 *Fair value adjustment recorded against over-the-counter derivative counterparty exposures to reflect the credit worthiness of the counterparty.*

HSBCs exposure to debt securities which benefit from guarantees provided by monoline insurers
(Audited)

Within both the trading and available-for-sale portfolios, HSBC holds bonds that are wrapped with a credit enhancement from a monoline insurer. Any deterioration in the credit profile of the monoline insurer is reflected in market prices and therefore in the carrying value of these securities in HSBCs balance sheet at 31 December 2007. For wrapped bonds held in the trading portfolio, the mark-to-market loss has been reflected through the income statement. For wrapped bonds held in the available-for-sale portfolio, the mark-to-market deterioration is reflected in equity unless the impairment is regarded as permanent, in which case it is reflected in the income statement. There was no permanent impairment recognised in respect of these assets at 31 December 2007.

HSBCs exposure to direct lending and irrevocable commitments to lend to monoline insurers
(Audited)

HSBC has extended liquidity facilities totalling US$158 million to monoline insurers, none of which was drawn at 31 December 2007 (31 December 2006: US$145 million, none of which was drawn).

Residual value risk management

(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 book value of equipment leased to customers on operating leases by the Group includes 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)

	2007	2006
	US$m	US$m
Within 1 year	**155**	200
Between 1-2 years	**243**	414
Between 2-5 years	**713**	379
More than 5 years	**1,892**	1,996
Total exposure	**3,003**	2,989

Operational risk management

(Unaudited)
Operational risk is the risk of loss arising from fraud, unauthorised activities, error, omission, inefficiency, systems failure or external events. It is inherent in every business organisation and covers a wide spectrum of issues.

HSBC manages this risk through a controls-based environment in which processes are documented, authorisation is independent and transactions are reconciled and monitored. In each of HSBC's subsidiaries, local management is responsible for the review and supervision of the operation of these controls. The control environment

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in each subsidiary is subject to an independent programme of periodic reviews undertaken by Internal Audit. This is supported by the monitoring of external operational risk events, which ensures that HSBC stays in line with industry best practice and takes account of lessons learned from publicised operational failures within the financial services industry.

HSBC has codified its operational risk management framework by issuing a high level standard, supplemented by more detailed formal policies. The detailed policies explain HSBCs approach to identifying, assessing, monitoring and controlling operational risk, give guidance on remedial action to be taken when rectifying operational risk events and set out responsibilities for meeting local regulatory requirements. Processes undertaken to manage operational risk are determined by reference to the scale and nature of each HSBC operation. The HSBC standard covers the following:

- operational risk management responsibility is assigned to senior management within each business operation;
- information systems are used to record the identification and assessment of operational risks and to generate appropriate, regular operational risk reporting;
- assessments are undertaken of the operational risks facing each business and the risks inherent in its processes, activities and products. Risk assessments incorporate an evaluation of the effectiveness of controls and are regularly reviewed to identify significant changes;
- operational risk loss data is collected and reported to senior management at the business unit level. Aggregate operational risk losses are recorded and details of incidents above a materiality threshold are reported to Group Head Office. A regular report on operational losses is made to Group Audit Committee and the Risk Management Meeting; and
- risk mitigation, including insurance, is considered where this is cost-effective.

In each of HSBCs subsidiaries, local management is responsible for implementing HSBC standards on operational risk throughout their operations and, where deficiencies are evident, rectifying them within a reasonable timeframe. Subsidiaries acquired by HSBC are required to assess, plan and implement the standards requirements within an agreed timescale.

HSBC maintains and tests contingency facilities to support operations in the event of disasters. Additional reviews and tests are conducted in the event that any HSBC office is affected by a business disruption event to incorporate lessons learned in the operational recovery from those circumstances. As part of HSBCs contingency planning, all country managers have prepared plans for the operation of their businesses with reduced staffing levels, should a flu pandemic occur. Country managers are required to update these plans as circumstances change.

Legal risk

(Unaudited)

Each operating company is required to implement policies, procedures and guidelines in respect of the management and control of legal risk which conform to HSBC standards. Legal risk falls within the definition of operational risk and includes contractual risk, legislative risk, intellectual property risk and litigation risk. Legal risk is the risk of:

- failing to act appropriately or diligently in response to a claim made against any HSBC company;
- failing to take the proper action to preserve recourse to insurers in respect of any claim against an HSBC company;
- being unable to successfully defend a claim brought against any HSBC company;
- HSBC being unable to take action to enforce its rights through the courts; or
- failing to take steps to mitigate the likelihood that a claim will be made against an HSBC company.

HSBC has a dedicated global legal function which is responsible for managing legal risk. This comprises the provision of legal advice and support in resisting claims and legal proceedings against HSBC companies, including analysis of legal issues and the management of any litigation, as well as in respect of non-routine debt recoveries or other litigation against third parties.

The Head Office legal department oversees the global legal function and is headed by a Group General Manager who reports to the Group Chairman. There are legal departments in 56 of the countries in which HSBC operates which have primary responsibility for identifying and assessing legal risk and advising local management in their respective jurisdictions on these matters. There is also a regional-level legal function in each of Europe, North America, Latin America, the Middle East, and Asia-Pacific.

HSBC policy requires operating companies to notify the appropriate in-house legal department immediately any litigation is either threatened or commenced against the Group or an employee. Claims which exceed US$1.5 million must be advised immediately to the appropriate regional legal department. Claims where the amount exceeds US$5 million, where the action is by a regulatory authority, where the proceedings are criminal, or where the claim might materially affect the Groups reputation must immediately be advised to the Head Office legal department. Such matters are then advised to the Risk Management Meeting of the Group Management Board in a monthly paper.

HSBC policy also requires that 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 the Group Management Board 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 Groups reputation, or, where the Head Office 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 of HSBC Holdings, and disclosure in the *Interim Report* and *Annual Report and Accounts* if appropriate.

Global security and fraud risk

(Unaudited)

Security and fraud risk issues are managed at Group level by Global Security and Fraud Risk. This unit, which has responsibility for physical, fraud, information and contingency risk, and security and business intelligence, is now fully integrated within the central Group Risk function. This will facilitate synergies between it and other risk functions, such as with Global Retail Risk Management in the selection, design and implementation of systems and processes to protect the Group against fraud by deterring fraudulent activity, detecting it where it does occur and mitigating its effects.

Pension risk

(Unaudited)

HSBC operates a number of pension plans throughout the world, as described in Note 8 on the Financial Statements. Some of these pension plans are defined benefit plans, of which the largest is the HSBC Bank (UK) Pension Scheme.

In order to fund these benefits, sponsoring group companies (and in some instances, employees) make regular contributions in accordance with advice from actuaries and in consultation with the schemes 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;
- 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 in the light of the market risk inherent in the investments and the 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 differs in different jurisdictions. For example, the HSBC Bank (UK) Pension Scheme, which accounts for over 40 per cent of the net liability of the Group's pension plans, is overseen by a corporate Trustee. This scheme's Trustee regularly monitors the market risks inherent in the scheme.

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Reputational risk management

(Unaudited)

The safeguarding of HSBC's reputation is of paramount importance to its continued prosperity and is the responsibility of every member of staff, and 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.

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 Reputational Risk Committee ('RRC') has been established at which relevant Group functions with responsibility for activities and functions which attract reputational risk are represented. The primary role of the RRC is to consider areas and activities presenting significant reputational risk and, where appropriate, to make recommendations to the Risk Management Meeting and the Group Management Board for policy or procedural changes to mitigate such risk.

Standards on all major aspects of business are set for HSBC and for individual subsidiaries, businesses and functions. Reputational risks, including ESG matters, are considered and assessed by the Board, the Group Management Board, 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 304), 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, environmental impact, anti-corruption measures and employee relations. The policy manuals address risk issues in detail and co-operation between Head Office departments and businesses is required to

ensure a strong adherence to HSBC's risk management system and its corporate responsibility practices.

Sustainability risk management

(Unaudited)

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 Group Head Office, a separate function, Group Corporate Sustainability, is mandated to manage these risks globally. Its 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 on a consistent basis and to either HSBC's own standards, or international standards or local regulations, whichever is the higher.

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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. Many of these products are manufactured by HSBC subsidiaries, but where the Group considers it operationally more effective, third parties are engaged to manufacture and provide insurance products which HSBC sells through its banking network. The Group works with a limited number of market-leading partners to provide these products. When manufacturing products, the Group underwrites the insurance risk and retains the risks and rewards associated with writing insurance contracts. HSBCs exposure to risks associated with manufacturing insurance contracts in its subsidiaries and its management of these risks are discussed below.

One advantage of the bancassurance model to HSBC is that, where the Group manufactures products to sell to customers, the underwriting profit is retained within the Group as is the commission paid by the manufacturer to the bank distribution channel. When HSBC sells products provided by third parties, it earns a commission. HSBC sells insurance products across all its customer groups, mainly utilising its 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.

HSBCs bancassurance business operates in all five of the Groups geographical regions with over 35 legal entities manufacturing insurance products. The majority of these insurance operations are subsidiaries of banking legal entities and comply with their management control procedures. In addition to local management requirements, the insurance operations follow guidelines issued by the Group Insurance Head Office. The Group Insurance Head Office is headed by the Groups Managing Director of Insurance, supported by a Chief Operating Officer and Chief Finance Officer. The role of Group Insurance Head Office includes setting the control framework for monitoring and measuring insurance risk in line with existing Group practices, and defining insurance-specific policies and guidelines for inclusion in the Group Instruction Manuals. The control framework for monitoring risk includes the Group Insurance Risk Committee, to which four Group Insurance sub-committees report,

focusing on operational risk, insurance risk, market and liquidity risk, and credit risk. The sub-committees of the Group Insurance Risk Committee were introduced during 2007. The processes and controls employed to monitor individual risks are described under their respective headings below. The main contracts manufactured by HSBC are described below.

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. The largest portfolio, which is in Hong Kong, is a book of endowment and whole-life policies, with annual bonuses awarded to policyholders. In addition, certain minimum return levels are guaranteed.

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.

Other investment contracts include pension contracts written in Hong Kong.

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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 predominant focus in most markets is insurance for home and contents for individuals, with cover for selected commercial customers largely written in Asia and Latin America.

A very limited portfolio of liability business is written (other than that which is included in the motor book).

Credit non-life insurance is concentrated in North America and Europe. This business is originated in conjunction with the provision of loans.

Given the nature of the contracts written by the Group, the risk to which the Group insurance operations are exposed falls into two principal categories: insurance risk and financial risk.

The following section describes the nature and extent of the risks that arise in the Groups insurance subsidiaries and the principal approach that HSBC adopts to managing them. The majority of the risk in the insurance business resides in the manufacturing activities.

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 the combined cost of claims, administration and acquisition of the contract may exceed the aggregate amount of premiums received and investment income. The cost of a claim can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, where the policy has a savings element, the performance of the assets held to support the liabilities.

HSBC manages its exposure to insurance risk by applying formal underwriting, reinsurance and claims-handling procedures designed to ensure compliance with regulations and insurance risk appetite, the latter proposed by local businesses and authorised centrally. This is supplemented by undertaking stress testing.

The insurance contracts sold by the Group relate, in the main, to core underlying banking activities such as savings or investment products and

credit life products. The Groups manufacturing focuses on personal lines, i.e. contracts written for individuals. Personal lines tend to be of higher volume and lower individual value than commercial lines, and this diversifies the insurance risk.

Life and non-life business insurance risks are controlled by high level procedures set centrally, supplemented as appropriate with locally-imposed measures which take account of specific local market conditions and regulatory requirements. For example, manufacturing entities are required to obtain authorisation from Group Insurance Head Office to write certain classes of business, with restrictions applying particularly to commercial and liability non-life insurance. Local ALCOs are required to monitor certain risk exposures, in particular for life business.

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 particular events, such as earthquakes or a pandemic, 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.

The following tables provide an analysis of the insurance risk exposures by geography and by type of business. By definition, HSBC is not exposed to insurance risk on investment contracts, so they have not been included in the insurance risk management analysis.

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. Separate tables are therefore 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.

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Report of the Directors: The Management of Risk (continued)

Insurance operations > Insurance risk

Analysis of life insurance risk – liabilities to policyholders
(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 2007						
Life (non-linked)						
Insurance contracts with DPF[1]	**940**	**8,489**	**231**	–	–	**9,660**
Credit life	**235**	–	–	**82**	–	**317**
Annuities	**413**	–	**28**	**1,154**	**1,532**	**3,127**
Term assurance and other long-term contracts	**675**	**74**	**85**	**125**	**307**	**1,266**
Total life (non-linked)	**2,263**	**8,563**	**344**	**1,361**	**1,839**	**14,370**
Life (linked)	**1,720**	**2,019**	**467**	–	**2,193**	**6,399**
Investment contracts with DPF[1,2]	**18,954**	–	**29**	–	–	**18,983**
Insurance liabilities to policyholders	**22,937**	**10,582**	**840**	**1,361**	**4,032**	**39,752**
At 31 December 2006						
Life (non-linked)						
Insurance contracts with DPF[1]	195	6,001	193	–	–	6,389
Credit life	130	–	–	200	–	330
Annuities	271	–	26	1,106	1,370	2,773
Term assurance and other long-term contracts	1,134	75	89	–	236	1,534
Total life (non-linked)	1,730	6,076	308	1,306	1,606	11,026
Life (linked)	1,270	765	402	–	1,248	3,685
Investment contracts with DPF[1,2]	–	–	20	–	–	20
Insurance liabilities to policyholders	3,000	6,841	730	1,306	2,854	14,731

1 *Insurance contracts and investment contracts with discretionary participation features ('DPF') can give policyholders the contractual right to receive, as a supplement to their guaranteed benefits, additional benefits that may be a significant portion of the total contractual benefits, but whose amount and timing is determined by HSBC. These additional benefits are contractually based on the performance of a specified pool of contracts or assets, or the profit of the company issuing the contracts. The increase in investment contracts with DPF resulted from the acquisition in March 2007 of the remaining 50.01 per cent share in HSBC Assurances, the French insurance business, that the Group did not already own, resulting in the consolidation of the assets and liabilities of HSBC Assurances.*

2 *Although investment contracts with DPF are financial investments, HSBC continues to account for them as insurance contracts as permitted by IFRS 4.*

(Audited)

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 are typically set by reference to the entity's own experience. Economic assumptions, such as investment returns and interest rates, are typically set by reference to market observable data.

The above table of liabilities to life insurance policyholders provides an overall summary of HSBC's life insurance activity. In particular, the table highlights that the most significant products are investment contracts with DPF issued in France, insurance contracts with DPF issued in Hong Kong, annuities issued in North America and Latin America and unit-linked contracts issued in Europe, Hong Kong and Latin America.

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. Expense risk can generally be managed through pricing. The level of expenses in the contract will be one of the items considered when setting premiums rates.

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Analysis of non-life insurance risk – net written insurance premiums [1]

(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
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)**
2006						
Accident and health	26	97	5	–	10	138
Motor	185	15	13	–	157	370
Fire and other damage	221	22	5	2	9	259
Liability	1	13	2	8	24	48
Credit (non-life)	264	–	–	173	–	437
Marine, aviation and transport	1	11	3	–	12	27
Other non-life insurance contracts	13	24	–	37	20	94
Total net written insurance premiums	711	182	28	220	232	1,373
Net insurance claims incurred and movement in liabilities to policyholders	(451)	(76)	(11)	(79)	(111)	(728)
2005						
Accident and health	33	67	3	3	6	112
Motor	192	20	11	4	302	529
Fire and other damage	251	34	3	5	61	354
Liability	229	17	2	91	14	353
Credit (non-life)	225	–	–	202	–	427
Marine, aviation and transport	–	16	4	–	22	42
Other non-life insurance contracts	10	29	–	17	12	68
Total net written insurance premiums	940	183	23	322	417	1,885
Net insurance claims incurred and movement in liabilities to policyholders	(485)	(66)	(9)	(138)	(196)	(894)

1 *Net written insurance premiums represent gross written premiums less gross written premiums ceded to reinsurers.*

(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 represents the largest class of non-life business in 2007. 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 is worse than expected. 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 the time.

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Report of the Directors: The Management of Risk (continued)

Insurance operations > Insurance risk

Balance sheet of insurance manufacturing subsidiaries by type of contract

(Audited)

	Insurance contracts					**Investment contracts**				
	Contracts with DPF[1] US$m	**Unit-linked US$m**	**Annuities US$m**	**Term assurance[2] US$m**	**Non-life US$m**	**Contracts with DPF[3] US$m**	**Unit-linked US$m**	**Other US$m**	**Other assets[4] US$m**	**US$m**
At 31 December 2007										
Financial assets:										
– trading assets	–	–	**37**	–	**22**	–	–	–	**35**	**94**
– financial assets designated at fair value	**3,424**	**5,799**	**610**	**559**	**130**	**6,210**	**12,379**	**1,610**	**2,992**	**33,713**
– derivatives	**2**	**52**	–	–	**1**	**78**	**250**	**3**	**30**	**416**
– financial investments	**4,518**	–	**1,265**	**328**	**1,071**	**12,305**	–	**1,526**	**2,939**	**23,952**
– other financial assets	**1,896**	**520**	**1,047**	**716**	**1,175**	**3**	**762**	**714**	**1,483**	**8,316**
Total financial assets	**9,840**	**6,371**	**2,959**	**1,603**	**2,399**	**18,596**	**13,391**	**3,853**	**7,479**	**66,491**
Reinsurance assets	**4**	**57**	**337**	**264**	**653**	–	–	–	**54**	**1,369**
PVIF[5]	–	–	–	–	–	–	–	–	**1,965**	**1,965**
Other assets and investment properties	**65**	**2**	**30**	**104**	**193**	**399**	**46**	**52**	**1,196**	**2,087**
Total assets	**9,909**	**6,430**	**3,326**	**1,971**	**3,245**	**18,995**	**13,437**	**3,905**	**10,694**	**71,912**
Liabilities under investment contracts designated at fair value	–	–	–	–	–	–	**12,725**	**3,328**	–	**16,053**
	–	–	–	–	–	–	–	**312**	–	**312**

Liabilities under investment contracts carried at amortised cost										
Liabilities under insurance contracts	**9,660**	**6,399**	**3,127**	**1,583**	**2,854**	**18,983**	**—**	**—**	**—**	**42,606**
Deferred tax	**—**	**7**	**3**	**22**	**3**	**—**	**6**	**—**	**582**	**623**
Other liabilities	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**3,888**	**3,888**
Total liabilities	**9,660**	**6,406**	**3,130**	**1,605**	**2,857**	**18,983**	**12,731**	**3,640**	**4,470**	**63,482**
Total equity	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**8,430**	**8,430**
Total equity and liabilities[6]	**9,660**	**6,406**	**3,130**	**1,605**	**2,857**	**18,983**	**12,731**	**3,640**	**12,900**	**71,912**

For footnotes, see page 269.

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	Insurance contracts					Investment contracts			
	Contracts with DPF[1] US$m	Unit-linked US$m	Annuities US$m	Term assurance[2] US$m	Non-life US$m	Unit-linked US$m	Other US$m	Other assets[4] US$m	Total US$m
At 31 December 2006									
Financial assets:									
– trading assets	–	–	–	–	117	–	–	39	156
– financial assets designated at fair value	1,418	2,998	366	950	94	10, 041	1,597	974	18,438
– derivatives	96	417	–	–	–	363	3	–	879
– financial investments	3,842	–	1,223	390	1,554	–	1,441	2,173	10,623
– other financial assets	794	52	719	138	712	222	428	632	3,697
Total financial assets	6,150	3,467	2,308	1,478	2,477	10, 626	3,469	3,818	33,793
Reinsurance assets	2	58	271	773	665	–	–	48	1,817
PVIF[5]	–	–	–	–	–	–	–	1,549	1,549
Other assets and investment properties	538	203	395	356	215	154	204	614	2,679
Total assets	6,690	3,728	2,974	2,607	3, 357	10,780	3,673	6,029	39,838
Liabilities under investment contracts designated at fair value	–	–	–	–	–	10,003	3,275	–	13,278
Liabilities under investment contracts carried at amortised cost	–	–	–	–	–	–	216	–	216
Liabilities under insurance contracts	6,389	3,685	2,773	1,864	2, 939	–	20	–	17,670
Deferred tax	–	–	–	–	–	–	–	403	403
Other liabilities	–	–	–	–	–	–	–	2,322	2,322
Total liabilities	6,389	3,685	2,773	1,864	2,939	10,003	3,511	2,725	33,889
Total equity	–	–	–	–	–	–	–	5,949	5,949
Total equity and liabilities[7]	6,389	3,685	2,773	1,864	2,939	10,003	3,511	8,674	39,838

1 *Discretionary participation features.*
2 *Term assurance includes credit life insurance.*
3 *New category disclosed following HSBC's acquisition of HSBC Assurances. Although investment contracts with DPF are financial investments, HSBC continues to account for them as insurance contracts as permitted by IFRS 4.*
4 *Other assets comprise shareholder assets.*
5 *Present value of in-force long-term insurance contracts and investment contracts with DPF.*

6 *Does not include assets, liabilities and shareholders funds of associated insurance company, Ping An Insurance* .
7 *Does not include assets, liabilities and shareholders funds of associated insurance companies , HSBC Assurances and Ping An Insurance.*

A principal tool used to manage the Groups 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 stresses applied include factors which impact on insurance risk such as mortality and lapse rates. Of particular importance is the need to match the expected pattern of cash

inflows with the benefits payable on the underlying contracts which, in some cases, can extend for many years. The table above shows the composition of assets and liabilities and demonstrates that there was an appropriate level of matching at the end of 2007. It may not always be possible to achieve a complete matching of asset and liability durations, partly because there is uncertainty over the receipt of all future premiums and partly because the duration of liabilities may exceed the duration of the longest available dated fixed interest investments.

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Report of the Directors: The Management of Risk (continued)

Insurance operations > Financial risks

Balance sheet of insurance manufacturing subsidiaries by geographical region
(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 2007						
Financial assets:						
– trading assets	**–**	**–**	**–**	**–**	**94**	**94**
– financial assets designated at fair value	**22,824**	**6,733**	**796**	**–**	**3,360**	**33,713**
– derivatives	**410**	**5**	**–**	**1**	**–**	**416**
– financial investments	**13,805**	**6,251**	**78**	**2,425**	**1,393**	**23,952**
– other financial assets	**3,345**	**3,259**	**197**	**653**	**862**	**8,316**
Total financial assets	**40,384**	**16,248**	**1,071**	**3,079**	**5,709**	**66,491**
Reinsurance assets	**1,095**	**48**	**28**	**83**	**115**	**1,369**
PVIF[1]	**892**	**810**	**65**	**–**	**198**	**1,965**
Other assets and investment properties	**787**	**926**	**7**	**52**	**315**	**2,087**
Total assets	**43,158**	**18,032**	**1,171**	**3,214**	**6,337**	**71,912**
Liabilities under investment contracts designated at fair value	**11,720**	**4,285**	**48**	**–**	**–**	**16,053**
Liabilities under investment contracts carried at amortised cost	**–**	**–**	**–**	**–**	**312**	**312**
Liabilities under insurance contracts	**24,788**	**10,843**	**903**	**1,652**	**4,420**	**42,606**
Deferred tax	**371**	**143**	**12**	**–**	**97**	**623**
Other liabilities	**3,392**	**193**	**28**	**18**	**257**	**3,888**
Total liabilities	**40,271**	**15,464**	**991**	**1,670**	**5,086**	**63,482**
Total equity	**2,887**	**2,568**	**180**	**1,544**	**1,251**	**8,430**
Total equity and liabilities[2]	**43,158**	**18,032**	**1,171**	**3,214**	**6,337**	**71,912**
At 31 December 2006						
Financial assets:						
– trading assets	–	–	–	–	156	156
– financial assets designated at fair value	11,750	4,120	733	–	1,835	18,438
– derivatives	720	159	–	–	–	879
– financial investments	1,190	5,621	67	2,433	1,312	10,623
– other financial assets	689	1,312	108	940	648	3,697
Total financial assets	14,349	11,212	908	3,373	3,951	33,793

Reinsurance assets	1,560	47	25	93	92	1,817
PVIF[1]	798	697	54	—	—	1,549
Other assets and investment properties	619	1,297	34	273	456	2,679
Total assets	17,326	13,253	1,021	3, 739	4,499	39,838
Liabilities under investment contracts designated at fair value	9,069	4,164	45	—	—	13,278
Liabilities under investment contracts carried at amortised cost	—	—	—	—	216	216
Liabilities under insurance contracts	4,624	7,084	790	2,010	3,162	17,670
Deferred tax	251	123	10	—	19	403
Other liabilities	1,475	337	20	195	295	2,322
Total liabilities	15,419	11,708	865	2,205	3,692	33,889
Total equity	1,907	1,545	156	1,534	807	5,949
Total equity and liabilities[3]	17,326	13,253	1,021	3,739	4,499	39,838

1 *Present value of in-force long-term insurance contracts and investment contracts with DPF.*
2 *Does not include assets, liabilities and shareholders’ funds of associated insurance company, Ping An Insurance.*
3 *Does not include assets, liabilities and shareholders’ funds of associated insurance companies , HSBC Assurances and Ping An Insurance.*

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Financial risks

(Audited)

HSBCs 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 risk, 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 insurance, pensions and annuities administration and intermediation, are exposed to financial risk, but not to a significant extent.

In addition to policies provided for Group-wide application through the Group Instruction Manuals,

insurance manufacturing subsidiaries may implement additional risk management procedures which reflect local market conditions and regulatory requirements.

In many jurisdictions, local regulatory requirements prescribe the type, quality and concentration of assets that HSBCs insurance manufacturing 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 HSBCs insurance manufacturing subsidiaries at 31 December 2007 by type of liability, and provides a view of the exposure to financial risk:

Financial assets held by insurance manufacturing subsidiaries

(Audited)

	At 31 December 2007				
	Life linked contracts[1] US$m	Life non-linked contracts[2] US$m	Non-life insurance[3] US$m	Other assets[4] US$m	Total US$m
Trading assets					
Debt securities		37	22	35	94
Financial assets designated at fair value					
Treasury bills	51		96	34	181
Debt securities	7,741	3,591	28	2,272	13,632
Equity securities	10,386	8,822	6	686	19,900
	18,178	12,413	130	2,992	33,713
Financial investments					
Held-to-maturity:					
Treasury bills					
Debt securities		6,253	144	408	6,805

	—	6,253	144	408	6,805
Available-for-sale:					
Treasury bills	—	2	126	130	258
Other eligible bills	—	—	176	172	348
Debt securities	—	13,677	563	2,065	16,305
Equity securities	—	10	62	164	236
	—	13,689	927	2,531	17,147
Derivatives	302	83	1	30	416
Other financial assets[7]	1,282	4,376	1,175	1,483	8,316
	19,762	36,851	2,399	7,479	66,491

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Report of the Directors: The Management of Risk (continued)

Insurance operations > Financial risks > Market risk

	At 31 December 2006				
	Life linked contracts[1] US$m	Life non-linked contracts[2] US$m	Non-life insurance[3] US$m	Other assets[4] US$m	Total[6] US$m
Trading assets					
Debt securities	–	–	117	39	156
Financial assets designated at fair value					
Treasury bills	54	24	55	–	133
Debt securities	4,304	2,492	32	934	7,762
Equity securities	8,681	1,815	7	40	10,543
	13,039	4,331	94	974	18,438
Financial investments					
Held-to-maturity:					
Treasury bills	–	–	44	–	44
Debt securities	–	5,585	279	333	6,197
	–	5,585	323	333	6,241
Available-for-sale:					
Treasury bills	–	14	102	141	257
Other eligible bills	–	–	355	145	500
Debt securities	–	1,284	738	1,415	3,437
Equity securities	–	13	36	139	188
	–	1,311	1,231	1,840	4,382
Derivatives	780	99	–	–	879
Other financial assets[7]	274	2,079	712	632	3,697
	14,093	13,405	2,477	3,818	33,793

1 *Comprises life linked insurance contracts and linked long-term investment contracts.*
2 *Comprises life non-linked insurance contracts and non-linked long-term investment contracts.*
3 *Comprises non-life insurance contracts.*
4 *Comprises shareholder assets.*
5 *Do not include financial assets of insurance manufacturing associate, Ping An Insurance.*
6 *Do not include financial assets of insurance manufacturing associates, HSBC Assurances and Ping An Insurance.*
7 *Comprises mainly loans and advances to banks, cash and intercompany balances with other non-insurance legal entities.*

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 55.4 per cent of financial assets was invested in debt securities at 31 December 2007 (2006: 51.9 per cent) with 30.3 per cent (2006: 31.8 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 risk of this product on behalf of the policyholders by holding appropriate assets in segregated funds or portfolios to which the liabilities are linked. HSBC typically 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 29.7 per cent of the total financial assets of HSBCs insurance manufacturing subsidiaries at the end of 2007 (2006: 41.7 per cent).

Market risk
(Audited)

Insurance and investment products manufactured by HSBCs insurance manufacturing subsidiaries typically comprise features or combinations of features which may not be easily or exactly replicated by investments. Market risk arises from the mismatch between product liabilities and the investment assets which back them. For example, interest rate risk arises from the mismatch between asset and liability yields and maturities.

Description of market risks
(Audited)

The main features of products manufactured by HSBCs insurance manufacturing subsidiaries which generate market risks, and the market risks to which these features expose the subsidiaries, are discussed in the sections which follow.

Long-term insurance or investment products may incorporate investment return guarantees, divided into the following categories:

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- 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 are usually exposed to falls in market interest rates as these result in lower yields on the assets supporting guaranteed investment returns payable to policyholders.

The table below shows, in respect of each category of guarantee, the total policyholders' liabilities 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
(Audited)

	2007			2006		
	Liabilities to policy-holders US$m	**Investment returns implied by guarantee[1] %**	**Current yields %**	Liabilities to policy-holders US$m	Investment returns implied by guarantee[2] %	Current yields %
Annuities in payment	**716**	**0.0 – 8.5**	**5.1 – 18.1**	1,240	0.0 – 7.0	5.2 – 18.6
Deferred annuities	**116**	**0.0 – 6.0**	**3.8 – 8.6**	420	0.0 – 6.0	3.9 – 8.6
Deferred annuities	**609**	**6.0 – 9.0**	**5.7**	640	6.0 – 9.0	5.7
Annual return	**12,875**	**0.0 – 4.5**	**3.2 – 8.7**	6,379	0.0 – 3.0	3.3 – 4.5
Annual return	**352**	**4.5 – 6.0**	**3.2 – 8.5**	508	3.0 – 6.0	3.8 – 7.9
Capital	**11,311**	**0.0**	**3.8 – 4.8**	1,196	0.0	2.9 – 4.1
Market performance[3]	**3,605**	**n/a**	**n/a**	3,723	n/a	n/a

1 *Excluding guarantees from associate insurance company Ping An Insurance.*
2 *Excluding guarantees from associate insurance companies, HSBC Assurances and Ping An Insurance.*
3 *There is no specific investment return implied by market performance guarantees because the guarantees are expressed as lying within prescribed ranges of average market returns.*

A certain number of these products have been discontinued, including the US$609 million deferred 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.

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 asset values fall and customers seek to surrender their

policies, assets may have to be sold at a loss to fund redemptions.

Insurance and investment products with DPF are primarily invested in bonds, but a proportion of their investment portfolios is allocated to equity securities in order to provide customers with potentially enhanced returns. Subsidiaries with portfolios of such products are exposed to falls in the market price of equity securities when the risk cannot be managed through the discretionary bonus policy.

A subsidiary holding a portfolio of long-term insurance and investment products, especially with DPF, may attempt to reduce exposure to one particular market by investing in assets in countries other than the country 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 to hedge the foreign exchange exposure of these assets and the subsidiary will be exposed to a strengthening of its local currency against the currency of the related assets.

For unit-linked contracts, market risk is substantially borne by the policyholder. HSBC typically retains an exposure 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)

HSBCs insurance manufacturing subsidiaries manage market risk by using some or all of the techniques relevant to the contracts being written by the subsidiary. The techniques applied may include:

- for products with DPF, adjusting bonus rates to manage the liabilities to policyholders. The management of bonus rates is achieved by regularly evaluating their sustainability. In practice, this means that a 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 invests in bonds which produce a return at least equal to the investment return implied by the guarantee;

- 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 premium level or the price structure;

- including features designed to mitigate market risk in new products, for example, surrender penalty charges to recoup losses incurred when policyholders surrender their policies; and

- exiting investment portfolios when the level of risk is no longer acceptable.

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 local ALCO to ensure that its mandate is consistent with local regulations. All mandates must be reviewed and agreed annually with Group Insurance Head Office, and aggregate limits are approved by the Risk Management Meeting of the Group Management Board.

How the exposures to risks are measured
(Audited)

HSBCs 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 Meeting, 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 upward 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 rate 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. The most significant limitation is that the one basis point parallel shift in yield curves measure does not capture the non-linear relationships between the value of certain assets and liabilities and interest rates which arise, 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 below the investment return implied by the guarantee, shortfalls will fall 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 aggregated profits of the insurance manufacturing subsidiaries for the year and their net assets. A quarterly process was introduced for HSBCs insurance manufacturing subsidiaries during 2007 to report stress tests 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.

HSBCs insurance manufacturing subsidiaries identify those assets and lia bilities whose values in the financial statements are sensitive to each category of market risk and revalue them assuming different market rates. The outcome of the exercise

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is measured in terms of the change in profit after tax and net assets under the stress-tested assumptions, after taking into consideration tax and accounting treatments where material and relevant.

The following table illustrates the effect on the aggregated profit for the year and net assets 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 value 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.

Sensitivity of HSBC's insurance subsidiaries to risk factors
(Audited)

	2007		2006	
	Impact on profit for the year US$m	**Impact on net assets US$m**	Impact on profit for the year US$m	Impact on net assets US$m
+ 100 basis points parallel shift in yield curves	**67**	**(29)**	(13)	(111)
− 100 basis points parallel shift in yield curves	**(71)**	**49**	24	103
10 per cent increase in equity prices	**147**	**151**	93	95
10 per cent decrease in equity prices	**(145)**	**(149)**	(86)	(87)
10 per cent increase in US dollar exchange rate compared to all currencies	**12**	**12**	(10)	(10)
10 per cent decrease in US dollar exchange rate compared to all currencies	**(12)**	**(12)**	10	10
Sensitivity to credit spread increases	**(15)**	**(30)**	(7)	(12)

The sensitivity of the net profit of HSBC's insurance subsidiaries to the effects of increases in credit spreads is a fall of US$15 million (2006: US$7 million fall). The sensitivity is expressed on an after tax basis consistent with the other sensitivities noted above and has been calculated using simplified assumptions based on 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. The impact of movements in credit spreads has become more significant in 2007 due to increased volatility in credit spreads.

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$29.8 billion (2006: US$14.1 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). 36 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 would have no impact on the profit after tax.

HSBC's exposure to credit risk in its insurance manufacturing subsidiaries primarily arises from their portfolios of invested assets held, their reinsurance transactions and any credit protection products they write.

HSBC sells certain unit-linked life insurance contracts via a co-insurance agreement with a third party. The insurance contracts issued under the co-insurance agreement include market return guarantees, which are underwritten by the third party. HSBC has a credit risk exposure arising on the guarantees were the counterparty unable to meet the terms of the guarantees. At 31 December 2007, the exposure to the counterparty was small.

The exposure to credit risk products and the management of the risks associated with credit protection products are included in the analyses of life and non-life insurance risk from page 266 to 267.

Management of HSBC's insurance manufacturing subsidiaries is responsible for the credit risk, quality and performance of their investment portfolios. Investment credit mandates and limits are set locally by the insurance manufacturing subsidiaries and approved by their local insurance ALCO and Credit Risk function before receiving concurrence centrally from Group Credit Risk. The form and content of the mandates

Report of the Directors: The Management of Risk (continued)

Insurance operations > Financial risks > Credit risk

accord with centrally set investment credit risk guidance regarding credit quality, industry sector concentration and liquidity restrictions, but allow for local regulatory and country-specific conditions. The assessment of 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 HSBC’s Group Credit Risk function, 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 Credit Risk Committee.

Credit quality

(Audited)

The following table presents the analysis of treasury bills, other eligible bills and debt securities within HSBC’s insurance business by rating agency designation based on Standard & Poor’s ratings or equivalent. Only assets supporting non-linked liabilities are included in the table since financial risk on assets supporting linked liabilities is predominantly borne by the policyholder.

The table indicates that 72.3 per cent (2006: 74.5 per cent) of the assets included in the table are invested in AA or AAA rated investments.

Treasury bills, other eligible bills and debt securities in HSBC’s insurance subsidiaries (Audited)

	Treasury bills US$m	Other eligible bills US$m	Debt securities US$m	Total US$m
At 31 December 2007				
Supporting liabilities under non-linked insurance and investment contracts				
AAA	**114**	**63**	**8,819**	**8,996**
AA– to AA+	**–**	**113**	**8,876**	**8,989**
A– to A+	**–**	**–**	**4,115**	**4,115**
Lower than A–	**96**	**–**	**2,211**	**2,307**
Unrated	**14**	**–**	**294**	**308**
	224	**176**	**24,315**	**24,715**

Supporting shareholders funds[1]				
AAA	**118**	**165**	**2,082**	**2,365**
AA to AA+		**7**	**1,212**	**1,219**
A to A+			**786**	**786**
Lower than A	**39**		**632**	**671**
Unrated	**7**		**68**	**75**
	164	**172**	**4,780**	**5,116**
Total[2]				
AAA	**232**	**228**	**10,901**	**11,361**
AA to AA+		**120**	**10,088**	**10,208**
A to A+			**4,901**	**4,901**
Lower than A	**135**		**2,843**	**2,978**
Unrated	**21**		**362**	**383**
	388	**348**	**29,095**	**29,831**
Of which issued by:				
governments	**388**		**7,140**	**7,528**
local authorities			**175**	**175**
asset-backed securities			**201**	**201**
corporates and other		**348**	**21,579**	**21,927**
	388	**348**	**29,095**	**29,831**
Of which classified as:				
trading assets			**94**	**94**
financial instruments designated at fair value	**130**		**5,891**	**6,021**
available-for-sale securities	**258**	**348**	**16,305**	**16,911**
held-to-maturity investments			**6,805**	**6,805**
	388	**348**	**29,095**	**29,831**

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(Audited)	Treasury bills US$m	Other eligible bills US$m	Debt securities US$m	Total US$m
At 31 December 2006				
Supporting liabilities under non-linked insurance and investment contracts				
AAA	217	145	3,876	4,238
AA– to AA+	–	210	3,994	4,204
A– to A+	–	–	1,880	1,880
Lower than A–	–	–	667	667
Unrated	22	–	110	132
	239	355	10,527	11,121
Supporting shareholders' funds[1]				
AAA	119	137	918	1,174
AA– to AA+	–	8	903	911
A– to A+	–	–	692	692
Lower than A–	21	–	180	201
Unrated	1	–	28	29
	141	145	2,721	3,007
Total[3]				
AAA	336	282	4,794	5,412
AA– to AA+	–	218	4,897	5,115
A– to A+	–	–	2,572	2,572
Lower than A–	21	–	847	868
Unrated	23	–	138	161
	380	500	13,248	14,128
Of which issued by:				
– governments	380	–	2,825	3,205
– local authorities	–	–	69	69
– asset-backed securities	–	–	223	223
– corporates and other	–	500	10,131	10,631
	380	500	13,248	14,128
Of which classified as:				
– trading assets	–	–	156	156
– financial instruments designated at fair value	79	–	3,458	3,537
– available-for-sale securities	257	500	3,437	4,194
– held-to-maturity investments	44	–	6,197	6,241
	380	500	13,248	14,128

1 *Shareholders' funds comprise solvency and unencumbered assets.*
2 *Does not include treasury bills, other eligible bills and debt securities held by in surance manufacturing associate, Ping An Insurance.*
3 *Does not include treasury bills, other eligible bills and debt securities held by insurance manufacturing associates, HSBC Assurances and Ping An Insurance.*

(Audited)

Credit risk also arises when part of the insurance risk incurred by HSBC is assumed by reinsurers. The credit risk exposure for reinsurers is monitored by Group Insurance Head Office and is reported quarterly to the Group Insurance Risk Committee and the Group Insurance Credit Risk Committee.

The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries, analysed by Standard & Poor's reinsurance credit rating data or their equivalent, was as follows:

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Report of the Directors: The Management of Risk (continued)

Insurance operations > Financial risks > Liquidity risk

Reinsurance
(Audited)

	Reinsurers share of liabilities under insurance contracts			
	Linked insurance contracts US$m	**Non-linked insurance contracts US$m**	**Total US$m**	**Reinsurance debtors US$m**
At 31 December 2007				
AAA	**7**	**33**	**40**	**1**
AA to AA	**28**	**297**	**325**	**26**
A to A+		**669**	**669**	**16**
Lower than A	**22**	**10**	**32**	**2**
Unrated		**249**	**249**	**9**
Total[1]	**57**	**1,258**	**1,315**	**54**
At 31 December 2006				
AAA	10	106	116	
AA to AA	33	812	845	37
A to A+		586	586	5
Lower than A	15	37	52	3
Unrated		170	170	3
Total[2]	58	1,711	1,769	48

1 *Does not include reinsurers share of liabilities under insurance contracts and reinsurance debtors of insurance manufacturing associate, Ping An Insurance.*
2 *Does not include reinsurers share of liabilities under insurance contracts and reinsurance debtors of insurance manufacturing associates, HSBC Assurances and Ping An Insurance.*

Liquidity risk
(Audited)

It is an inherent characteristic of almost all insurance contracts that there is uncertainty over the amount and the timing of settlement of claims liabilities that may arise, and this leads to liquidity risk.

To fund the cash outflows arising from claims liabilities, HSBCs insurance manufacturing subsidiaries utilise liquidity primarily from the following sources:

- cash inflows arising from premiums from new business, policy renewals and recurring premium products;

- cash inflows arising from interest and dividends on investments and principal repayments of maturing debt investments;
- cash resources; and
- cash inflows from the sale of investments.

HSBCs insurance manufacturing subsidiaries manage liquidity risk by utilising some or all of the following techniques:

- matching cash inflows with expected cash outflows using specific cash flow projections or more general asset and liability matching techniques such as duration matching;
- maintaining sufficient cash resources;
- investing in good credit-quality investments with deep and liquid markets to the degree to which they exist;
- monitoring investment concentrations and restricting them where appropriate, for example, debt issues or issuers; and
- establishing committed contingency borrowing facilities.

During 2007, a quarterly process has been introduced whereby HSBCs insurance manufacturing subsidiaries are required to complete and submit liquidity risk reports to Group Insurance Head Office for collation and review by the Group Insurance Market and Liquidity Risk Meeting. Liquidity risk is assessed in these reports by measuring changes in expected cumulative net cash flows under a series of stress scenarios designed to determine the effect of reducing expected available liquidity and accelerating cash outflows. This is achieved by, for example, assuming new business or renewals are lower, and surrenders or lapses are greater than expected.

As indicated in the table headed Expected maturity of insurance contract liabilities below and in the analyses of life and non-life insurance risks on pages 266 to 267, a significant proportion of the Groups non-life insurance business is viewed as short term, with the settlement of liabilities expected to occur within one year of the period of risk. There is a greater spread of expected maturities for the life business where, in a large proportion of cases, the

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liquidity risk is borne in conjunction with policyholders (wholly in the case of unit-linked business).

The following tables show the expected undiscounted cash flows for insurance contract liabilities and the remaining contractual maturity of investment contract liabilities, respectively, at 31 December 2007.

The profile of the expected maturity of the insurance contracts as at 31 December 2007 has remained stable compared with 2006. The increase in the undated investment contract liabilities arises principally from the incorporation of HSBC Assurances balance sheet as a subsidiary at 31 December 2007.

Expected maturity of insurance contract liabilities
(Audited)

	Expected cash flows (undiscounted)				
	Within 1 year US$m	**1-5 years US$m**	**5-15 years US$m**	**Over 15 years US$m**	**Total US$m**
At 31 December 2007[1]					
Non-life insurance	**1,337**	**1,352**	**164**	**1**	**2,854**
Life insurance (non-linked)	**1,887**	**5,310**	**15,986**	**13,269**	**36,452**
Life insurance (linked)	**507**	**1,894**	**3,644**	**5,014**	**11,059**
	3,731	**8,556**	**19,794**	**18,284**	**50,365**
At 31 December 2006[2,3]					
Non-life insurance	1,679	1,136	118	6	2,939
Life insurance (non-linked)	1,096	4,190	13,455	12,646	31,387
Life insurance (linked)	337	1,162	2,071	2,099	5,669
	3,112	6,488	15,644	14,751	39,995

1 *Does not include investment contracts by insurance manufacturing associate, Ping An Insurance.*
2 *2006 balances for life insurance have been restated to ensure a consistent presentation with 2007 balances for this disclosure .*
3 *Does not include investment contracts by insurance manufacturing associates, HSBC Assurances and Ping An Insurance.*

Remaining contractual maturity of investment contract liabilities
(Audited)

	Liabilities under investment contracts by insurance underwriting subsidiaries			
	Linked investment contracts US$m	**Other investment contracts US$m**	**Investment contracts with DPF US$m**	**Total US$m**
At 31 December 2007[1]				
Remaining contractual maturity:				
due within 1 year	**286**	**331**	**1**	**618**
due between 1 and 5 years	**1,234**	**48**	**28**	**1,310**
due between 5 and 10 years	**950**			**950**

due after 10 years	**3,386**	**44**		**3,430**
undated[2]	**6,869**	**3,217**	**18,954**	**29,040**
	12,725	**3,640**	**18,983**	**35,348**
At 31 December 2006[3]				
Remaining contractual maturity:				
due within 1 year	274	265		539
due between 1 and 5 years	1,238	45	20	1,303
due between 5 and 10 years	856			856
due after 10 years	3,312			3,312
undated[2]	4,323	3,181		7,504
	10,003	3,491	20	13,514

1 *Does not include investment contracts by insurance manufacturing associate, Ping An Insurance.*
2 *In most cases, policyholders have the option to terminate their contracts at any time and receive the surrender values of their policies. These may be significantly lower than the amounts shown above.*
3 *Does not include investment contracts by insurance manufacturing associates, HSBC Assurances and Ping An Insurance.*

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Report of the Directors: The Management of Risk (continued)

Present value of in-force long-term insurance business
(Audited)

The HSBC life insurance business is accounted for using the embedded value approach, which, *inter alia*, provides a comprehensive framework for the evaluation of insurance and related risks. The present value of the in-force long-term (‘PVIF’) asset at 31 December 2007 was US$2.0 billion (2006: US$1.5 billion). The present value of the shareholders’ interest in the profits expected to emerge from the book of in-force policies at 31 December can be stress-tested to assess the ability of the life business book to withstand adverse developments. A key feature of the life insurance business is the importance of managing the assets, liabilities and risks in a coordinated fashion rather than individually. This reflects the greater interdependence of these three elements for life insurance than is generally the case for non-life insurance.

The following table shows the effect on the PVIF of reasonably possible changes in the main economic assumptions, changes in the risk-free and risk discount rates, across all insurance manufacturing subsidiaries.

It should be noted that, due to certain conditions that may exist within the contracts, the effects may be non-linear and so the results of the stress-testing

Sensitivity of PVIF to changes in economic assumptions
(Audited)

	PVIF at 31 December	
	2007	2006
	US$m	US$m
+ 100 basis points shift in risk-free rate	**195**	130
– 100 basis points shift in risk-free rate	**(232)**	(141)
+ 100 basis points shift in risk discount rate	**(95)**	(64)
– 100 basis points shift in risk discount rate	**106**	70

disclosed may not be extrapolated to higher levels of stress. In calculating the various scenarios, all other assumptions are held stable except for testing the effect of the shift in the risk-free rate, when consequential changes to investment returns, risk discount rates and bonus rates are also incorporated. The sensitivities shown are before actions that could be taken by management to mitigate effects and before consequential changes in policyholder behaviour.

The following table shows the movements recorded during the year in respect of PVIF and the net assets of insurance operations:

Movements in PVIF and net assets of insurance operations
(Audited)

	2007			2006		
	PVIF US$m	**Net assets of insurance operations US$m**	**Total US$m**	PVIF US$m	Net assets of insurance operations US$m	Total US$m
At 1 January	**1,549**	**4,400**	**5,949**	1,400	3,582	4,982
Value of new business written during the year[1]	**380**		**380**	254		254
Acquisitions of subsidiaries/portfolios	**390**	**262**	**652**			
Movements arising from in-force business:						
expected return	**(175)**		**(175)**	(233)		(233)
experience variances[2]	**53**		**53**	31		31
change in operating assumptions	**(86)**		**(86)**	(17)		(17)
Investment return variances				13		13
Changes in investment assumptions	**4**		**4**	3		3
Return on net assets		**1,235**	**1,235**		752	752
Disposals of subsidiaries/portfolios		**(250)**	**(250)**			
Exchange differences and other	**(150)**	**59**	**(91)**	98	95	193
Capital transactions		**759**	**759**		(29)	(29)
At 31 December	**1,965**	**6,465**	**8,430**	1,549	4,400	5,949

1 *Value of net new business during the year is the present value of the projected stream of profits from the business.*

2 *Experience variances include the effect of the difference between demographic, expen se and persistency assumptions used in the previous PVIF calculation and actual experience observed during the year.*

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Non-economic assumptions
(Audited)

The policyholder liabilities and PVIF are determined by reference to non-economic assumptions which include, for non-life manufacturers, claims costs and expense rates and, for life manufacturers, mortality and/or morbidity, lapse rates and expense rates. The table below shows the sensitivity of profit for the year to, and net assets at, 31 December 2007 to reasonably possible changes in these non-economic assumptions at 31 December 2007 across all insurance manufacturing subsidiaries, with comparatives for 2006.

Claims costs is a risk associated with non-life insurance business. If the cost of claims increases, a negative impact on profit would occur.

Mortality and morbidity risk is typically associated with life insurance contracts. The impact of an increase in mortality or morbidity on profit depends on the type of business being written. For a portfolio of term assurance contracts, an increase in mortality would have a negative impact on profit since the instances of claims would increase. For a portfolio of annuity contracts, an increase in

mortality rates typically has a positive impact on profit as the period over which the benefit is being paid to the policyholder is shortened. However, where an annuity contract includes life cover, the positive impact of reduced future annuity payments observed through an increase in mortality can be offset by the benefits payable under the life cover.

Sensitivity to lapse rates is dependent on the type of contracts being written. For insurance contracts, the cost of claims is funded by premiums received and income earned on the investment portfolio supporting the liabilities. For a portfolio of term assurance, an increase in lapses typically leads to a negative impact on profit due to the loss of future premium income on the lapsed policies. For a portfolio of annuity contracts, an increase in lapse rates results in a positive impact on profit as the period over which the Group is obliged to pay benefits to the policyholder is shortened.

Expense rate risk is the exposure to a change in expense rates. To the extent that increased expenses cannot be passed on to the policyholder, an increase in expense rates will have a negative impact on profits.

Sensitivity analysis
(Audited)

	Effect on profit for the year to 31 December			**Effect on net assets at 31 December**		
	Life US$m	**Non-life US$m**	**Total US$m**	**Life US$m**	**Non-life US$m**	**Total US$m**
2007						
20% increase in claims costs	–	**(138)**	**(138)**	–	**(138)**	**(138)**

20% decrease in claims costs	—	**138**	**138**	—	**138**	**138**
10% increase in mortality and/or morbidity rates	**(21)**	—	**(21)**	**(21)**	—	**(21)**
10% decrease in mortality and/or morbidity rates	**9**	—	**9**	**9**	—	**9**
50% increase in lapse rates	**(16)**	—	**(16)**	**(16)**	—	**(16)**
50% decrease in lapse rates	**61**	—	**61**	**61**	—	**61**
10% increase in expense rates	**(23)**	**(6)**	**(29)**	**(23)**	**(6)**	**(29)**
10% decrease in expense rates	**23**	**6**	**29**	**23**	**6**	**29**
2006						
20% increase in claims costs	—	(118)	(118)	—	(118)	(118)
20% decrease in claims costs	—	118	118	—	118	118
10% increase in mortality and/or morbidity rates	(8)	—	(8)	(8)	—	(8)
10% decrease in mortality and/or morbidity rates	15	—	15	15	—	15
50% increase in lapse rates	10	—	10	10	—	10
50% decrease in lapse rates	22	—	22	22	—	22
10% increase in expense rates	(21)	(2)	(23)	(21)	(2)	(23)
10% decrease in expense rates	21	2	23	21	2	23

Capital management and allocation

Capital management
(Audited)

HSBCs capital management approach is driven by its strategy and organisational requirements, taking into account the regulatory and commercial environment in which it operates. The Groups strategy underpins HSBCs Capital Management Framework which has been approved by the Group Management Board. It is HSBCs policy to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times. It also maintains a strong discipline over its investment decisions and where it allocates its capital, seeking to ensure that returns on investment are appropriate after taking account of capital costs. In addition, the level of capital held by HSBC Holdings and other major subsidiaries, particularly HSBC Finance, is determined by its rating targets.

HSBCs strategic intention is to allocate capital to businesses based on their economic profit generation and, within this process, regulatory and economic capital requirements and the cost of capital are key factors. The responsibility for global capital allocation principles and decisions rests with the Group Management Board. Stress testing is used as an important mechanism in understanding the sensitivities of the core assumptions in the capital plans to the adverse impact of extreme, but plausible, events. Stress testing allows senior management to formulate management action in advance of conditions starting to reflect the stress scenarios identified. The Group has identified the following as being the material risks faced and managed through the Capital Management Framework; credit, market, operational, asset and liability management, pension, and insurance risks.

In 2007, HSBC continued to manage its capital against its benchmark minimum tier 1 capital ratio of 8.25 per cent, which it has used under the current Basel Capital Accord (Basel I) for the purposes of its long-term capital planning. In 2008, as the Group operates under the new framework for calculating minimum capital requirements known as Basel II, it will target a tier 1 capital ratio within the range 7.5 to 9.0 per cent, based on core tier 1 capital plus innovative tier 1 capital, less deductions from tier 1 capital under the FSAs Basel II disclosure rules.

HSBC recognises the effect on shareholder returns of the level of equity capital employed within the Group and seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on

equity that are possible with greater leverage.

The Capital Management Framework covers the different capital measures within which HSBC manages its capital in a consistent and aligned manner. These include the market capitalisation, invested capital, economic capital and regulatory capital. HSBC defines invested capital as the equity capital invested in HSBC by its shareholders. Economic capital is the capital requirement calculated internally by HSBC to support the risks to which it is exposed and is set at a confidence level consistent with a AA target credit rating. Regulatory capital is the capital which HSBC is required to hold as determined by the rules established by the FSA for the consolidated Group and by HSBCs local regulators for individual Group companies.

An annual Group capital plan is prepared and approved by the Board with the objective of maintaining both the optimal amount of capital and the mix between the different components of capital. The Groups policy is to hold capital in a range of different forms and from diverse sources and all capital raising is agreed with major subsidiaries as part of their individual and the Groups capital management processes. HSBC Holdings and its major subsidiaries raise non-equity tier 1 capital and subordinated debt in accordance with the Groups guidelines on market and investor concentration, cost, market conditions, timing, effect on composition and maturity profile. The subordinated debt requirements of other HSBC companies are met internally.

Each subsidiary manages its own capital required to support planned business growth and meet local regulatory requirements, within the context of the approved annual Group capital plan. As part of HSBCs Capital Management Framework, capital generated in excess of planned requirements is returned to HSBC Holdings, normally by way of dividends.

HSBC Holdings is primarily a provider of equity capital to its subsidiaries. These investments are substantially funded by HSBC Holdings own capital issuance and profit retentions. HSBC Holdings seeks to maintain a prudent balance between the composition of its capital and that of its investment in subsidiaries.

Capital measurement and allocation
(Audited)

The FSA supervises HSBC on a consolidated basis and, as such, receives information on the capital adequacy of, and sets capital requirements for,

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HSBC as a whole. Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements. In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities. Since 1988, when the governors of the Group of Ten central banks agreed to guidelines for the international convergence of capital measurement and standards, known as Basel I, the banking supervisors of HSBC’s major banking subsidiaries have exercised capital adequacy supervision within a broadly similar framework.

The FSA implements the capital adequacy requirements issued by the Basel Committee on Banking Supervision (“the Basel Committee”) as implemented by the relevant EU Directives. In June 2006, the EU Capital Requirements Directive (“CRD”) was formally adopted by the Council and European Parliament and it required EU Member States to bring implementing provisions into force on 1 January 2007. The CRD recast the Banking Consolidation Directive and the Capital Adequacy Directive, which had previously applied.

In October 2006, the FSA published the General Prudential Sourcebook (“GENPRU”) and the Prudential Sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”), which took effect from 1 January 2007 and implemented the CRD in the UK. GENPRU introduced changes to the definition of capital and the methodology for calculating a firm’s capital resources requirements. BIPRU sets out the FSA’s rules implementing the other CRD requirements for banks, building societies and investment firms and groups containing such firms. Transitional provisions regarding the implementation of capital requirements calculations meant that, in general, unless firms notified the FSA to the contrary, they continued to apply the existing capital requirements calculations until 1 January 2008; changes that took effect on that date are described below in the section “Basel II”.

In implementing these EU Directives, the FSA requires each bank and banking group to maintain an individually prescribed ratio of total capital to risk-weighted assets, taking into account both balance sheet assets and off-balance sheet transactions.

HSBC’s capital is divided into two tiers:

- Tier 1 capital comprises core tier 1 capital and innovative tier 1 securities. Core tier 1 capital comprises shareholders’ funds, and minority interests in tier 1 capital, after adjusting for items reflected in shareholders’ funds which are treated differently for the purposes of capital adequacy. The book values of goodwill and intangible assets are deducted in arriving at core tier 1 capital.

- Tier 2 capital comprises qualifying subordinated loan capital, collective impairment allowances, minority and other interests in tier 2 capital and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale.
  Tier 2 capital also includes reserves arising from the revaluation of properties.

Various limits are applied to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 per cent of overall tier 1 capital, qualifying tier 2 capital cannot exceed tier 1 capital, and qualifying term subordinated loan capital may not exceed 50 per cent of tier 1 capital. There are also limitations on the amount of collective impairment allowances which may be included as part of tier 2 capital. From the total of tier 1 and tier 2 capital are deducted the carrying amounts of unconsolidated investments, investments in the capital of banks, and certain regulatory items.

Changes to the definition of capital came into force on 1 January 2007. They include the introduction of proportional consolidation of banking associates, which previously were either fully consolidated or deducted from capital, the relaxation of rules covering the deduction of investments in other banks’ capital, and a change for disclosure purposes only to make certain deductions, previously from total capital, now 50 per cent from each of tier 1 and tier 2 capital in the published disclosures. This applies to deductions of investments in insurance subsidiaries and associates, but the FSA has granted a transitional provision, until 31 December 2012, under which any of these insurance investments that were acquired before 20 July 2006 may be deducted from the total of tier 1 and tier 2 capital instead. HSBC has elected to apply this transitional provision.

Banking operations are categorised as either trading book or banking book and risk-weighted assets are determined accordingly. Banking book risk-weighted assets are measured by means of a hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account any eligible collateral or guarantees. Banking book off-balance sheet items giving rise to credit, foreign exchange or interest rate risk are assigned weights appropriate to the category of the counterparty, taking into account any eligible collateral or guarantees. Trading book risk-weighted assets are determined by taking into account market-related risks such as foreign exchange, interest rate and equity position risks, and counterparty risk.

Basel II

(Audited)

The Basel Committee on Banking Supervision (the Basel Committee) has published Basel II which replaces the 1988 Basel Capital Accord. The supervisory objectives for Basel II are to promote safety and soundness in the financial system and maintain at least the current overall level of capital in the system; enhance competitive equality; constitute a more comprehensive approach to addressing risks; and focus on internationally active banks. Basel II is structured around three pillars: minimum capital requirements, supervisory review process and market discipline. The CRD is the means by which Basel II is implemented in the EU. The FSA gives effect to the CRD through GENPRU and BIPRU, as described above.

Basel II provides three approaches, of increasing sophistication, to the calculation of pillar 1 credit risk capital requirements. The most basic, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties, and groups other counterparties into broad categories and applies standardised risk weightings to these categories. In the next level, the internal ratings-based (IRB) foundation approach allows banks to calculate their credit risk regulatory capital requirement on the basis of their internal assessment of the probability that a counterparty will default, but with quantification of exposure and loss estimates being subject to standard supervisory parameters. Finally, the IRB advanced approach, will allow banks to use their own internal assessment of not only the probability of default but also the quantification of exposure at default and loss given default. Expected losses are calculated by multiplying the probability of default by the loss given default multiplied by the exposure at default. The capital resources requirement under the IRB approaches is intended to cover unexpected losses and is derived from a formula specified in the regulatory rules, which incorporates these factors and other variables such as maturity and correlation.

For credit risk, with FSA approval, HSBC has adopted the IRB advanced approach to Basel II for the majority of its business with effect from 1 January 2008, with the remainder on either IRB foundation or standardised approaches. A rollout plan is in place to extend coverage of the advanced approach over the next three years, leaving a small residue of exposures on the standardised approach.

Basel II also introduces capital requirements for operational risk and, again, contains three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of gross revenues allocated to each of eight defined business lines. Finally, the advanced measurement approach uses banks own statistical analysis and modelling of operational risk data to determine capital requirements. HSBC has adopted the standardised approach to the determination of Group operational risk capital requirements.

The basis of calculating capital changed with effect from 1 January 2008 and the effect on both tier 1 capital and total capital is shown in the table below, Impact of Basel II. The Groups capital base is reduced compared with Basel I by the extent to which expected losses exceed the total of individual and collective impairment allowances on IRB portfolios. These collective impairment allowances are no longer eligible for inclusion in tier 2 capital.

For disclosure purposes, this excess of expected losses over total impairment allowances in IRB portfolios is deducted 50 per cent from tier 1 and 50 per cent from tier 2 capital. In addition, a tax credit adjustment is made to tier 1 capital to reflect the tax consequences insofar as they impact on the availability of tier 1 capital to cover risks or losses.

Expected losses, derived under Basel II rules, represent losses that would be expected in the scenario of a severe downturn over a 12-month period. This definition differs from loan impairment allowances, which only address losses incurred within lending portfolios at the balance sheet date and are not permitted to recognise the additional level of conservatism that the regulatory measure requires through reflecting a downturn scenario. For rapidly revolving consumer credit portfolios such as credit cards, therefore, impairment allowances only capture some of the expected losses predicted over the next 12 months. These portfolios turn over three to four times per year, and therefore a large proportion of expected losses relate to credit advances not made at the measurement date.

The effect of the deduction of the difference between expected losses and total impairment allowances is to set the total effect on capital to be equal to the regulatory definition of expected losses. Because expected losses are based on long-term estimates and incorporate through-the-cycle considerations, it is not anticipated that they will be very volatile. The impact of this deduction, however,

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may vary from time to time as the accounting measure of impairment moves closer to or further away from the regulatory measure of expected losses.

The second pillar of Basel II (Supervisory Review and Evaluation Process) involves both firms and regulators taking a view on whether a firm should hold additional capital against risks not covered in pillar 1. Part of the pillar 2 process is the Internal Capital Adequacy Assessment Process which is the firms self assessment of risks not captured by pillar 1. The pillar 2 process culminates with the FSA providing firms with Individual Capital Guidance. The ICG replaces the current trigger ratio and is set as a capital resources requirement higher than that required under pillar 1, generally by a specified percentage.

Pillar 3 of Basel II is related to market discipline and aims to make firms more transparent by requiring them to publish specific, prescribed details of their risks, capital and risk management under the

Basel II framework. HSBC will provide qualitative pillar 3 disclosures during 2008, with the first full set of pillar 3 disclosures including quantitative tables, being made during the first half of 2009 as of 31 December 2008.

For individual banking subsidiaries, the timing and manner of implementing Basel II varies by jurisdiction according to requirements set by local banking supervisors. Applying Basel II across HSBCs geographically diverse businesses, which operate in a large number of different regulatory environments, presents a significant logistical and technological challenge, involving an extensive programme of implementation.

Basel II allows local regulators to exercise discretion in a number of areas. The extent to which their requirements diverge, coupled with how the FSA and the local regulators in the other countries in which HSBC operates interact, are key factors in completing implementation of Basel II locally.

Source and application of tier 1 capital Basel I

(Audited)

	2007	2006
	US$m	US$m
Movement in tier 1 capital		
At 1 January	**87,842**	74,403
Consolidated profits attributable to shareholders of the parent company	**19,133**	15,789
Dividends	**(10,241)**	(8,769)
Add back: shares issued in lieu of dividends	**4,351**	2,525
Increase in goodwill and intangible assets deducted	**(2,366)**	(3,668)
Ordinary shares issued	**477**	1,015
Other (including exchange differences)	**5,771**	6,547
At 31 December	**104,967**	87,842
Movement in risk-weighted assets		
(Unaudited)		
At 1 January	**938,678**	827,164
Movements	**185,104**	111,514
At 31 December	**1,123,782**	938,678

Report of the Directors: The Management of Risk (continued)

Capital management and allocation > RWAs

Capital structure at 31 December Basel I

	2007	2006
	US$m	US$m
Composition of regulatory capital		
(Audited)		
Tier 1 capital		
Shareholders equity	**128,160**	108,352
Minority interests and preference shares	**6,240**	7,413
Innovative tier 1 securities	**10,512**	9,932
Less :		
Goodwill capitalised and intangible assets	**(38,855)**	(36,489)
Other regulatory adjustments[1]	**(1,090)**	(1,366)
Total qualifying tier 1 capital	**104,967**	87,842
Tier 2 capital		
Reserves arising from revaluation of property and unrealised gains onavailable-for-sale equities	**4,393**	2,982
Collective impairment allowances	**14,047**	11,077
Perpetual subordinated debt	**3,114**	3,396
Term subordinated debt	**37,658**	30,677
Minority and other interests in tier 2 capital	**300**	425
Total qualifying tier 2 capital before deductions	**59,512**	48,557
Unconsolidated investments[2]	**(11,092)**	(7,512)
Investments in capital of other banks		(1,419)
Other deductions	**(747)**	(394)
Total regulatory capital	**152,640**	127,074
Risk-weighted assets		
(Unaudited)		
Banking book	**1,020,747**	857,198
Trading book	**103,035**	81,480
Total	**1,123,782**	938,678
Risk-weighted assets were included in the totals above in respect of:		
contingent liabilities	**51,731**	44,704
commitments	**65,068**	58,569
Capital ratios	**%**	%
(Unaudited)		
Total capital	**13.6**	13.5

Tier 1 capital	**9.3**	9.4

1 *Includes removal of the fair value gains and losses, net of deferred tax, arising from the credit spreads on debt issued by HSBC Holdings and its subsidiaries and designated at fair value.*
2 *Mainly comprises investments in insurance entities.*

HSBC complied with the FSAs capital adequacy requirements throughout 2007 and 2006. Tier 1 capital increased by US$17.1 billion. Retained profits contributed US$8.9 billion, shares issued, including shares issued in lieu of dividends, contributed US$4.8 billion and exchange differences added US$5.5 billion. These increases were partly offset by an increase in goodwill and intangible assets, which are deducted from capital, of US$2.4 billion, and are mainly due to the weakening of the US dollar against the pound sterling and the euro.

Total risk-weighted assets increased by US$185 billion, or 19.7 per cent. Of this increase,

US$95 billion reflects balance sheet growth, mainly in the loan book. A further US$39 billion arose from the proportional consolidation of banking associates, mainly Bank of Communications and Industrial Bank. The weakening US dollar gave rise to an increase of US$32 billion while increased trading book activity contributed US$19 billion.

Risk-weighted assets by principal subsidiary
(Unaudited)

In order to give an indication of how HSBCs capital is deployed, the table below analyses the disposition of risk-weighted assets by principal subsidiary. The risk-weighted assets are calculated using FSA rules and exclude intra-HSBC items.

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Risk-weighted assets Basel I

(Unaudited)

	2007 **US$m**	2006 US$m
The Hongkong and Shanghai Banking Corporation	**256,761**	181,292
Hang Seng Bank	**55,043**	43,607
The Hongkong and Shanghai Banking Corporation and other subsidiaries	**201,718**	137,685
HSBC Bank	**423,941**	360,028
HSBC Private Banking Holdings (Suisse)	**32,942**	26,476
HSBC France	**76,188**	60,406
HSBC Bank and other subsidiaries	**314,811**	273,146
HSBC North America	**336,998**	317,325
HSBC Finance	**135,757**	141,589
HSBC Bank Canada	**50,659**	35,674
HSBC Bank USA and other subsidiaries	**150,582**	140,062
HSBC Mexico	**18,513**	15,406
HSBC Bank Middle East	**25,226**	17,977
HSBC Bank Malaysia	**8,601**	7,201
HSBC Brazil	**27,365**	17,666
HSBC Bank Panama	**7,824**	6,434
Bank of Bermuda	**4,133**	4,370
HSBC Holdings sub-group	**1,138**	876
Other	**13,282**	10,103
	1,123,782	938,678

Report of the Directors: The Management of Risk (continued)

Capital management and allocation > Impact of Basel II / Biographies > Directors

Impact of Basel II

(Unaudited)

As reflected in the table below, the Groups capital base under Basel II is US$19.7 billion lower than under Basel I. This reduction in the capital base does not reflect a change in the risk profile of the underlying portfolios and the Group remains strongly capitalised.

The Groups risk-weighted assets under Basel II are broadly similar to the Basel I position. A reduction in the credit risk capital requirement has been more than offset by the new capital requirement for operational risk.

The Groups pro-forma capital position if it had been reporting on a Basel II basis at 31 December 2007 is as follows:

Capital position under Basel II

	Basel II pro-forma US$m *(Unaudited)*	**Basel II pro-forma %**[1] *(Unaudited)*	Basel I Actual US$m *(Audited)*
Composition of regulatory capital			
Tier 1 capital			
Shareholders equity	**128,160**		128,160
Minority interests and preference shares	**6,240**		6,240
Less :			
Goodwill capitalised and intangible assets	**(38,855)**		(38,855)
Other regulatory adjustments[2,3]	**136**		(1,090)
50% of excess of expected losses over impairment allowances	**(4,508)**		
Core tier 1 capital	**91,173**	**8.1**	94,455
Innovative tier 1 securities	**10,512**	**0.9**	10,512
Tier 1 capital ratio management basis		**9.0**	
Tier 2 capital			
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities	**4,393**		4,393
Collective impairment allowances[4]	**2,176**		14,047
Perpetual subordinated debt	**3,114**		3,114
Term subordinated debt	**37,658**		37,658
Minority and other interests in tier 2 capital	**300**		300
Total qualifying tier 2 capital before deductions	**47,641**	**4.2**	59,512

Total qualifying tier 2 capital before deductions plus innovative tier 1 securities	**58,153**		70,024
Unconsolidated investments[5]	**(11,092)**		(11,092)
50% of excess of expected losses over impairment allowances	**(4,508)**		—
Other deductions	**(747)**		(747)
Total deductions other than from tier 1 capital	**(16,347)**	**(1.4)**	(11,839)
Total regulatory capital	**132,979**	**11.8**	152,640
			(Unaudited)
Risk-weighted assets			
Credit risk	**976,138**		—
Market risk	**45,847**		—
Operational risk	**107,466**		—
Banking book	—		1,020,747
Trading book	—		103,035
Total	**1,129,451**		1,123,782

1 *Percentage of risk-weighted assets.*
2 *Includes removal of the fair value gains and losses, net of deferred tax, arising from the credit spreads on debt issued by HSBC Holdings and its subsidiaries and designated at fair value.*
3 *Includes a tax credit adjustment in respect of the excess of expected losses over impairment allowances.*
4 *Under Basel II, only collective impairment allowances on loan portfolios on the standardised approach are included in tier 2 capital.*
5 *Mainly comprises investments in insurance entities.*

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H S B C H O L D I N G S P L C

Report of the Directors: Governance

Corporate Governance Report

The information set out on pages 289 to 333 and information incorporated by reference constitutes the Corporate Governance Report of HSBC Holdings.

Directors

S K Green , Group Chairman

Age 59. An executive Director since 1998; Group Chief Executive from 2003 to May 2006. Joined HSBC in 1982. Chairman of HSBC Bank plc and HSBC North America Holdings Inc. and HSBC Private Banking Holdings (Suisse) SA. A Director of HSBC France and The Hongkong and Shanghai Banking Corporation Limited. Group Treasurer from 1992 to 1998. Executive Director, Global Banking and Markets from 1998 to 2003. Chairman of The British Bankers Association.

* **The Baroness Dunn** , DBE, Deputy Chairman
(Retiring 30 May 2008)

Age 68. An executive Director of John Swire & Sons Limited and a Director of Swire Pacific Limited. A non-executive Director since 1990 and a non- executive Deputy Chairman since 1992. A member of the Nomination Committee. A non-executive Director of The Hongkong and Shanghai Banking Corporation Limited from 1981 to 1996. A Patron of the UK Foundation of the University of British Columbia, a registered charity. A member of the Hong Kong Association and the Asia Task Force. A former Senior Member of the Hong Kong Executive Council and Legislative Council.

* **Sir Brian Moffat** , OBE, Deputy Chairman
(Retiring 30 May 2008)

Age 69. A non-executive Director since 1998 and a non-executive Deputy Chairman since 2001. A member of the Nomination Committee. A non- executive Director of Macsteel Global BV. Former Chairman of Corus Group plc and a former member of the Court of the Bank of England.

MF Geoghegan , CBE, Group Chief Executive

Age 54. An executive Director since 2004. Joined HSBC in 1973. Chairman of the Group Management Board. Chairman of HSBC Bank USA, N.A., HSBC USA Inc. and HSBC Bank Canada. Deputy Chairman of HSBC Bank plc. A Director of The Hongkong and Shanghai Banking Corporation Limited, HSBC France, HSBC National Bank USA and HSBC North America Holdings Inc. President of HSBC Bank Brasil S.A.-Banco Múltiplo from 1997 to 2003 and responsible for all of HSBC's business throughout South America from 2000 to 2003. Chief Executive of HSBC Bank plc from 2004 to March 2006. A non-executive Director and Chairman of Young Enterprise.

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Report of the Directors: Governance (continued)

Biographies > Directors

* **The Rt Hon the Lord Butler of Brockwell**,
KG, GCB, CVO *(Retiring 30 May 2008)*

Age 70. Master, University College, Oxford. A non- executive Director since 1998. Chairman of the Corporate Sustainability Committee and the HSBC Global Education Trust. A member of the International Advisory Board of Marsh McLennan Inc. Chaired the UK Government Review of Intelligence on Weapons of Mass Destruction in 2004. Secretary of the Cabinet and Head of the Home Civil Service in the United Kingdom from 1988 to 1998. A non-executive Director of Imperial Chemical Industries plc from 1998 to 2 January 2008.

 S A Catz *(Appointed 1 May 2008)*

Age 46. A non-executive Director with effect from 1 May 2008. President and Chief Financial Officer of Oracle Corporation. Managing Director of Donaldson, Lufkin & Jenrette from 1997 to 1999. Joined Oracle in 1999 and appointed to the Board of Directors in 2001.

V H C Cheng, OBE

Age 59. Chairman of The Hongkong and Shanghai Banking Corporation Limited. An executive Director since 1 February 2008. Chairman of HSBC Bank (China) Company Limited and HSBC Investments (Hong Kong) Limited and a Director of HSBC Bank Australia Limited. Joined HSBC in 1978. Appointed a Group General Manager in 1995 and a Group Managing Director in 2005. A Director of Great Eagle Holdings Limited and a Member of the Exchange Fund Advisory Committee of the Hong Kong Monetary Authority. Vice Chairman of the China Banking Association from 10 December 2007. Appointed a member of the National Committee of the 11th Chinese Peoples Political Consultative Conference (CPPCC), and a senior advisor to the 11th Beijing Municipal Committee of the CPPCC. Deputy Chairman and Chief Executive Officer of Hang Seng Bank Limited from 1998 to 2005. A Director of Swire Pacific Limited from 2005 to January 2008.

 J D Coombe

Age 62. Chairman of Hogg Robinson plc. A non- executive Director since 2005. A member of the Group Audit Committee and of the Remuneration Committee. A non-executive Director of Home Retail Group plc. A trustee of the Royal Academy Trust. Former executive Director and Chief Financial Officer of GlaxoSmithKline plc and a former member of the Supervisory Board of Siemens AG. A former Chairman of The Hundred Group of Finance Directors and a former member of the Accounting Standards Board.

 J L Durán

Age 43. Chief Executive of Carrefour SA and Chairman of its Management Board of Directors. A non-executive Director since 1 January 2008. Joined Carrefour SA in 1991. Chief Financial Officer and Managing Director, Organisation and Systems of Carrefour SA from 2001 to 2005.

 R A Fairhead

Age 46. Chief Executive Officer and Director of the Financial Times Group Limited and a Director of Pearson plc. Chairman of Interactive Data Corporation. A non-executive Director since 2004. Chairman of the Group Audit Committee. A non- executive Director of The Economist Newspaper Limited. Finance Director of Pearson plc from 2002 to June 2006. Former Executive Vice President, Strategy and Group Control of Imperial Chemical Industries plc.

D J Flint , CBE, Group Finance Director

Age 52. Joined HSBC as an executive Director in 1995. Non-executive Chairman of HSBC Finance Corporation. A non-executive Director of BP p.l.c. and a member of the Consultative Committee of the Large Business Advisory Board of HM Revenue & Customs. Chaired the Financial Reporting Council's review of the Turnbull Guidance on Internal Control. Served on the Accounting Standards Board and the Standards Advisory Council of the International Accounting Standards Board from 2001 to 2004. A former partner in KPMG.

A A Flockhart , CBE *(Appointed 1 May 2008)*

Age 56. Chief Executive Officer of The Hongkong and Shanghai Banking Corporation Limited and Global Head of Commercial Banking. An executive Director with effect from 1 May 2008. Joined HSBC in 1974. A Director of Hang Seng Bank Limited, HSBC Bank Australia Limited, HSBC Bank (China) Company Limited, and Chairman of HSBC Bank Malaysia Berhad. Managing Director of The Saudi British Bank from 1997 to 1999 and Senior Executive Vice-President, Commercial Banking, HSBC Bank USA, N.A. from 1999 to 2002. Chief Executive Officer, Mexico from 2002 to October 2006. President and Group Managing Director Latin America and the Caribbean from October 2006 to 20 July 2007. Appointed a Group General Manager in 2002 and a Group Managing Director in 2006.

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* **W K L Fung**, OBE

Age 59. Group Managing Director of Li & Fung Limited. A non-executive Director since 1998. A member of the Corporate Sustainability Committee. Deputy Chairman of The Hongkong and Shanghai Banking Corporation Limited. A Director of King Lun Management Limited. A non-executive Director of CLP Holdings Limited, Integrated Distribution Services Group Limited, Convenience Retail Asia Limited, Shui On Land Limited and VTech Holdings Limited. A member of the Hong Kong Trade Development Council. A former non-executive Director of Bank of Communications Co. Ltd. Former Chairman of the Hong Kong General Chamber of Commerce, the Hong Kong Exporters Association and the Hong Kong Committee for the Pacific Economic Cooperation Council.

S T Gulliver *(Appointed 1 May 2008)*

Age 48. Head of Global Banking and Markets and HSBC Global Asset Management. An executive Director with effect from 1 May 2008. Joined HSBC in 1980. A Director of HSBC Bank plc, HSBC Private Banking Holdings (Suisse) SA, HSBC USA Inc. and The Hongkong and Shanghai Banking Corporation Limited. A member of the Supervisory Board of HSBC Trinkaus & Burkhardt AG. Head of Treasury and Capital Markets in Asia-Pacific from 1996 to 2002. Head of Global Markets from 2002 to 2003 and Co-Head of Global Banking and Markets from 2003 to May 2006. Appointed a Group General Manager in 2000 and a Group Managing Director in 2004.

J W J Hughes-Hallett

Age 58. Chairman of John Swire & Sons Limited. A non-executive Director since 2005. A member of the Group Audit Committee and of the Nomination Committee. A non-executive Director of The Hongkong and Shanghai Banking Corporation Limited from 1999 to 2004. A non-executive Director and formerly Chairman of Cathay Pacific Airways Limited and Swire Pacific Limited. A director of China Festival 2008. A trustee of the Dulwich Picture Gallery and the Esmée Fairbairn Foundation. A member of the Hong Kong Association and of the Governing Body of the School of Oriental and African Studies, University of London.

W S H Laidlaw

Age 51. Chief Executive Officer of Centrica plc. A non-executive Director since 1 January 2008. A Trustee of RAFT, a medical charity for burns and reconstructive surgery. A member of the Business Council for International Understanding. President and Chief Operating Officer of Amerada Hess Corporation from 1995 to 2001. Chief Executive Officer of Enterprise Oil plc from 2001 to 2002. Executive Vice President of Chevron Corporation from 2003 to 2006, and a non-executive Director of Hanson PLC from 2003 to 24 August 2007.

Sir Mark Moody-Stuart , KCMG

Age 67. Chairman of Anglo American plc. A non- executive Director since 2001. Chairman of the Remuneration Committee and a member of the Corporate Sustainability Committee. A non- executive Director of Accenture Limited, Saudi Aramco, a Governor of Nuffield Hospitals and President of the Liverpool School of Tropical Medicine. Chairman of the Global Business Coalition on HIV/AIDS and the Global Compact Foundation. A former Director and Chairman of The Shell Transport and Trading Company, plc and former Chairman of the Committee of Managing Directors of the Royal Dutch/Shell Group of Companies.

G Morgan

Age 62. A non-executive Director since October 2006. A member of the Remuneration Committee. Non-executive chairman of SNC-Lavalin Group Inc. A member of the Board of Trustees of The Fraser Institute and the Energy Advisory Board of Accenture Limited. A non-executive Director of HSBC Bank Canada from 1996 until April 2006. Former Founding President, Chief Executive Officer and Vice Chairman of EnCana Corporation. A former Director of Alcan Inc.

N R N Murthy, CBE *(Appointed 1 May 2008)*

Age 61. A non-executive Director with effect from 1 May 2008. Chairman and Chief Mentor and former Chief Executive Officer of Infosys Technologies Limited. An independent non-executive Director of Unilever plc and New Delhi Television Limited and a Director of the United Nations Foundation. An independent non-executive Director of DBS Bank Limited until 2 April 2008.

- **S W Newton**

Age 66. Chairman of The Real Return Group Limited. A non-executive Director since 2002. A member of the Group Audit Committee. A member of the Investment Committee of The Wellcome Trust, and the Investment Board of Cambridge University. A Council Member of Imperial College,

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London, and Chairman of the committee advising the Council on the College Fund. An advisor to the Investment Committee of the Royal Marsden NHS Foundation Trust.

 S M Robertson, senior independent non-executive Director

Age 66. Non-executive Chairman of Rolls-Royce Group plc and the founder member of Simon Robertson Associates LLP. A non-executive Director since January 2006 and senior independent non-executive Director since 25 May 2007. A member of the Nomination Committee. A non- executive Director of Berry Bros. & Rudd Limited, The Economist Newspaper Limited and The Royal Opera House Covent Garden Limited. Chairman of Trustees of Ernest Kleinwort Charitable Trust. A trustee of the Eden Project and of the Royal Opera House Endowment Fund. A former Managing Director of Goldman Sachs International. Former Chairman of Dresdner Kleinwort Benson and a former non-executive Director of Inchcape plc, Invensys plc and the London Stock Exchange.

 Sir Brian Williamson, CBE

Age 63. Chairman of Electra Private Equity plc. A non-executive Director since 2002. Chairman of the Nomination Committee. A non-executive Director of Resolution plc. A member of the Supervisory Board of Euronext NV. A Director of Climate Exchange plc. A senior adviser to Fleming Family and Partners. Former Chairman of London International Financial Futures and Options Exchange, Gerrard Group plc and Resolution Life Group Limited. A former non-executive Director of the Financial Services Authority and of the Court of The Bank of Ireland.

* *Non-executive Director*
 Independent non-executive Director

Secretary

R G Barber

Age 57. Group Company Secretary. Appointed a Group General Manager in October 2006. Joined HSBC in 1980. Company Secretary of HSBC Holdings plc since 1990. Chairman of the Disclosure Committee. A member of the Listing Authority Advisory Committee of the Financial Services Authority and of the Primary Markets Group of the London Stock Exchange. Corporation Secretary of The Hongkong and Shanghai Banking Corporation Limited from 1986 to 1992 and Company Secretary of HSBC Bank plc from 1994 to 1996.

Adviser to the Board

D J Shaw

Age 61. An Adviser to the Board since 1998. Solicitor. A partner in Norton Rose from 1973 to 1998. A Director of The Bank of Bermuda Limited, HSBC Private Banking Holdings (Suisse) SA. A non-executive Director of Kowloon Development Company Limited and Shui On Land Limited.

Group Managing Directors

A Almeida

Age 51. Group Head of Human Resources. A Group Managing Director since 25 February 2008. Joined HSBC in 1992. Appointed a Group General Manager on 18 June 2007. Global Head of Human Resources for Global Banking and Markets, Group Private Banking, Global Transaction Banking and HSBC Amanah, from 1996 to June 2007.

C C R Bannister

Age 49. Group Managing Director, Insurance. A Group Managing Director since August 2006. Joined HSBC in 1994. Appointed a Group General Manager in 2001. Chairman of HSBC Insurance Holdings Limited since November 2006. Deputy Chief Executive Officer, HSBC Securities (USA) Inc. from 1996 to 1997 and Chief Executive Officer, Group Private Banking from 1998 to November 2006.

A A Flockhart , CBE

Appointed an executive Director with effect from 1 May 2008. See page 290.

S T Gulliver

Appointed an executive Director with effect from 1 May 2008. See page 291.

D H Hodgkinson

Age 57. Group Chief Operating Officer. A Group Managing Director since May 2006 and Director of The Bank of Bermuda Limited since May 2006. Chairman of HSBC Bank Middle East Limited since July 2006. Joined HSBC in 1969. Appointed a Group General Manager in 2003. Managing Director of The Saudi British Bank from 1999 to 2003. Deputy Chairman and Chief Executive Officer of HSBC Bank Middle East Limited from 2003 to May 2006.

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A Hungate

Age 41. Global Head of Personal Financial Services and Marketing. Joined HSBC as a Group Managing Director on 3 September 2007. Formerly Managing Director, Asia Pacific at Reuters. Worldwide Chief Marketing Officer of Reuters between 2002 and 2005.

D D J John

Age 57. Chief Executive, HSBC Bank plc. A Group Managing Director since March 2006. Joined HSBC Bank plc in 1971. Appointed a Group General Manager in 2000. Deputy Chairman and Chief Executive Officer, HSBC Bank Malaysia Berhad from 1999 to 2002. Chief Operating Officer of HSBC Bank plc from 2003 to 2005 and Deputy Chief Executive from 2005 to March 2006.

B P McDonagh

Age 49. Chief Executive Officer, HSBC North America Holdings Inc. A Group Managing Director since 21 February 2008. Joined HSBC in 1979. Appointed a Group General Manager in 2005. Chief Executive Officer, HSBC Finance Corporation and Chief Operating Officer, HSBC North America Holdings Inc. from 2007 to 21 February 2008. Chief Operating Officer, HSBC Bank USA from 2004 to 2006.

Y A Nasr

Age 53. Deputy Chairman and Chief Executive of HSBC Bank Middle East Limited since 22 May 2007. A Group Managing Director since 2004. Joined HSBC in 1976. Deputy Chairman of HSBC Bank Egypt S.A.E. since 31 May 2007. A Director of HSBC Private Banking Holdings (Suisse) SA since September 2006. Appointed a Group General Manager in 1998. President and Chief Executive Officer of HSBC Bank Canada from 1997 to 1999. President and Chief Executive Officer of HSBC USA Inc. and HSBC Bank USA from 1999 to 2003. President, HSBC Bank Brasil S.A.-Banco Múltiplo from 2003 to October 2006.

B Robertson

Age 53. Group Chief Risk Officer. A Group Managing Director since 25 February 2008. Joined HSBC in 1975. A Group General Manager since 2003. Head of Global Banking and Markets for North America from 2003 to 2005. Group General Manager, Group Credit and Risk from 2005 to September 2007.

Group General Managers

E Alonso

Age 52. Co-Head of Latin America and President and Chief Executive Officer, HSBC Bank Brasil S.A.-Banco Múltiplo and South America. Joined HSBC in 1997. Appointed a Group General Manager in October 2006.

P Y Antika

Age 47. Chief Executive Officer, HSBC Turkey. Joined HSBC in 1990. Appointed a Group General Manager in 2005.

R E T Bennett

Age 56. Group General Manager, Legal and Compliance. Joined HSBC in 1979. Appointed a Group General Manager in 1998.

N S K Booker

Age 49. Chief Operating Officer, HSBC Finance Corporation and Chief Operating Officer, HSBC North America. Joined HSBC in 1981. Appointed a Group General Manager in 2004.

P W Boyles

Age 52. Chief Executive Officer, HSBC France. Joined HSBC in 1975. Appointed a Group General Manager in January 2006.

D C Budd

Age 54. Director, International, HSBC Bank plc. Joined HSBC in 1972. Appointed a Group General Manager in 2005.

Z J Cama

Age 60. Group General Manager, International HSBC Holdings plc. Joined HSBC in 1968. Appointed a Group General Manager in 2001.

T M Detelich

Age 51. President, Consumer and Mortgage Lending, HSBC Finance Corporation. Joined HSBC Finance Corporation in 1976. Appointed a Group General Manager in October 2006.

I M Dorner

Age 53. Deputy Chairman and Chief Executive Officer, HSBC Bank Malaysia Berhad. Joined HSBC in 1986. Appointed a Group General Manager in June 2007.

J D Garner

Age 38. Group General Manager, Personal Financial Services and Direct Businesses, HSBC Bank plc. Joined HSBC in 2004. Appointed a Group General Manager in October 2006.

J L Gordon

Age 55. President and Chief Executive Officer, HSBC Bank Canada. Joined HSBC in 1987. Appointed a Group General Manager in 2005.

K M Harvey

Age 47. Group General Manager and Group Chief Information Officer. Joined HSBC Finance Corporation in 1989. Appointed a Group General Manager in 2004.

A M Keir

Age 49. Global Co-Head Commercial Banking. Joined HSBC in 1981. Appointed a Group General Manager in October 2006.

N L Kidwai

Age 50. Chief Executive Officer, HSBC India. Joined HSBC in 2002. Appointed a Group General Manager in October 2006.

M J W King

Age 51. Group General Manager, Internal Audit. Joined HSBC in 1986. Appointed a Group General Manager in 2002.

P J Lawrence

Age 46. Head of Global Banking and Markets, USA. President and Chief Executive Officer, HSBC Bank USA, N.A. and HSBC USA Inc. Joined HSBC in 1982. Appointed a Group General Manager in 2005.

M Leung

Age 55. Global Co-Head Commercial Banking. Joined HSBC in 1978. Appointed a Group General Manager in 2005.

A M Mahoney

Age 45. Group General Manager and Head of PFS Distribution. Joined HSBC in 1983. Appointed a Group General Manager in November 2006.

C M Meares

Age 50. Chief Executive Officer, Group Private Banking. Joined HSBC in 1980. Appointed a Group General Manager in November 2006.

W G Menezes

Age 62. Group Executive, Card Services, HSBC Finance Corporation. Joined HSBC in 1996. Appointed a Group General Manager in October 2006.

K Newman

Age 50. Senior Executive Vice President, Personal Financial Services, HSBC Bank USA, N.A. Joined HSBC in 1989. Appointed a Group General Manager in October 2006.

R C F Or

Age 58. Vice-Chairman and Chief Executive, Hang Seng Bank Limited and Director, The Hongkong and Shanghai Banking Corporation Limited. Joined HSBC in 1972. Appointed a Group General Manager in 2000.

K Patel

Age 59. Group General Manager, Chief Executive Officer, Africa. Joined HSBC in 1984. Appointed a Group General Manager in 2000.

R C Picot

Age 50. Group Chief Accounting Officer. Joined HSBC in 1993. Appointed a Group General Manager in 2003.

C D Spooner

Age 57. Head of Group Financial Planning & Tax. Joined HSBC in 1994. Appointed a Group General Manager in June 2007.

P A Thurston

Age 54. Co-Head of Latin America and President of HSBC Mexico and Central America. Joined HSBC in 1975. Appointed a Group General Manager in 2003.

P T S Wong

Age 56. Executive Director, Hong Kong and Mainland China, The Hongkong and Shanghai Banking Corporation Limited. Joined HSBC in 2005. Appointed a Group General Manager in 2005.

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Board of Directors

The Board

The objective of the management structures within HSBC, headed by the Board of Directors of HSBC Holdings and led by the Group Chairman, is to deliver sustainable value to shareholders. Implementation of the strategy set by the Board is delegated to the Group Management Board under the leadership of the Group Chief Executive.

HSBC Holdings has a unitary Board of Directors. The authority of each Director is exercised in Board Meetings where the Board acts collectively as a unit. At 3 March 2008, the Board comprises the Group Chairman, Group Chief Executive, two other executive Directors and 14 non-executive Directors. The names and brief biographical particulars of the Directors are listed on pages 289 to 292. The Group Chairman, Group Chief Executive and two other executive Directors are employees who carry out executive functions in HSBC in addition to their duties as Directors. Non-executive Directors are not HSBC employees and do not participate in the daily business management of HSBC. Non-executive Directors bring an external perspective, constructively challenge and help develop proposals on strategy, scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. The non-executive Directors have a wealth of experience across a number of industries and business sectors, including the leadership of large, complex multinational enterprises. The roles of non-executive Directors as members of Board committees are set out on pages 300 to 304. It is estimated that non-executive Directors spend 24 days per annum on HSBC business after an induction phase, with Committee members devoting significant additional time.

The Board is responsible for managing the business of HSBC Holdings and, in doing so, may exercise all of the powers of HSBC Holdings, subject to any relevant laws and regulations and to the Memorandum and Articles of Association. In particular, the Board may exercise all the powers of the Company to borrow money and to mortgage or charge all or any part of the undertaking, property or assets (present and future) of HSBC Holdings and may also exercise any of the powers conferred on it by the Companies Act 1985 and Companies Act 2006 (as appropriate) and/or by shareholders. The Board is able to delegate and confer on certain Directors holding executive office any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it

thinks fit. In addition, the Board may establish any local or divisional boards or agencies for managing the business of HSBC Holdings in any specified locality and delegate and confer on any local or divisional board, manager or agent so appointed any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it thinks fit. The Board may also, by power of attorney or otherwise, appoint any person or persons to be the agent of HSBC Holdings and may delegate to any such person or persons any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it thinks fit.

The Board sets the strategy for HSBC through the five-year strategic plan and approves the operating plans presented by management for the achievement of the strategic objectives. The operating plans ensure the efficient disposition of HSBC's resources for the achievement of these objectives. The Board delegates the management and day-to-day running of HSBC to the Group Management Board but retains to itself approval of certain matters including operating plans and performance targets, procedures for monitoring and control of operations, the authority or the delegation of authority to approve credit, market risk limits, acquisitions, disposals, investments, capital expenditure or realisation or creation of a new venture, specified senior appointments, and any substantial change in balance sheet management policy.

The Directors who served during the year were, Lord Butler, R K F Ch'ien, J D Coombe, Baroness Dunn, R A Fairhead, D J Flint, W K L Fung, M F Geoghegan, S K Green, S Hintze, J W J Hughes-Hallett, Sir Brian Moffat, Sir Mark Moody-Stuart, G Morgan, S W Newton, S M Robertson, H Sohmen and Sir Brian Williamson. J F Gil Díaz was appointed a Director on 2 January 2007 and resigned on 5 March 2007.

The Board of Directors meets regularly and Directors receive information between meetings about the activities of committees and developments in HSBC's business.

Eight Board meetings were held during 2007. The table that follows gives details of Directors attendance at meetings of the Board, Group Audit Committee, Nomination Committee and Remuneration Committee during 2007.

During 2007, the non-executive Directors and the Group Chairman met twice without the presence of the Group Chief Executive and Group Finance Director. In addition, the non-executive Directors

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Report of the Directors: Governance (continued)

Board of Directors / The Board

met four times without the Group Chairman including a meeting to appraise the Group Chairman’s performance.

In addition to the meetings of the principal Committees referred to in the following pages,

sixteen other meetings of Committees of the Board were held during the year to discharge business delegated by the Board.

All Directors attended the 2007 Annual General Meeting.

	Board Meetings		**Group Audit Committee Meetings**		**Nomination Committee Meetings**		**Remuneration Committee Meetings**	
	Attended	Possible[1]	**Attended**	Possible	**Attended**	Possible	**Attended**	Possible
Lord Butler	**7**	8	–	–	–	–	–	–
Baroness Dunn	**8**	8	–	–	**2**	2	–	–
R K F Ch’ien	**5**	5[2]	**2**	3[2]	–	–	–	–
J D Coombe	**8**	8	**7**	7	–	–	**8**	8
R A Fairhead	**6**	8	**7**	7	–	–	–	–
D J Flint	**8**	8	–	–	–	–	–	–
W K L Fung	**6**	8	–	–	–	–	**4**	4[3]
M F Geoghegan	**8**	8	–	–	–	–	–	–
J F Gil Díaz[4]	–	3	–	–	–	–	–	–
S K Green	**8**	8	–	–	–	–	–	–
S Hintze	**5**	5[2]	–	–	–	–	**3**	4[2]
J W J Hughes-Hallett	**7**	8	**6**	7	**2**	2	–	–
Sir Brian Moffat	**7**	8	**3**	3[3]	**2**	2	–	–
Sir Mark Moody-Stuart	**8**	8	–	–	–	–	**8**	8
G Morgan	**6**	8	–	–	–	–	**4**	4[5]
S W Newton	**8**	8	**4**	4[5]	–	–	–	–
S M Robertson	**7**	8	–	–	**1**	2	–	–
H Sohmen	**4**	5[2]	–	–	–	–	–	–
Sir Brian Williamson	**8**	8	–	–	**2**	2	–	–

1 *Includes a meeting called at short notice in February 2007 to discuss a trading update about the mortgage services operation in HSBC Finance Corporation.*
2 *Retired as a Director on 25 May 2007.*
3 *Ceased to be a member on 25 May 2007.*
4 *Retired as a Director on 5 March 2007.*
5 *Appointed a member on 25 May 2007.*

Group Chairman and Group Chief Executive

The roles of Group Chairman and Group Chief Executive are separated and held by experienced full-time Directors.

There is a clear division of responsibilities at the head of the Company between the running of the Board and the executive responsibility for running HSBCs business. The Group Chairmans responsibilities include the long-term strategic development of HSBC, the development of relationships with governments and other significant external parties and performance appraisal of the Group Chief Executive. The Group Chairman also monitors the performance of the Group Finance Director and, subject to the Group Chief Executives recommendation, approves risk, capital allocation and capital investment decisions within authorities delegated by the Board. The Group Chief Executive has responsibility for developing business plans and delivering performance against these.

S K Green became Group Chairman at the conclusion of the Annual General Meeting on 26 May 2006 and M F Geoghegan succeeded

S K Green as Group Chief Executive. The appointments were made after consulting with representatives of major institutional investors and explaining the succession planning and independent external search process undertaken. S K Green and M F Geoghegan stood for re-election at the 2006 Annual General Meeting and were both re-elected ahead of taking up their new roles from the conclusion of that Meeting.

Board balance and independence of Directors

The balance of the Board includes a strong presence of both executive and non-executive Directors such that no individual or small group can dominate the Boards decision making. Following the 2008 Annual General Meeting, the Board will comprise 19 Directors, 12 of whom are independent non-executive Directors. The size of the Board is appropriate given the complexity and geographical spread of HSBCs business and the significant time demands placed on the non-executive Directors, particularly those who serve as members of Board committees.

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The Board has appointed S M Robertson as the senior independent non-executive Director. The principal role of the senior independent non-executive Director is to support the Group Chairman in his role, to lead the non-executive Directors in the oversight of the Group Chairman and to ensure there is a clear division of responsibility between the Group Chairman and Group Chief Executive. The senior independent non-executive Director is also available to shareholders for concerns which the normal channels have failed to resolve or are inappropriate.

The Board considers all of the non-executive Directors to be independent in character and judgement. Baroness Dunn, Sir Brian Moffat, Lord Butler and W K L Fung have served on the Board for more than nine years, however, and in that respect only, do not meet the usual criteria for independence set out in the UK Combined Code on corporate governance. The Board has therefore determined S A Catz, J D Coombe, J L Durán, R A Fairhead, J W J Hughes-Hallett, W S H Laidlaw, Sir Mark Moody-Stuart, G Morgan, N R N Murthy, S W Newton, S M Robertson, and Sir Brian Williamson to be independent. In reaching its determination of each non-executive Director's independence the Board has concluded that there are no relationships or circumstances which are likely to affect a Director's judgement and any relationships or circumstances which could appear to do so were considered not to be material.

When determining independence the Board considers that calculation of the length of service of a non-executive Director begins on the date of his or her first election by shareholders as a Director of HSBC Holdings. Given the complexity and geographical spread of HSBC's business, the experience of previous service on a subsidiary company Board can be a considerable benefit to HSBC and does not detract from a Director's independence.

In accordance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, each non-executive Director determined by the Board to be independent has provided an annual confirmation of his or her independence to HSBC Holdings.

Information, induction and ongoing development

The Board regularly reviews reports on progress against financial objectives, on business developments and on investor and external relations and receives reports from the Chairmen of Board Committees and from the Group Chief Executive.

The Board receives regular reports and presentations on strategy and developments in the customer groups and principal geographical areas. Regular reports are also provided to the Board, the Group Audit Committee and the Group Management Board on credit exposures and the loan portfolio, asset and liability management, liquidity, litigation and compliance and reputational issues. The agenda and supporting papers are distributed in advance of all Board and Committee meetings to allow time for appropriate review and to facilitate full discussion at the meetings. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The Directors have free and open contact with management at all levels. Group Managing Directors and Group General Managers meet informally with Directors after Board meetings. Board offsite visits are made each year to enable Directors to see at first hand the operations of subsidiary companies in local environments and to meet management, employees and customers. In 2007 the Board visited New York and Curitiba.

Full, formal and tailored induction programmes, with particular emphasis on internal controls, are arranged for newly appointed Directors. The programmes consist of a series of meetings with other Directors and senior executives to enable new Directors to receive information and familiarise themselves with HSBC's strategy, operations and internal controls. Prior to their appointment, each Director receives comprehensive guidance on the duties and liabilities of a Director of HSBC Holdings. Opportunities to update and develop skills and knowledge, through externally run seminars and through briefings by senior executives, are provided to all Directors.

Performance evaluation

In November 2007, ICSA Corporate Services Limited was commissioned to undertake an evaluation of the effectiveness of the Board. This was to investigate the performance of the Board as a whole and, in that context, the main Board committees and individual Directors. The evaluation examined whether eight key areas met the Board's needs and expectations: Board responsibilities; oversight; Board meetings; information received; support for the Board; Board composition; working together; and outcome and achievements. The report on the evaluation has been reviewed by the Board and has been used by the non-executive Directors, led by the senior independent non-executive Director, in their evaluation of the performance of the Group Chairman. The review concluded that the Board and its committees were functioning effectively. It is the intention of the Board of HSBC Holdings to continue to review its performance and that of its Directors annually.

Appointment, retirement and re-election of Directors

The Board may at any time appoint any person who is willing to act as a Director, either to fill a vacancy or as an addition to the existing Board, but the total number of Directors shall not exceed twenty-five. Any Director so appointed by the Board shall retire at the Annual General Meeting following their appointment and shall be eligible for re-election but is not taken into account in determining the number of Directors who are to retire by rotation at such meeting. The Board may appoint any Director to hold any employment or executive office and may revoke or terminate any such appointment. Shareholders may, by ordinary resolution, appoint a person as a Director or remove any Director before the expiration of his period of office. At each Annual General Meeting, one third of the Directors who are subject to retirement by rotation are required to retire and may offer themselves for re-election by shareholders. In addition to those required to retire by rotation, any Director who was not elected or reelected at either of the preceding two Annual General Meetings and any non-executive Director who has served in office for a continuous period of nine years or more at the date of the Annual General Meeting is required to retire and may offer him or herself for re-election by shareholders.

R K F Ch□ien, S Hintze and H Sohmen retired as Directors at the conclusion of the Annual General Meeting held on 25 May 2007. J L Durán and W S H Laidlaw were appointed non-executive Directors on 1 January 2008. V H C Cheng was appointed an executive Director on 1 February 2008. A A Flockhart and S T Gulliver have been appointed executive Directors, and S A Catz and N R N Murthy have been appointed non-executive Directors with effect from 1 May 2008.

S A Catz, V H C Cheng, J L Durán, A A Flockhart, S T Gulliver, W S H Laidlaw and N R N Murthy, having been appointed since the Annual General Meeting in 2007, will retire at the forthcoming Annual General Meeting and offer themselves for re-election.

Lord Butler, J D Coombe, Baroness Dunn, D J Flint, W K L Fung, J W J Hughes-Hallett, Sir Brian Moffat and S W Newton will retire by rotation at the forthcoming Annual General Meeting. With

the exception of Lord Butler, Baroness Dunn and Sir Brian Moffat, who are to retire, they offer themselves for re-election.

None of the non-executive Directors seeking re-election at the forthcoming Annual General Meeting has a service contract. Of the executive Directors who are seeking re-election, D J Flint is employed on a rolling contract dated 29 September 1995 which requires 12 months□ notice to be given by the Company and nine months□ notice to be given by Mr Flint. V H C Cheng and A A Flockhart are employed on rolling contracts dated 1 October 1978 and 6 July 1974 respectively, which require three months□ notice to be given by either partyS T Gulliver is employed on a rolling contract dated 8 December 2005 which requires twelve months□ notice to be given by either party.

Following the performance evaluation of the Board, the Group Chairman has confirmed that the non-executive Directors standing for re-election at the Annual General Meeting continue to perform effectively and to demonstrate commitment to their roles.

Brief biographical particulars of all Directors including those seeking re-election at the Annual General Meeting, are given on pages 289 to 292.

Relations with shareholders

The Board ensures all Directors, including non-executive Directors, develop an understanding of the views of major shareholders through attendance at analyst presentations and other meetings with institutional investors and their representative bodies. The Board also met with representatives of institutional shareholders in 2007 to discuss corporate governance matters.

The Group Chairman, Group Chief Executive, Group Finance Director and other senior executives hold regular meetings with institutional investors and report to the Board on those meetings.

As described in the Directors Remuneration Report, a consultation with institutional shareholders on the framework of Directors remuneration and proposed changes to The HSBC Share Plan began in January 2008.

S M Robertson, senior independent non-executive Director since the conclusion of the 2007 Annual General Meeting, and other non-executive Directors met and corresponded with institutional investors and their representatives to discuss strategy, remuneration policy and governance. The senior independent non-executive Director is also available to shareholders should they have concerns

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which contact through the normal channels of Group Chairman, Group Chief Executive, Group Finance Director or other executives has failed to resolve or for which such contact would be inappropriate. Invitations to meet S M Robertson prior to his appointment as senior independent non-executive Director were extended to the Group's largest shareholders. The senior independent non-executive Director may be contacted through the Group Company Secretary at 8 Canada Square, London E14 5HQ.

Indemnification of Directors, relevant audit information and contracts of significance

The Articles of Association of HSBC Holdings provide that Directors are entitled to be indemnified out of the assets of the Company against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 1985. Such indemnity provisions have been in place during the financial year but have not been utilised by the Directors.

Each person who is a Director at the date of approval of this report confirms that so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and the Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given pursuant to section 234ZA of the UK Companies Act 1985 and should be interpreted in accordance therewith and subject to the provisions thereof.

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

Corporate governance codes

HSBC is committed to high standards of corporate governance. HSBC Holdings has complied throughout the year with the applicable code provisions of the Combined Code on Corporate Governance issued by the Financial Reporting Council and the Code on Corporate Governance Practices in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

The Board of HSBC Holdings has adopted a code of conduct for transactions in HSBC Group securities by Directors that complies with The Model

Code in the Listing Rules of the Financial Services Authority and with The Model Code for Securities Transactions by Directors of Listed Issuers ('Hong Kong Model Code') set out in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, save that The Stock Exchange of Hong Kong Limited has granted certain waivers from strict compliance with the Hong Kong Model Code, primarily to take into account accepted practices in the UK, particularly in respect of employee share plans. Following a specific enquiry, each Director has confirmed he or she has complied with the code of conduct for transactions in HSBC Group securities throughout the year.

Differences in HSBC Holdings/New York Stock Exchange corporate governance practices

Under the NYSE's corporate governance rules for listed companies, as a NYSE-listed foreign private issuer, HSBC Holdings must disclose any significant ways in which its corporate governance practices differ from those followed by US companies subject to NYSE listing standards. HSBC Holdings believes the following to be the significant differences between its corporate governance practices and NYSE corporate governance rules applicable to US companies.

US companies listed on the NYSE are required to adopt and disclose corporate governance guidelines. The Listing Rules of the UK Financial Services Authority require each listed company incorporated in the UK to include in its *Annual Report and Accounts* a narrative statement of how it has applied the principles of the Combined Code and a statement as to whether or not it has complied with the code provisions of the Combined Code throughout the accounting period covered by the *Annual Report and Accounts*. A company that has not complied with the Code provisions, or complied with only some of the Code provisions or (in the case of provisions whose requirements are of a continuing nature) complied for only part of an accounting period covered by the report, must specify the Code provisions with which it has not complied, and (where relevant) for what part of the reporting period such non-compliance continued, and give reasons for any non-compliance. As stated above, HSBC Holdings complied throughout 2007 with the applicable code provisions of the Combined Code. The Combined Code does not require HSBC Holdings to disclose the full range of corporate governance guidelines with which it complies.

Under NYSE standards, companies are required to have a nominating/corporate governance committee, composed entirely of independent directors. In addition to identifying individuals qualified to become Board members, this committee must develop and recommend to the Board a set of corporate governance principles. HSBC's Nomination Committee, which follows the requirements of the Combined Code, includes a majority of members who are independent. All members of the Committee are non-executive Directors and three of the five members, including the Committee chairman, are independent non-executive Directors. The Committee's terms of reference do not require the Committee to develop and recommend corporate governance principles for HSBC Holdings. As stated above, HSBC Holdings is subject to the corporate governance principles of the Combined Code.

Pursuant to NYSE listing standards, non-management directors must meet on a regular basis without management present and independent directors must meet separately at least once per year. During 2007, HSBC Holdings' non-executive Directors met twice as a group with the Group Chairman, but without the Group Chief Executive or Group Finance Director present, and met four times as a group without the Group Chairman, Group Chief Executive or Group Finance Director present. HSBC Holdings' practice, in this regard, complies with the Combined Code.

In accordance with the requirements of the Combined Code, HSBC Holdings discloses in its annual report how the Board, its committees and the Directors are evaluated (on page 297) and it provides extensive information regarding Directors' compensation in the Directors' Remuneration Report (on pages 322 to 332). The terms of reference of HSBC Holdings' Audit, Nomination and Remuneration Committees are available at www.hsbc.com/boardcommittees.

NYSE listing standards require US companies to adopt a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. In addition to the Group Business Principles and Values, which apply to the employees of all HSBC companies, pursuant to the requirements of the Sarbanes-Oxley Act the Board of HSBC Holdings has adopted a Code of Ethics applicable to the Group Chairman and the Group Chief Executive, as the principal executive officers, and to the Group Finance Director and Group Chief Accounting Officer. HSBC Holdings' Code of Ethics is available on www.hsbc.com/codeofethics or from the Group Company Secretary at 8 Canada Square, London E14 5HQ. If the Board amends or waives

the provisions of the Code of Ethics, details of the amendment or waiver will appear at the same website address. During 2007, HSBC Holdings made no amendments to its Code of Ethics and granted no waivers from its provisions. The Group Business Principles and Values are available on www.hsbc.com/businessprinciplesandvalues.

Under NYSE listing rules applicable to US companies, independent directors must comprise a majority of the Board of directors. Currently, over half of HSBC Holdings' Directors are independent.

Under the Combined Code the HSBC Holdings Board determines whether a Director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the Director's judgement. Under the NYSE rules a director cannot qualify as independent unless the Board affirmatively determines that the director has no material relationship with the listed company; in addition the NYSE rules prescribe a list of circumstances in which a director cannot be independent. The Combined Code requires a company's Board to assess director independence by affirmatively concluding that the director is independent of management and free from any business or other relationship that could materially interfere with the exercise of independent judgement.

Lastly, a chief executive officer of a US company listed on the NYSE must annually certify that he or she is not aware of any violation by the company of NYSE corporate governance standards. In accordance with NYSE listing rules applicable to foreign private issuers, HSBC Holdings Group Chief Executive is not required to provide the NYSE with this annual compliance certification. However, in accordance with rules applicable to both US companies and foreign private issuers, the Group Chief Executive is required promptly to notify the NYSE in writing after any executive officer becomes aware of any material non-compliance with the NYSE corporate governance standards applicable to HSBC Holdings.

HSBC Holdings is required to submit annual and interim written affirmations of compliance with applicable NYSE corporate governance standards, similar to the affirmations required of NYSE-listed US companies.

Board committees

The Board has appointed a number of committees consisting of certain Directors, Group Managing Directors and, in the case of the Corporate

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Sustainability Committee, certain co-opted non-director members. The following are the principal committees:

Group Management Board

The Group Management Board meets regularly and operates as a general management committee under the direct authority of the Board. The objective of the Group Management Board is to maintain a reporting and control structure whereby all of the line operations of HSBC are accountable to individual members of the Group Management Board who report to the Group Chief Executive who in turn reports to the Group Chairman. The Board has set objectives and measures for the Group Management Board. These will align senior executives objectives and measures with the strategy and operating plans throughout HSBC. The members of the Group Management Board are M F Geoghegan (Chairman), V H C Cheng and D J Flint, who are executive Directors, and A Almeida, C C R Bannister, A A Flockhart, S T Gulliver, D H Hodgkinson, A Hungate, D D J John, B P McDonagh, Y A Nasr and B Robertson, all of whom are Group Managing Directors.

The Group Management Board exercises the powers, authorities and discretions of the Board in so far as they concern the management and day-to-day running of HSBC Holdings in accordance with such policies and directions as the Board may from time to time determine. Matters reserved for approval by the Board are described on page 295.

Following each meeting the Group Chief Executive reports to the Board on the Group Management Boards activities.

Group Audit Committee

The Group Audit Committee meets regularly with HSBCs senior financial, internal audit, credit, legal and compliance management and the external auditor to consider HSBC Holdings financial reporting, the nature and scope of audit reviews and the effectiveness of the systems of internal control, compliance and risk management. The members of the Group Audit Committee throughout 2007 were, R A Fairhead (appointed Chairman on 25 May 2007), J D Coombe and J W J Hughes-Hallett. S W Newton was appointed a member of the Committee on 25 May 2007. Sir Brian Moffat ceased to be Chairman and a member of the Committee on 25 May 2007. R K F Chien retired as a Director of HSBC Holdings and ceased to be a member of the Committee on 25 May 2007. All members of the Committee are independent non-executive Directors.

The Board has determined that R A Fairhead, J D Coombe, J W J Hughes-Hallett and S W Newton are independent according to SEC criteria, and that R A Fairhead, J D Coombe, and J W J Hughes-Hallett may be regarded as audit committee financial experts for the purposes of section 407 of the Sarbanes-Oxley Act and as having recent and relevant financial experience.

Appointments to the Committee are made for periods of up to three years, extendable by no more than two additional three-year periods, so long as members continue to be independent.

Formal and tailored induction programmes are held for newly-appointed Committee members and appropriate training is provided on an ongoing and timely basis.

There were seven meetings of the Group Audit Committee during 2007. The table on page 296 gives details of Directors attendance at these meetings. Following each meeting the Committee reports to the Board on its activities.

At each meeting, the Committee has the opportunity to meet with the external auditor, without management present, to facilitate the discussion of any matter relating to its remit and any issue arising from the audit. Similar arrangements have been adopted for the Committee to meet with the internal auditor.

The terms of reference of the Committee, which are reviewed annually, are available at www.hsbc.com/boardcommittees. To ensure consistency of scope and approach by subsidiary company audit committees, the Group Audit Committee has established core terms of reference to guide subsidiary company Boards when adopting terms of reference for their audit committees. Subsidiary company audit committees are required to provide bi-annual certificates to the Committee relating to the financial statements and internal control procedures of those subsidiaries.

The Group Audit Committee is accountable to the Board and assists it in meeting its responsibilities for maintaining an effective system of internal control and compliance and for meeting its external financial reporting obligations. The Committee undertakes an annual review of the effectiveness of HSBC's system of internal control, which is described on page 304, and reviews the Company's financial statements before they are considered by the Board.

Regular reports are received on the risks involved in HSBCs business and how they are controlled and monitored by management which enable the Committee to review the effectiveness of HSBCs risk management framework. Each year the Committee agrees a schedule of presentations to be made to it by management during the ensuing year on the operation of the risk control framework within the Group. The presentations specifically address risk indicators and performance measures such as indicators of credit, liquidity and interest rate risk. During 2007 the Committee also received frequent reports on the US mortgage services business, credit performance in the US and the impact of the tightening of liquidity in the money markets. Comprehensive reports are received at each meeting from the Group Chief Risk Officer, the Head of Group Compliance, the Group General Manager, Legal and Compliance and the Group General Manager Internal Audit. Periodic presentations are made by other functional heads and line management.

The reports from the Group General Manager Internal Audit include information on frauds and special investigations and weakness in internal controls identified through internal audit reports or reviews of regulatory reports and external auditors reports. The Committee monitors and reviews the effectiveness of the internal audit function and receives summaries of periodic peer reviews of HSBCs principal internal audit functions. HSBC has adopted the Principles of the International Institute of Internal Auditors, which include a periodic external quality assurance review of the internal audit function. The first such review was undertaken by Independent Audit Limited during 2007.

The Committee receives regular updates on changes in law, regulations and accounting standards and practices and the preparations being made to respond to those requirements. During 2007, the Committee received regular updates on the review of internal financial reporting controls required by section 404 of the Sarbanes-Oxley Act and the implementation of the Basel II capital adequacy requirements. The Committee also considered a report on HSBCs compliance with the recommendations of the Institute of International Finances Special Committee on Liquidity Risk.

The Committee has approved procedures for the receipt, retention and handling of complaints regarding accounting, internal accounting controls and auditing matters. The Committee receives regular reports regarding the nature, investigation

and resolution of material complaints and concerns from the Head of Group Compliance.

The Committee is directly responsible on behalf of the Board for the selection, oversight and remuneration of the external auditor. The Committee reviews and monitors the external auditors independence and objectivity and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements.

The Committee reviews the strategy and approves the terms for the engagement of the external auditor for the audit of the Annual Report and Accounts. Regular reports on the progress of the audit facilitate the Committees assessment of the effectiveness of the audit.

The Committee receives reports from the external auditor on its own policies and procedures regarding independence and quality control and oversees the appropriate rotation of audit partners within the external auditor. The external auditor provides the Committee with an annual confirmation of its independence in accordance with industry standards.

On the recommendation of the Committee the Board has approved a policy for the employment by HSBC of former employees of the external auditor or its affiliates. The Committee monitors this policy through the receipt of an annual report of those former employees of the external auditor employed by HSBC and the number of former employees of the external auditor currently employed in senior positions in HSBC. The reports enable the Committee to consider whether there has been any impairment, or appearance of impairment, of the auditor’s judgement or independence in respect of the audit.

The Group Audit Committee has established policies for the pre-approval of specific services that may be provided by the principal auditor, KPMG Audit Plc and its affiliates (‘KPMG’). These policies are kept under review and amended as necessary to meet the dual objectives of ensuring that HSBC benefits in a cost effective manner from the cumulative knowledge and experience of its auditor, while also ensuring that the auditor maintains the necessary degree of independence and objectivity. These pre-approval policies apply to all services where HSBC Holdings or any of its subsidiaries pays for the service, or is a beneficiary or addressee of the service and has selected or influenced the choice of KPMG. All services entered into with KPMG during 2007 were pre-approved by the Committee or were entered into under pre-approval policies established by the Committee. A quarterly update on non-audit

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services provided by KPMG is presented to the Committee.

The pre-approved services relate to regulatory reviews, agreed-upon procedures reports, other types of attestation reports, the provision of advice and other non-audit services allowed under SEC independence rules. They fall into the categories of audit services, audit-related services, tax services and other services.

All services provided by KPMG relating to the implementation of section 404 of the Sarbanes-Oxley Act were specifically pre-approved by the Group Audit Committee.

An analysis of the remuneration paid in respect of audit and non-audit services provided by KPMG for each of the last three years is disclosed in Note 9 on the Financial Statements.

The Committee has recommended to the Board that KPMG Audit Plc be reappointed auditor at the forthcoming Annual General Meeting.

Remuneration Committee

The role of the Remuneration Committee and its membership are set out in the Directors Remuneration Report on page 322.

Nomination Committee

The Nomination Committee is responsible for leading the process for Board appointments and for identifying and nominating, for approval by the Board, candidates for appointment to the Board. Before recommending an appointment to the Board, the Committee evaluates the balance of skills, knowledge and experience on the Board and, in the light of this, identifies the role and capabilities required for a particular appointment. Candidates are considered on merit against these criteria. Care is taken to ensure that appointees have enough time to devote to HSBC. Prospective Directors are asked to identify any significant other commitments and confirm they have sufficient time to discharge what is expected of them. In accordance with the Articles of Association all Directors are subject to election by shareholders at the Annual General Meeting following their appointment by the Board and to re-election at least every three years. The members of the Nomination Committee throughout 2007 were Sir Brian Williamson (appointed Chairman on 25 May 2007), Baroness Dunn and Sir Brian Moffat. J W J Hughes-Hallett and S M Robertson were appointed members of the Committee on 25 May 2007. Lord Butler ceased to be a member on 25 May 2007.

There were two Nomination Committee meetings during 2007. The table on page 296 gives details of Directors attendance at these meetings.

Following each meeting the Committee reports to the Board on its activities.

The terms of reference of the Committee are available at www.hsbc.com/boardcommittees.

The appointments of J F Gil Díaz, J L Durán and W S H Laidlaw as non-executive Directors and V H C Cheng as an executive Director were made on the advice and recommendation of the Nomination Committee. J F Gil Díaz, former Secretary of Finance and Public Credit in Mexico, was identified by the Nomination Committee and so neither an external consultancy nor open advertising was used in connection with his appointment. An external consultancy was used in connection with the appointments of J L Durán and W S H Laidlaw.

The terms and conditions of appointment of non-executive Directors are available for inspection at 8 Canada Square, London E14 5HQ and will be made available for 15 minutes before the Annual General Meeting and during the Meeting itself.

The Committee makes recommendations to the Board concerning: plans for succession for both executive and non-executive Directors; the appointment of any Director to executive or other office; suitable candidates for the role of senior independent non-executive Director; the re-election by shareholders of Directors retiring by rotation; the renewal of the terms of office of non-executive Directors; membership of Board Committees, in consultation with the Group Chairman and the chairman of such committees as appropriate; any matters relating to the continuation in office of any Director at any time; Directors fees and committee fees for the Company; and appointments and reappointments to the Boards of Directors of major subsidiary companies as appropriate.

The Committee regularly reviews the structure, size and composition (including the skills, knowledge and experience required) of the Board and makes recommendations to the Board as appropriate. It keeps under review the leadership needs of HSBC, with a view to ensuring the continued ability of HSBC to compete effectively in the marketplace. The Board has satisfied itself that the Nomination Committee has in place appropriate plans for orderly succession to the Board and senior management positions as well as procedures to ensure an appropriate balance of skills and experience within HSBC and on the Board.

Report of the Directors: Governance (continued)

Board of Directors > Board committees / Internal control

Corporate Sustainability Committee

The Corporate Sustainability Committee is responsible for overseeing corporate responsibility and sustainability policies, principally environmental, social and ethical matters and for advising the Board, committees of the Board and executive management on such matters. The terms of reference of the Committee are available at www.hsbc.com/boardcommittees. The members of the Committee throughout 2007 were Lord Butler (Chairman), W K L Fung and Sir Mark Moody-Stuart (each of whom is a non-executive Director) and G V I Davis and Lord May, who are non-director members of the Committee. S Hintze was a member of the Committee until her retirement as a Director at the conclusion of the 2007 Annual General Meeting.

There were five meetings of the Corporate Sustainability Committee during 2007. Following each meeting the Committee reports to the Board on its activities.

Further information will be in HSBCs *Sustainability Report 2007*, available in May 2008.

Internal control

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

The key procedures that the Directors have established are designed to provide effective internal control within HSBC and accord with the Internal Control: Revised Guidance for Directors on the Combined Code issued by the Financial Reporting Council. Such procedures for the ongoing identification, evaluation and management of the significant risks faced by HSBC have been in place throughout the year and up to 3 March 2008, the date of approval of the *Annual Report and Accounts 2007*. In the case of companies acquired during the year, the internal controls in place are being reviewed against HSBCs benchmarks and integrated into HSBCs processes.

HSBCs key internal control procedures include the following:

- Authority to operate the various subsidiaries and responsibilities for financial performance against plans and for capital expenditure is delegated to their respective chief executive officers within limits set by the Board of Directors of HSBC Holdings. Sub-delegation of authority from the Board to individuals requires these individuals, within their respective delegation, to maintain a clear and appropriate apportionment of significant responsibilities and to oversee the establishment and maintenance of systems of controls appropriate to the business. The appointment of executives to the most senior positions within HSBC requires the approval of the Board of Directors of HSBC Holdings.

- Functional, operating, financial reporting and certain management reporting standards are established by Group Head Office management committees, for application across the whole of HSBC. These are supplemented by operating standards set by functional and local management as required for the type of business and geographical location of each subsidiary.

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Systems and procedures are in place in HSBC to identify, control and report on the major risks including credit, changes in the market prices of financial instruments, liquidity, operational error, breaches of law or regulations, unauthorised activities and fraud. Exposure to these risks is monitored by risk management committees, asset and liability committees and executive committees in subsidiaries and by the Group Management Board for HSBC as a whole. A risk management meeting of the Group Management Board, chaired by the Group Finance Director, is held monthly. These risk management meetings address asset, liability and management issues. Minutes of the risk management meetings of the Group Management Board are submitted to the Group Audit Committee and to the Board of Directors.

- A Disclosure Committee has been established to review material disclosures made by HSBC Holdings for any errors, misstatements or omissions. The membership of the Disclosure Committee, which is chaired by the Group Company Secretary, includes the heads of the Finance, Legal, Risk, Compliance, Corporate Communications, Investor Relations and Internal Audit functions and representatives

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from the principal regions, customer groups and global businesses.

- Processes are in place to identify new risks from changes in market practices or customer behaviours which could expose HSBC to heightened risk of loss or reputational damage. During 2007 attention continued to be directed towards evolving best practice in the areas of internet banking; counterparty risk management policy following the publication of the Corrigan report in July 2005; best practice guidance emerging on liquidity management from the Institute of International Finance; the implications of a slowing housing market in the US coupled with rising payment obligations under ARMs; Group exposure to monolines and money market funds; the impact on the Group of the market illiquidity situation; and the implications of changed customer behaviour in the UK regarding seeking protection from credit obligations.

- Periodic strategic plans are prepared for key customer groups, global product groups, support functions and certain geographies within the framework of the Group Strategic Roadmap. Rolling operating plans are prepared and adopted by all major HSBC operating companies, and set out the key business initiatives and the likely financial effects of those initiatives.

- Centralised functional control is exercised over all computer system developments and operations. Common systems are employed for similar business processes wherever practicable. Credit and market risks are measured and reported on in subsidiaries and aggregated for review of risk concentrations on a Group-wide basis.

- Authorities to enter into credit exposures and market risk exposures are delegated with limits to line management in the subsidiaries. In addition, functional management in Group Head Office is responsible for setting policies, procedures and standards in the following areas of risk: credit risk; market risk; liquidity risk; operational risk; IT risk; insurance risk; accounting risk; tax risk; legal and regulatory compliance risk; human resources risk; reputational risk; and purchasing risk.

- Policies to guide subsidiary companies and management at all levels in the conduct of business to safeguard the Group's reputation are established by the Board of HSBC Holdings and the Group Management Board, subsidiary

  company Boards, Board committees or senior management. Reputational risks can arise from environmental, social or governance issues, or as a consequence of operational risk events. As a banking group, HSBC's good reputation depends upon the way in which it conducts its business but it can also be affected by the way in which clients, to which it provides financial services, conduct their business.

- The internal audit function, which is centrally controlled, monitors the effectiveness of internal control structures across the whole of HSBC. The work of the internal audit function is focused on areas of greatest risk to HSBC as determined by a risk-based approach. The head of this function reports to the Group Chairman and the Group Audit Committee.

- Management is responsible for ensuring that recommendations made by the internal audit function are implemented within an appropriate and agreed timetable. Confirmation to this effect must be provided to internal audit. Management must also confirm annually to internal audit that offices under their control have taken or are in the process of taking the appropriate actions to deal with all significant recommendations made by external auditors in management letters or by regulators following regulatory inspections.

The Group Audit Committee has kept under review the effectiveness of this system of internal control and has reported regularly to the Board of Directors. The key processes used by the Committee in carrying out its reviews include: regular business and operational risk assessments; regular reports from the heads of key risk functions including Internal Audit and Compliance; the production annually of reviews of the internal control framework applied at Group Head Office and major operating subsidiary level measured against HSBC benchmarks, which cover all internal controls, both financial and non-financial; semi-annual confirmations from chief executives of principal subsidiary companies as to whether there have been any material losses, contingencies or uncertainties caused by weaknesses in internal controls; internal audit reports; external audit reports; prudential reviews; and regulatory reports. In addition, where unexpected losses have arisen or where incidents have occurred which indicate gaps in the control framework or in adherence to Group policies, the Group Audit Committee has reviewed special reports, prepared at the instigation of management, which analyse the cause of the issue, the lessons learned and the actions proposed by management to address the issue.

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Report of the Directors: Governance (continued)

Board of Directors > Directors' interests / Employees

The Directors, through the Group Audit Committee, have conducted an annual review of the effectiveness of HSBC's system of internal control covering all material controls, including financial, operational and compliance controls and risk management systems. The Group Audit Committee has received confirmation that management has taken or is taking the necessary action to remedy any failings or weaknesses identified through the operation of HSBC's framework of controls.

Directors' interests

Pursuant to the requirements of the UK Listing Rules and according to the register maintained by HSBC Holdings pursuant to section 352 of the Securities and Futures Ordinance of Hong Kong, the Directors of HSBC Holdings at the year-end had the following interests, all beneficial unless otherwise stated, in the shares and loan capital of HSBC and its associated corporations:

HSBC Holdings ordinary shares of US$0.50

		At 31 December 2007					
	At 1 January 2007	**Beneficial owner**	**Child under 18 or spouse**	**Trustee**	**Jointly with another person**	**Controlled corporation**	**Total interests**[1]
J D Coombe	39,799	**12,528**	—	**33,799**[2]	—	—	**46,327**
Baroness Dunn	176,525	**155,014**	—	**28,650**[2]	—	—	**183,664**
D J Flint	104,947	**83,467**	—	**29,314**[3]	—	—	**112,781**
W K L Fung	328,000	**328,000**	—	—	—	—	**328,000**
M F Geoghegan	113,525	**385,189**	—	—	—	—	**385,189**
S K Green	401,796	**491,297**	—	—	**45,355**	—	**536,652**
J W J Hughes-Hallett	1,668,986	—	—	**554,435**[2]	—	—	**554,435**
Sir Brian Moffat	12,149	—	—	—	**17,783**	—	**17,783**
Sir Mark Moody-Stuart	10,840	**5,000**	**840**	**5,000**[2]	—	—	**10,840**
G Morgan	—	**50,000**	—	—	—	—	**50,000**
S W Newton	5,631	**5,903**	—	—	—	**50,949**	**56,852**
S M Robertson	131,976	**5,317**	—	**93,000**[2]	—	—	**98,317**
Sir Brian Williamson	17,281	**23,164**	—	—	—	—	**23,164**

1 *Each of the total interests represents less than 0.02 per cent of the shares in issue. Details of executive Directors' other interests in HSBC Holdings ordinary shares of US$0.50 arising from employee share plans are set out in the Directors' Remuneration Report on pages 330 to 332. At 31 December 2007, the aggregate interests under the Securities and Futures Ordinance of Hong Kong of D J Flint, M F Geoghegan and S K Green in HSBC Holdings ordinary shares of US$0.50, including interests arising through employee share plans are: D J Flint – 877,404; M F Geoghegan – 1,509,480; and S K Green – 1,710,886.*

2 *Non-beneficial.*

3 *Non-beneficial interest in 9,772 HSBC Holdings ordinary shares of US$0.50.*

M F Geoghegan has an interest as beneficial owner in 280,000 ordinary shares of HK$5.00 each in Hang Seng Bank (representing less than 0.02 per cent of the shares in issue), which he acquired during the year.

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

As a Director of HSBC Private Banking Holdings (Suisse), S K Green has an interest as beneficial owner in one share of CHF1,000 in that company (representing less than 0.01 per cent of the shares in issue), which he held throughout the year. S K Green has waived his rights to receive dividends on the share and has undertaken to transfer the share to HSBC on ceasing to be a Director of HSBC Private Banking Holdings (Suisse).

As Directors of HSBC France, S K Green and M F Geoghegan each have an interest as beneficial owner in one share of 5 in that company (representing less than 0.01 per cent of the shares in issue), which they held throughout the year. The Directors have waived their rights to receive dividends on these shares and have undertaken to transfer these shares to HSBC on ceasing to be Directors of HSBC France.

No Directors held any short positions as defined in the Securities and Futures Ordinance of Hong Kong in the shares and loan capital of HSBC and itsassociated corporations. Save as stated above and in the Directors Remuneration Report, none of the Directors had an interest in any shares or debentures of HSBC or any associated corporation at the beginning or at the end of the year, and none of the Directors or members of th eir immediate family was

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awarded or exercised any right to subscribe for any shares or debentures in any HSBC corporation during the year.

Since the end of the year, the interests of each of the following Directors have increased by the number of HSBC Holdings ordinary shares shown against their name:

HSBC Holdings ordinary shares of US$0.50

	Beneficial owner	**Jointly with another person**	**Beneficiary of a trust**	**Controlled corporation**
J D Coombe	**127**[1]	—	—	—
Baroness Dunn	**506**[1]	—	—	—
D J Flint	**882**[2]	296[1]	**7,705**[3]	—
M F Geoghegan	**2,286**[1]	—	**11,361**[3]	—
S K Green	**4,825**[4]	—	**11,836**[3]	—
Sir Brian Moffat	**179**[1]	—	—	—
G Morgan	**505**[1]	—	—	—
S W Newton	**60**[1]	—	—	**515**[1]
S M Robertson	**53**[1]	—	—	—
Sir Brian Williamson	**234**[1]	—	—	—

1 *Scrip dividend.*
2 *Comprises scrip dividend on shares held as beneficial owner (779 shares), the acquisition of shares in the HSBC Holdings UK Share Ownership Plan through regular monthly contributions (33 shares), the automatic reinvestment of dividend income on shares heldin the plan (14 shares) and by the automatic reinvestment of dividend income by an Individual Savings Account and Personal Equity Plan manager (56 shares).*
3 *Scrip dividend on conditional awards held under The HSBC Share Plan and the HSBC Holdings Restricted Share Plan 2000.*
4 *Comprises scrip dividend on shares held as beneficial owner (4,778 shares), the acquisition of shares in the HSBC Holdings UK Share Ownership Plan through regular monthly contributions (33 shares) and the automatic reinvestment of dividend income on shares held in the plan (14 shares).*

W S H Laidlaw had beneficial and non-beneficial interests in 20,000 and 4,500 HSBC Holdings ordinary shares respectively, on 1 January 2008, the date he was appointed a Director of HSBC Holdings.

V H C Cheng had beneficial interests in 244,539 HSBC Holdings ordinary shares and 408,022 conditional long-term incentive awards of Performance Shares on 1 February 2008, the date he was appointed a Director of HSBC Holdings.

There have been no other changes in the share and loan capital interests of the Directors until the date of this Report. Any subsequent changes up to the last practicable date before the publication of the *Notice of Annual General Meeting* will be set out in the notes to that Notice.

At 31 December 2007, Directors and Senior Management held, in aggregate, beneficial interests in 12,849,034 HSBC Holdings ordinary shares (0.1 per cent of the issued ordinary shares).

At 31 December 2007, executive Directors and Senior Management held, in aggregate, options to subscribe for 58,795 HSBC Holdings ordinary shares under the HSBC Holdings Executive Share Option Scheme and HSBC Holdings savings-related share option plans. These options are exercisable between 2008 and 2013 at prices ranging from £5.3496 to £7.6736 per share.

Employees

At 31 December 2007, HSBC's customers were served by 330,000 full and part-time employees worldwide, compared with 312,000 at 31 December 2006 and 284,000 at 31 December 2005. The main centres of employment are the UK with approximately 56,700 employees; the US 43,000; India 33,000; Hong Kong 29,000; Brazil 27,000; Mexico 23,000 and France 15,000. HSBC negotiates with recognised unions. The highest concentrations of union membership are in Argentina, Brazil, Colombia, Egypt, France, Germany, Jordan, Lebanon, Malaysia, Malta, Mexico, the Philippines, Singapore and the UK. It is HSBC's policy to maintain well-developed communications and consultation programmes and there have been no material disruptions to its operations from labour disputes during the past five years.

HSBC continues to develop the capabilities of its people. Formal policies and structures are in place to provide career development and training for all employees, with particular emphasis on increasing international mobility to enrich the diversity of the employees' experience. HSBC's talent strategy, which focuses on the development of leadership capability and smooth succession planning, continues. This is being achieved through mutual and open dialogue and planned development from graduate through to senior management levels.

Report of the Directors: Governance (continued)

Employees > Involvement / Disabled persons / Remuneration policy / Share plans

HSBC continues to be committed to creating a diverse and inclusive work environment reflective of its customer base, international workforce, and communities in which it operates. It has a Group-wide strategy that aims to improve gender, ethnicity and age diversity to ensure the long-term sustainability of the organisation. There is particular focus on increasing gender and ethnic diversity at senior management levels. Diversity initiatives are implemented at a country level taking local and national laws into account. Employee network groups and mentoring programmes are promoted and established where possible to facilitate open discussion of workplace issues for employees belonging to minority groups, and to foster an environment that celebrates diversity.

HSBC recognises its role as an employer in a wider context and is committed to employee health issues, promoting employee involvement in community and not-for-profit organisations and providing flexible working opportunities. As a responsible employer and corporate citizen, HSBC recognises the need to address the issues raised by HIV/AIDS in the workplace and, in 2007, launched a HIV/AIDS policy. The policy defines the approach and minimum standards to be achieved by HSBC entities around the world. Key principles include non-discrimination and confidentiality, voluntary testing, commitment to prevention, education, awareness, care and support. To coincide with the launch of the Group policy an e-learning module and a dedicated intranet site was established to provide education on the important issues surrounding HIV/AIDS.

HSBC considers its people to be fundamental to its past and future success. In its pursuit of making HSBC the best place to work, HSBC maintains an ongoing dialogue with employees, and looks to understand how they are motivated and engaged. In 2007, HSBC conducted its first Global People Survey which comprised questions designed to measure employee engagement levels consistently across the Group. The survey covered HSBCs permanent global workforce, and responses were received from almost 290,000 employees, a significant response rate of 88 per cent. Questions were summarised under 12 dimensions. On all of the dimensions, employees rated HSBC above external global norms. Particular areas of strength were HSBCs brand reputation, its commitment to corporate sustainability and the quality of its direct managers. HSBC has communicated the results and key action plans are being developed to improve engagement. Following the success of the first survey, plans are underway for the second survey in 2008.

Employee involvement

HSBC values open communication with its employees. Employees are encouraged to discuss operational and strategic issues, and ways of improving performance, with their line managers. Open communication throughout the organisation is encouraged and opportunities to share individual perspectives are created through networking events, management blogs, international assignments and learning and development programmes. Information is regularly given to employees about employment matters and the financial and economic factors affecting HSBCs performance. This is communicated via management channels, internal seminars, training programmes, in-house magazines and an intranet site accessible to the majority of HSBCs employees worldwide.

Employment of disabled persons

HSBC believes in providing equal opportunities to all employees. The employment of disabled persons is included in this commitment and the recruitment, training, career development and promotion of disabled persons is based on the aptitudes and abilities of the individual. Should employees become disabled during employment, every effort is made to continue their employment and, if necessary, appropriate training is provided.

Remuneration policy

As the quality and commitment of its human capital is deemed fundamental to HSBC's success, the Board's stated strategy is to attract, retain and motivate the very best people.

In a business that is based on trust and relationships, HSBC's broad policy is to recruit those who are committed to making a long-term career with the organisation since trust and relationships are built over time.

Remuneration is an important component in people's decisions on which company to join and to stay with, but it is not the overriding one; it is HSBC's experience that people are attracted to, an organisation with strong values, one which is meritocratic and competitive and which offers transparent and interesting career development.

In line with the overall principles applied by the Remuneration Committee as described on page 322 in the Directors' Remuneration Report:

- employees' salaries are reviewed annually in the

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context of individual and business performance, market practice, internal relativities and competitive market pressures. Allowances and benefits are largely determined by local market practice;

- employees participate in various variable pay arrangements. Discretionary variable pay plans will normally make reference to the achievement of objectives which are ultimately aligned to those at the Group level, and which typically cover financial, customer, process and people targets. These targets typically include revenue growth, expense control, customer recommendation, employee engagement, adherence to HSBCs ethical standards, lending guidelines, internal controls and procedures to maintain a strong and secure operating platform. Actual levels of pay will depend on the performance of constituent businesses, the individuals concerned and competitive market practice;

- HSBC has a long history of paying close attention to its customers in order to provide value for both customers and shareholders. This has been achieved by ensuring that the interests of HSBC and its employees are aligned with those of its shareholders and that HSBCs approach to risk management serves the interests of all. Accordingly, employees are encouraged to participate in the success they help to create, through the HSBC Holdings savings-related share option plans and local share ownership and profit sharing arrangements.

Employee share plans

To help align the interests of employees with those of shareholders, share options are granted under all-employee share plans and discretionary awards of Performance Shares and Restricted Shares are made under The HSBC Share Plan. There have been no awards of discretionary share options since 30 September 2005.

Set out on pages 309 to 317 are particulars of outstanding employee share options, including those held by employees working under employment contracts that are regarded as continuous contracts for the purposes of the Hong Kong Employment Ordinance. The options were granted at nil consideration. No options have been granted to substantial shareholders, suppliers of goods or services, or in excess of the individual limit for each share plan. No options were cancelled during the year.

Employee share plans are subject to the following limits on the number of HSBC Holdings ordinary shares that may be subscribed for. In any 10-year period not more than 10 per cent of the HSBC Holdings ordinary shares in issue from time to time (approximately 1,187 million HSBC Holdings ordinary shares at 3 March 2008) may in aggregate become issuable pursuant to the grant of options or be issued other than pursuant to options under all-employee share plans. In any 10-year period not more than 5 per cent of the HSBC Holdings ordinary shares in issue from time to time (approximately 593 million HSBC Holdings ordinary shares on 3 March 2008) may in aggregate be put under option under The HSBC Share Plan or be issuable pursuant to the HSBC Holdings Group Share Option Plan, the HSBC Executive Share Option Scheme, the HSBC Holdings Restricted Share Plan 2000 or The HSBC Share Plan. The number of HSBC Holdings ordinary shares that may be issued on exercise of all options granted on or after 27 May 2005 under The HSBC Share Plan and any other plans must not exceed 1,119,000,000 HSBC Holdings ordinary shares. Under the HSBC Holdings savings-related share option plans, The HSBC Share Plan, HSBC Holdings Group Share Option Plan and the HSBC Holdings Executive Share Option Scheme there were options outstanding over 260,714,579 HSBC Holdings ordinary shares at 31 December 2007. Particulars of options over HSBC Holdings shares held by Directors of HSBC Holdings are set out on page 331 of the Directors Remuneration Report.

The effect on earnings per share of granting share options and share awards is shown in diluted earnings per share on the face of the consolidated income statement, with further details disclosed in Note 13 on the Financial Statements. The effect on basic earnings per share of dilutive share options and share awards would be to dilute it by 1.2 per cent.

All-employee share option plans

The HSBC Holdings Savings-Related Share Option Plan and the HSBC Holdings Savings-Related Share Option Plan: International are all-employee share plans under which eligible HSBC employees (those employed within the Group on the first working day of the year of grant) may be granted options to acquire HSBC Holdings ordinary shares. Employees may make contributions of up to £250 (or equivalent) each month over a period of one, three or five years which may be used on the first, third or fifth anniversary of the commencement of the relevant savings contract, at the employees election, to exercise the options. Alternatively, the employee

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may elect to have the savings, plus (where applicable) any interest or bonus, repaid in cash. Options granted over a one-year period will be exercisable within three months following the first anniversary of the commencement of the savings contract. Options granted over three or five-year periods will be exercisable within six months following the third or fifth anniversary of the commencement of the relevant savings contract. In the case of redundancy, retirement on grounds of injury or ill health, retirement at or after normal retirement age, the transfer of the employing business to another party, or a change of control of the employing company, options may be exercised before completion of the relevant savings contract.

Under the HSBC Holdings Savings-Related Share Option Plan and the HSBC Holdings Savings-Related Share Option Plan: International the option exercise price is determined by reference to the average market value of the ordinary shares on the

five business days immediately preceding the invitation date, then applying a discount of 20 per cent (except for the one-year options awarded under the US sub-plan where a 15 per cent discount is applied). The exercise period of the options awarded under all-employee share plans may be advanced to an earlier date in certain circumstances, for example on retirement, and may be extended in certain circumstances, for example on the death of a participant, the executors may exercise the option up to six months beyond the normal exercise period. The closing price per HSBC Holdings ordinary share on 24 April 2007, the day before options were awarded in 2007 under the HSBC Holdings Savings-Related Share Option Plan and the HSBC Holdings Savings-Related Share Option Plan: International, was £9.21. The all-employee share option plans will terminate on 27 May 2015 unless the Directors resolve to terminate the plans at an earlier date.

HSBC Holdings Savings-Related Share Option Plan

HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (£)	Exercisable from	Exercisable until	Options at 1 January 2007	Options awarded during year	Options exercised during[1] year	Options lapsed during year	Options at 31 December 2007
11 Apr 2001	6.7536	1 Aug 2006	31 Jan 2007	59,421	–	45,047	14,374	–
2 May 2002	6.3224	1 Aug 2007	31 Jan 2008	3,552,436	–	3,404,960	60,713	86,763
23 Apr 2003	5.3496	1 Aug 2006	31 Jan 2007	177,912	–	131,858	46,054	–
23 Apr 2003	5.3496	1 Aug 2008	31 Jan 2009	11,001,155	–	164,054	434,148	10,402,953
21 Apr 2004	6.4720	1 Aug 2007	31 Jan 2008	3,110,196	–	2,862,811	114,418	132,967
21 Apr 2004	6.4720	1 Aug 2009	31 Jan 2010	5,295,786	–	46,221	308,473	4,941,092
	6.6792	1 Aug 2008	31 Jan 2009	3,959,600	–	50,595	386,135	3,522,870

24 May 2005								
24 May 2005	6.6792	1 Aug 2010	31 Jan 2011	5,329,930	–	25,815	365,684	4,938,431
26 Apr 2006	7.6736	1 Aug 2009	31 Jan 2010	4,653,146	–	20,423	815,325	3,817,398
26 Apr 2006	7.6736	1 Aug 2011	31 Jan 2012	3,550,685	–	3,747	484,766	3,062,172
25 Apr 2007	7.0872	1 Aug 2010	31 Jan 2011	–	6,166,897	407	399,118	5,767,372
25 Apr 2007	7.0872	1 Aug 2012	31 Jan 2013	–	4,228,735	206	153,058	4,075,471

1 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £9.12.*

HSBC Holdings Savings-Related Share Option Plan: International

To encourage greater participation in the HSBC Holdings Savings-Related Share Option Plan: International, two amendments were approved at the 2005 Annual General Meeting. The first was the introduction of the facility to save and have option

prices expressed in US dollars, Hong Kong dollars and euros as well as in pounds sterling. Where applicable, the US dollars, Hong Kong dollars and euro exercise prices are converted from the sterling exercise price at the applicable exchange rate on the working day preceding the relevant invitation date. The second amendment was to provide the choice of options over one year in addition to three and five year terms.

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HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price	Exercisable from	Exercisable until	Options at 1 January 2007	Options awarded during year	Options exercised during[1] year	Options lapsed during year	Options at 31 December 2007
	(£)							
11 Apr 2001	6.7536	1 Aug 2006	31 Jan 2007	40,853	—	11,473	29,380	—
2 May 2002	6.3224	1 Aug 2007	31 Jan 2008	1,063,521	—	832,209	192,140	39,172
23 Apr 2003	5.3496	1 Aug 2008	31 Jan 2009	10,488	—	—	—	10,488
8 May 2003	5.3496	1 Aug 2006	31 Jan 2007	310,378	—	120,785	189,593	—
8 May 2003	5.3496	1 Aug 2008	31 Jan 2009	5,827,034	—	77,890	680,642	5,068,502
21 Apr 2004	6.4720	1 Aug 2007	31 Jan 2008	47,070	—	15,770	155	31,145
21 Apr 2004	6.4720	1 Aug 2009	31 Jan 2010	12,365	—	—	—	12,365
10 May 2004	6.4720	1 Aug 2007	31 Jan 2008	8,613,295	—	7,394,632	968,135	250,528
10 May 2004	6.4720	1 Aug 2009	31 Jan 2010	2,953,476	—	30,234	369,055	2,554,187
24 May 2005	6.6792	1 Aug 2008	31 Jan 2009	10,956,064	—	141,018	1,379,824	9,435,222
24 May 2005	6.6792	1 Aug 2010	31 Jan 2011	3,743,916	—	19,417	320,921	3,403,578
26 Apr 2006	7.6736	1 Aug 2007	31 Oct 2007	860,609	—	727,512	101,439	31,658
26 Apr 2006	7.6736	1 Aug 2009	31 Jan 2010	2,324,779	—	8,155	512,297	1,804,327
26 Apr 2006	7.6736	1 Aug 2011	31 Jan 2012	518,112	—	367	111,002	406,743
25 Apr 2007	7.0872	1 Aug 2008	31 Oct 2008	—	1,647,064	26	103,072	1,543,966
25 Apr 2007	7.0872	1 Aug 2010	31 Jan 2011	—	3,573,175	287	136,795	3,436,093
25 Apr 2007	7.0872	1 Aug 2012	31 Jan 2013	—	1,019,913	—	44,150	975,763
	(US$)							
26 Apr 2006	14.1621[2]	1 Aug 2007	31 Oct 2007	591,818	—	493,725	98,093	—
26 Apr 2006	13.3290	1 Aug 2007	31 Oct 2007	112,660	—	92,917	14,470	5,273
26 Apr 2006	13.3290	1 Aug 2009	31 Jan 2010	1,749,146	—	7,220	266,055	1,475,871
26 Apr 2006	13.3290	1 Aug 2011	31 Jan 2012	478,476	—	1,412	91,099	385,965
25 Apr 2007	14.7478[2]	1 Aug 2008	31 Oct 2008	—	729,015	—	57,566	671,449
25 Apr 2007	13.8803	1 Aug 2008	31 Oct 2008	—	347,176	—	9,396	337,780

25 Apr 2007	13.8803	1 Aug 2010	31 Jan 2011		2,817,545	232	129,390	2,687,923
25 Apr 2007	13.8803	1 Aug 2012	31 Jan 2013		804,104	362	43,083	760,659
	()							
26 Apr 2006	11.0062	1 Aug 2007	31 Oct 2007	42,046		38,928	2,271	847
26 Apr 2006	11.0062	1 Aug 2009	31 Jan 2010	188,857			12,057	176,800
26 Apr 2006	11.0062	1 Aug 2011	31 Jan 2012	39,570			4,075	35,495
25 Apr 2007	10.4217	1 Aug 2008	31 Oct 2008		128,427		5,795	122,632
25 Apr 2007	10.4217	1 Aug 2010	31 Jan 2011		376,440		14,598	361,842
25 Apr 2007	10.4217	1 Aug 2012	31 Jan 2013		128,871		3,015	125,856
	(HK$)							
26 Apr 2006	103.4401	1 Aug 2007	31 Oct 2007	1,295,846		1,160,815	133,070	1,961
26 Apr 2006	103.4401	1 Aug 2009	31 Jan 2010	4,255,761		16,734	347,873	3,891,154
26 Apr 2006	103.4401	1 Aug 2011	31 Jan 2012	1,110,391		1,516	84,033	1,024,842
25 Apr 2007	108.4483	1 Aug 2008	31 Oct 2008		2,225,766	367	117,273	2,108,126
25 Apr 2007	108.4483	1 Aug 2010	31 Jan 2011		4,561,313	826	79,232	4,481,255
25 Apr 2007	108.4483	1 Aug 2012	31 Jan 2013		1,350,798	317	18,407	1,332,074

1 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £9.13.*

2 *Exercisable at a 15 per cent discount to the average market value of the ordinary shares on the five business days immediately preceding the invitation date.*

Report of the Directors: Governance (continued)

Employees > Share plans / Subsidiary company share plans

Discretionary Share Plans

Note 10 on the Financial Statements gives detail on share-based payments, including awards of Performance Shares and Restricted Shares made in 2007.

The HSBC Share Plan was approved at the 2005 Annual General Meeting. Awards of Performance Shares are made under this Plan to executive Directors and other senior executives. The performance conditions for awards of Performance Shares are described under Long-term incentive plan on page 324.

Awards of Performance Shares are directed to those senior executives who can influence corporate performance such as members of the Group Management Board.

Awards of Restricted Shares are typically made to other employees based on individual performance, business performance and competitive market practice.

Restricted Share awards define the number of shares to which the employee will become entitled, generally between one and three years from the date of the award, subject to the individual remaining in employment. All awards of Performance Shares and Restricted Shares will be satisfied by the transfer of existing shares.

Since 2005, awards of share options under The HSBC Share Plan have only been granted in very limited circumstances. There may be particular circumstances in the future where option grants could be appropriate. No options were awarded under The HSBC Share Plan in 2007.

Prior to 2005, discretionary awards of share options, with vesting subject to the attainment of a predetermined TSR performance condition, were made to employees at all levels of HSBC.

The vesting of these options was subject to the attainment of pre-determined relative TSR performance criteria, except in HSBC France (which was acquired in 2000) where performance criteria were phased in. Under the HSBC Holdings Group Share Option Plan, the maximum grant of options which could be granted to an employee in any one

year (together with the Performance Share awards under the HSBC Holdings Restricted Share Plan 2000) was 150 per cent (or in exceptional circumstances 225 per cent) of the employees annual salary at the date of grant plus any bonus paid in the previous year.

Under the HSBC Executive Share Option scheme the maximum value of options which could be granted to an employee in any one year was four times the employees relevant earnings. Subject to the attainment of the relative TSR performance condition where applicable, options are generally exercisable between the third and the tenth anniversary of the date of grant. Employees of a subsidiary that is sold or transferred out of HSBC may exercise options awarded under the HSBC Group Share Option Plan or the HSBC Holdings Executive Share Option Scheme within six or twelve months respectively of the sale or transfer, regardless of whether the performance condition is met.

The maximum value of options that may be granted to an employee in any one year under The HSBC Plan (when taken together with any Performance Share award made under The HSBC Share Plan) is 700 per cent of the employees annual salary at the date of grant.

The exercise price of options granted under The HSBC Share Plan, and previously under the HSBC Holdings Group Share Option Plan, is the higher of the average market value of the ordinary shares on the five business days prior to the grant of the option or the market value of the ordinary shares on the date of grant of the option. The exercise price of options granted under the HSBC Holdings Executive Share Option Scheme was the market value of the ordinary shares on the business day prior to the grant of the option. The HSBC Share Plan will terminate on 27 May 2015 unless the Directors resolve to terminate the Plan at an earlier date.

The exercise period of the options awarded under discretionary share incentive plans may be advanced to an earlier date in certain circumstances, for example on retirement, or on the death of a participant, options may be exercised up to 12 months beyond the normal exercise period.

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HSBC Holdings Executive Share Option Scheme[1]
HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (£)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year[2]	Options lapsed during year	Options at 31 December 2007
24 Mar 1997	5.0160	24 Mar 2000	24 Mar 2007	188,074	188,053	21	—
12 Aug 1997	7.7984	12 Aug 2000	12 Aug 2007	9,000	—	9,000	—
16 Mar 1998	6.2767	16 Mar 2001	16 Mar 2008	678,434	243,293	7,500	427,641
29 Mar 1999	6.3754	3 Apr 2002	29 Mar 2009	11,808,970	1,829,283	184,774	9,794,913
10 Aug 1999	7.4210	10 Aug 2002	10 Aug 2009	100,058	9,000	—	91,058
31 Aug 1999	7.8710	31 Aug 2002	31 Aug 2009	4,000	—	—	4,000
3 Apr 2000	7.4600	3 Apr 2003	3 Apr 2010	9,248,569	1,108,267	219,372	7,920,930

1 *The HSBC Holdings Executive Share Option Scheme expired on 26 May 2000. No options have been granted under the Scheme since that date.*
2 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £9.15.*

HSBC Holdings Group Share Option Plan[1]
HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (£)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year[2]	Options lapsed during year	Options at 31 December 2007
4 Oct 2000	9.6420	4 Oct 2003	4 Oct 2010	321,176	—	14,535	306,641
23 Apr 2001	8.7120	23 Apr 2004	23 Apr 2011	29,400,469	1,450,759	783,613	27,166,097
30 Aug 2001	8.2280	30 Aug 2004	30 Aug 2011	179,193	22,175	6,538	150,480
7 May 2002	8.4050	7 May 2005	7 May 2012	32,501,697	2,176,110	762,898	29,562,689
30 Aug 2002	7.4550	30 Aug 2005	30 Aug 2012	361,600	2,500	4,500	354,600
2 May 2003	6.9100	2 May 2006	2 May 2013	34,541,586	4,584,914	999,377	28,957,295
29 Aug 2003	8.1300	29 Aug 2006	29 Aug 2013	445,894	30,250	20,860	394,784
3 Nov 2003	9.1350	3 Nov 2006	3 Nov 2013	4,885,800	—	816,000	4,069,800
30 Apr 2004	8.2830	30 Apr 2007	30 Apr 2014	58,455,504	84,941	4,527,677	53,842,886
27 Aug 2004	8.6500	27 Aug 2007	27 Aug 2014	332,470	—	20,470	312,000
20 Apr 2005	8.3620	30 Apr 2008	20 Apr 2015	7,360,795	—	265,500	7,095,295

1 *The HSBC Holdings Group Share Option Plan expired on 26 May 2005. No options have been granted under the Plan since that date.*
2

The weighted average closing price of the shares immediately before the dates on which options were exercised was £9.23.

The HSBC Share Plan
HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (£)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year	Options lapsed during year	Options at 31 December 2007
21 Jun 2005	8.794	21 Jun 2008	21 Jun 2009	552,526	—	103,071	449,455
30 Sep 2005	9.170	30 Sep 2008	30 Sep 2015	74,985	—	—	74,985

Subsidiary company share plans

HSBC France and subsidiary company

When it was acquired in 2000, HSBC France and one of its subsidiary companies, HSBC Private Bank France, operated employee share option plans under

which options could be granted over their respective shares. No further options will be granted under either of these companies' plans. The following are details of options to acquire shares in HSBC France and HSBC Private Bank France.

Report of the Directors: Governance (continued)

Employees > Subsidiary company share plans

HSBC France
shares of □5

Date of award	Exercise price (□)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during1 year	Options lapsed during year	Options at 31 December 2007[1]
7 May 1997	37.05	7 Jun 2000	7 May 2007	66,000	66,000	□	□
29 Apr 1998	73.48	7 Jun 2000	29 Apr 2008	192,154	91,775	□	100,379
7 Apr 1999	81.71	7 Jun 2000	7 Apr 2009	383,602	79,200	□	304,402
12 Apr 2000	142.50	1 Jan 2002	12 Apr 2010	646,125	43,875	□	602,250

1 *Following exercise of the options, the HSBC France shares will be exchanged for HSBC Holdings ordinary shares in the same ratio as for the acquisition of HSBC France (13 HSBC Holdings ordinary shares for each HSBC France share). At 31 December 2007, The HSBC Holdings Employee Benefit Trust 2001 (No. 1) held 11,665,278 HSBC Holdings ordinary shares which may be exchanged for HSBC France shares arising from the exercise of these options.*

HSBC Private Bank France
shares of □2

Date of award	Exercise price (□)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during[1] year	Options lapsed during year	Options at 31 December 2007[1]
21 Dec 1999	10.84	21 Dec 2000	21 Dec 2009	57,130	23,880	□	33,250
9 Mar 2000	12.44	27 Jun 2004	31 Dec 2010	27,626	7,000	□	20,626
15 May 2001	20.80	15 May 2002	15 May 2011	155,025	13,500	□	141,525
1 Oct 2002	22.22	2 Oct 2005	1 Oct 2012	163,075	17,500	□	145,575

1 *Following exercise of the options, the HSBC Private Bank France shares will be exchanged for HSBC Holdings ordinary shares in the ratio of 1.83 HSBC Holdings ordinary shares for each HSBC Private Bank France share. At 31 December 2007, The CCF Employee Benefit Trust 2001 held 955,952 HSBC Holdings ordinary shares which may be exchanged for HSBC Private Bank France shares arising from the exercise of these options.*

HSBC Finance and its subsidiaries

Following the acquisition of HSBC Finance in 2003, all outstanding options and equity-based awards over HSBC Finance common shares were converted into rights to receive HSBC Holdings ordinary shares in the same ratio as the share exchange offer for the acquisition of HSBC Finance (2.675 HSBC Holdings ordinary shares for each HSBC Finance common share) and the exercise prices per share were adjusted accordingly. No further options will be granted under any of these plans.

All outstanding options and other equity-based awards over HSBC Finance common shares granted before 14 November 2002, being the date the

transaction was announced, vested on completion of the acquisition. Options and equity-based awards granted on or after 14 November 2002 are exercisable on their original terms, save that they have been adjusted to reflect the exchange ratio.

The following are details of options and equity-based awards to acquire shares in HSBC Holdings.

At 31 December 2007, the HSBC (Household) Employee Benefit Trust 2003 held 1,856,417 HSBC Holdings ordinary shares and 196,455 American Depositary Shares, each of which represents five HSBC Holdings ordinary shares, which may be used to satisfy the exercise of employee share options.

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HSBC Finance: 1996 Long-Term Executive Incentive Compensation Plan

HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (US$)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year[1]	Options lapsed during year	Options at 31 December 2007
14 May 1997	11.29	14 May 1998	14 May 2007	100,315	—	100,315	—
10 Nov 1997	14.60	10 Nov 1998	10 Nov 2007	573,684	490,088	83,596	—
15 Jun 1998	17.08	15 Jun 1999	15 Jun 2008	802,500	802,500	—	—
1 Jul 1998	19.21	1 Jul 1999	1 Jul 2008	80,250	—	—	80,250
9 Nov 1998	13.71	9 Nov 1999	9 Nov 2008	2,020,741	1,179,175	—	841,566
17 May 1999	16.99	17 May 2000	17 May 2009	334,375	—	—	334,375
31 Aug 1999	13.96	31 Aug 2000	31 Aug 2009	337,051	36,113	—	300,938
8 Nov 1999	16.96	8 Nov 2000	8 Nov 2009	4,782,902	532,325	—	4,250,577
30 Jun 2000	15.70	30 Jun 2001	30 Jun 2010	26,846	—	—	26,846
8 Feb 2000	13.26	8 Feb 2001	8 Feb 2010	66,875	—	—	66,875
13 Nov 2000	18.40	13 Nov 2001	13 Nov 2010	6,349,114	620,600	—	5,728,514
12 Nov 2001	21.37	12 Nov 2002	12 Nov 2011	7,571,322	—	—	7,571,322
20 Nov 2002	10.66	20 Nov 2003[2]	20 Nov 2012	3,125,202	670,904	—	2,454,298

1 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £9.37.*

2 *25 per cent of the original award was exercisable on each of the first, second, third and fourth anniversaries of the date of award. The exercise period may be advanced to an earlier date in certain circumstances, e.g. retirement.*

HSBC Finance: 1996 Long-Term Executive Incentive Compensation Plan[1]

HSBC Holdings ordinary shares of US$0.50

Date of award	Vesting from[2]	Vesting until[2]	Rights at 1 January 2007	Rights vested during year[3]	Rights lapsed during year	Rights at 31 December 2007
15 Nov 2002	15 Nov 2005	15 Nov 2007	2,409	1,517	892	—
20 Nov 2002	20 Nov 2005	20 Nov 2007	539,027	518,417	20,610	—
2 Dec 2002	2 Dec 2005	2 Dec 2007	3,123	1,339	—	1,784
16 Dec 2002	16 Dec 2005	16 Dec 2007	11,774	11,774	—	—
20 Dec 2002	20 Dec 2005	20 Dec 2007	88,286	88,286	—	—
2 Jan 2003	2 Jan 2006	2 Jan 2008	893	446	—	447
15 Jan 2003	15 Jan 2006	15 Jan 2008	20,959	10,479	—	10,480
3 Feb 2003	3 Feb 2006	3 Feb 2008	6,344	3,170	268	2,906
14 Feb 2003	14 Feb 2006	14 Feb 2008	98,265	49,131	—	49,134

3 Mar 2003	3 Mar 2006	3 Mar 2008	893	446	—	447

1 *Awards of Restricted Stock Rights which represent a right to receive shares for nil consideration if the employee remains in the employment of HSBC Finance at the date of vesting.*
2 *Restricted Stock Rights vest one third on each of the third, fourth and fifth anniversaries of the date of award. The exercise period may be advanced to an earlier date in certain circumstances, e.g. retirement.*
3 *The weighted average closing price of the shares immediately before the dates on which rights vested was £8.47.*

Beneficial Corporation: 1990 Non-Qualified Stock Option Plan

HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (US$)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year[1]	Options lapsed during year	Options at 31 December 2007
14 Nov 1997	9.20	14 Nov 1998	14 Nov 2007	131,248	—	131,248	—
19 Nov 1997	9.39	19 Nov 1998	19 Nov 2007	309,225	309,225	—	—
1 Dec 1997	9.68	1 Dec 1998	1 Dec 2007	49,218	—	49,218	—

1 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £9.22.*

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Report of the Directors: Governance (continued)

Employees > Subsidiary company share plans / Employee compensation

Beneficial Corporation: BenShares Equity Participation Plan

HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (US$)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year[1]	Options lapsed during year	Options at 31 December 2007
31 Jan 1997	9.87	31 Jan 1998	31 Jan 2007	20,113	10,261	9,852	—
15 Nov 1997	11.04	15 Nov 1998	15 Nov 2007	36,407	32,837	3,570	—

1 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £9.05.*

Renaissance Holdings, Inc: Amended and Restated 1997 Incentive Plan

HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (US$)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year[1]	Options lapsed during year	Options at 31 December 2007
31 Oct 1997	1.25	31 Oct 1998	31 Oct 2007	1,325	1,071	254	—
1 Jan 1998	1.25	1 Jan 1999	1 Jan 2008	1,424	—	—	1,424
1 Oct 1998	1.74	1 Oct 1999	1 Oct 2008	803	—	—	803
1 Jan 1999	2.24	1 Jan 2000	1 Jan 2009	5,024	—	—	5,024

1 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £8.92.*

Bank of Bermuda

Following the acquisition of Bank of Bermuda in 2004, all outstanding options over Bank of Bermuda shares were converted into rights to receive HSBC Holdings ordinary shares based on the consideration of US$40 for each Bank of Bermuda share and the average closing price of HSBC Holdings ordinary shares, derived from the London Stock Exchange Daily Official List, for the five business days preceding the closing date of the acquisition. No

further options will be granted under any of these plans.

All outstanding options over Bank of Bermuda shares vested on completion of the acquisition. The following are details of options to acquire shares in HSBC Holdings. At 31 December 2007, the HSBC (Bank of Bermuda) Employee Benefit Trust 2004 held 1,889,903 HSBC Holdings ordinary shares which may be used to satisfy the exercise of these options.

Bank of Bermuda: Executive Share Option Plan 1997

HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (US$)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year[1]	Options lapsed during year	Options at 31 December 2007
1 Jul 1998	9.61	1 Jul 1999	1 Jul 2008	67,813	—	—	67,813
23 Feb 1999	7.40	23 Feb 2000	23 Feb 2009	11,684	6,780	—	4,904
3 Aug 1999	7.10	3 Aug 2000	3 Aug 2009	9,331	1,697	—	7,634
4 Feb 2000	7.21	4 Feb 2001	4 Feb 2010	40,185	8,507	—	31,678
1 Jun 2000	7.04	1 Jun 2001	1 Jun 2010	61,649	—	—	61,649
31 Jul 2000	10.11	31 Jul 2001	31 Jul 2010	27,744	—	—	27,744
11 Jan 2001	14.27	11 Jan 2002	11 Jan 2011	161,829	107,886	—	53,943

1 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £8.95.*

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Bank of Bermuda: Share Option Plan 2000
HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (US$)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during[1] year	Options lapsed during year	Options at 31 December 2007
11 Jan 2001	14.27	11 Jan 2002	11 Jan 2011	134,857			134,857
6 Feb 2001	16.41	6 Feb 2002	6 Feb 2011	630,646	51,084	4,392	575,170
29 Mar 2001	15.39	29 Mar 2002	29 Mar 2011	270			270
16 Apr 2001	15.57	16 Apr 2002	16 Apr 2011	539			539
6 Jun 2001	18.35	6 Jun 2002	6 Jun 2011	8,091			8,091
16 Jul 2001	16.87	16 Jul 2002	16 Jul 2011	14,930			14,930
28 Aug 2001	15.39	28 Aug 2002	28 Aug 2011	13,486			13,486
26 Sep 2001	12.79	26 Sep 2002	26 Sep 2011	438,585	84,694		353,891
30 Jan 2002	15.60	30 Jan 2003	30 Jan 2012	1,226			1,226
5 Feb 2002	16.09	5 Feb 2003	5 Feb 2012	865,382	95,775	6,836	762,771
10 Jul 2002	15.84	10 Jul 2003	10 Jul 2012	12,260			12,260
4 Feb 2003	10.69	4 Feb 2004	4 Feb 2013	139,658	6,616		133,042
21 Apr 2003	11.85	21 Apr 2004	21 Apr 2013	20,840	14,007		6,833

1 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £9.08.*

Bank of Bermuda: Directors Share Option Plan
HSBC Holdings ordinary shares of US$0.50

Date of award	Exercise price (US$)	Exercisable from	Exercisable until	Options at 1 January 2007	Options exercised during year	Options lapsed during year	Options at 31 December 2007
22 Sep 1999	8.02	22 Sep 2000	22 Sep 2009	3,082			3,082
20 Sep 2000	11.31	20 Sep 2001	20 Sep 2010	4,046			4,046
28 Mar 2001	15.76	28 Mar 2002	28 Mar 2011	12,811			12,811
3 Apr 2002	16.01	3 Apr 2003	3 Apr 2012	24,520			24,520
30 Apr 2003	12.23	30 Apr 2004	30 Apr 2013	4,904			4,904

Employee compensation and benefits

Note 9 on the Financial Statements gives details about employee compensation and benefits including pension plans.

Set out below is information in respect of the five individuals (including a Director of HSBC Holdings) whose emoluments were the highest in HSBC for the year ended 31 December 2007.

	£000
Basic salaries, allowances and benefits in kind	**2,797**

Pension contributions	**500**
Bonuses paid or receivable	**24,566**
Total	**27,863**
Total (US$000)	**55,775**

Their emoluments are within the following bands:

	Number of Employees
£3,700,001 – £3,800,000	**1**
£4,400,001 – £4,500,000	**1**
£4,700,001 – £4,800,000	**1**
£4,900,001 – £5,000,000	**1**
£9,900,001 – £10,000,000	**1**

The aggregate remuneration of Directors and Senior Management for the year ended 31 December 2007 was US$92,586,000.

The aggregate amount set aside or accrued to provide pension, retirement or similar benefits for Directors and Senior Management for the year ended 31 December 2007 was US$2,027,455.

Executive Directors and members of Senior Management are generally subject to notice periods of up to 12 months and a normal retirement age of 65.

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Corporate sustainability

Corporate sustainability is the term used at HSBC to describe the Group's approach to meeting a wide range of non-financial responsibilities which, although not generally enshrined as legal or regulatory requirements, constitute business practices expected of the Group by its stakeholders, including shareholders, customers and employees. Insofar as these expectations concern HSBC's impact on the long-term environmental, social and economic well-being of the world at large, corporate sustainability influences the Group's response to encouraging sustainable development. Previously, HSBC described these activities under the heading, 'Corporate responsibility'.

Investing in sustainability

HSBC seeks to meet society's expectations by managing all aspects of its business ethically, responsibly and in an increasingly sustainable way. The Group's key business values include a commitment to the highest personal standards of integrity at all levels, including honesty, transparency and fair dealing in all its business activities. In recent years HSBC has intensified its efforts to embed sustainability into the way it manages risk and business development opportunities. This acknowledges that HSBC's continuing financial success depends, in part, on its ability to identify and address non-financial considerations which are material to the business.

Recognising that HSBC's core financial services businesses have the potential to exert the most influence over sustainability issues, a Group Corporate Sustainability unit was formed in 2007 to work closely with individuals and businesses in all customer groups to help them to manage sustainability risks and to pursue opportunities in environmental markets worldwide.

Group Corporate Sustainability acts as a focal point for the management of HSBC's environmental and social initiatives. Environmental initiatives are directed primarily to issues arising from climate change, including its effect on energy production and usage, water management and biodiversity. Social initiatives are centred on community action to promote education as a lasting way of alleviating poverty. The Group Corporate Sustainability unit allows HSBC to join up its business development, risk management, business operations, community investment and reporting activities. The unit also works closely with Group Marketing to further embed sustainability into the brand; with Group Communications to ensure that sustainability initiatives are communicated to internal and external audiences; and with Group Human Resources to integrate this area into employee engagement and talent management strategies. The unit reports directly to the Group Chairman.

HSBC aims for consistency in the implementation of its sustainability strategy across all Group businesses, and has identified four themes as relevant to its response to the United Nations Millennium Development Goals of resisting climate change, achieving water availability, protecting biodiversity and alleviating poverty. These themes are risk management (policies and processes); business development; operations (buildings, travel, suppliers and IT); and community investment (education and environment).

The Group's Sustainable Risk Management Unit has published policies laying down minimum standards for lending and investment covering relationships with clients in energy, forest land and products, freshwater infrastructure, mining and metals and the chemicals industry. Each policy focuses on how HSBC's involvement in these environmentally sensitive industries can contribute to sustainable development.

In recognition of its leadership in building responsible practices into the way it does business, HSBC moved from 7th to 4th in the Accountability Rating prepared by Accountability. HSBC continued to earn a high score of 95 and a triple-A rating in the Carbon Disclosure Project, a climate change index ranking FT500 corporations.

In 2005, HSBC was the first major banking organisation in the world to become carbon neutral. HSBC remains committed to reducing its own carbon emissions and helping to bring about a low-carbon economy.

HSBC created a Climate Change Centre of Excellence in 2007. The Centre’s goal is to evaluate the implications of climate change for the HSBC Group, its Global Research division and relevant businesses. The Centre is HSBC’s central source of climate knowledge, translating a wide range of expertise – from academic studies, think tanks and government regulations – into business opportunities for the bank and its clients. The Centre works closely with HSBC’s Global Research sector heads and analysts on integrating the financial implications of climate change and relevant government regulations into their sectoral research. It also supports the implementation of HSBC’s Carbon Finance Strategy, announced in June 2006, and advises a range of HSBC businesses for which climate change is increasingly important.

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In 2007, HSBC appointed Lord Stern, the renowned academic and former World Bank Chief Economist, as Special Adviser to the Chairman on Economic Development and Climate Change. Lord Stern is responsible for advising HSBC on economic development issues and the implications of climate change on the Group and its clients. His role includes:

- providing direct advice on specific strategic issues in emerging markets where the bank has aspirations to grow its business;
- advising on the socio-economic implications of climate change and representing HSBC on these issues;
- contributing to management development programmes, from graduate intake through to senior management development activities; and
- providing advice to major clients of the Group who seek to develop sustainable business strategies or other programmes relating to climate change and to economic development issues.

Community involvement

HSBC has a longstanding commitment to supporting the communities in which it operates. In 2006, for example, the HSBC Global Education Trust launched Future First, a five-year programme designed to help street children, children in care and orphans. HSBCs operations around the world collaborate with local charitable organisations to make a lasting and beneficial difference by supporting projects that bring these children into the mainstream of society. The programme complements HSBCs sustainable business development focus on poverty, for which a microfinance strategy was developed during 2006. To date, US$2 million has been allocated to 80 projects in 30 countries. These projects will benefit 37,000 children.

In May 2007, the Group Chairman launched the HSBC Climate Partnership, committing US$100 million over five years to fund the work of The Climate Group, Earthwatch Institute, Smithsonian Tropical Research Institute and WWF to inspire action by individuals, businesses and governments around the world on the challenge of climate change. The HSBC Climate Partnership, which will strengthen the Groups leadership position and help HSBC employees to use their business skills and climate change knowledge to build a more sustainable future, represents one of the largest single corporate donations to each of the charity partners and one of the largest employee engagement programmes by any organisation on climate change.

HSBC participated in the Prince of Wales Accounting for Sustainability Project, which seeks to develop systems to help public and private sector organisations account more accurately for the wider social and environmental costs of their activities.

Health and safety

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

Health and Safety Policies, Group standards and procedures are set by Group Corporate Real Estate and are implemented by Health, Safety and Fire Co-ordinators based in each country in which HSBC operates.

Despite the considerable international pressure on terrorist networks over the past few years, the global threat from terrorism persists. HSBC remains committed to maintaining its preparedness and to ensuring the highest standards of health and safety wherever in the world it operates.

Group Security provides regular risk assessments in areas of increased risk to assist management in judging the level of terrorist threat. In addition, Regional Security functions conduct regular security reviews to ensure measures to protect HSBC staff, buildings, assets and information are appropriate for the level of threat.

Supplier payment policy

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

Copies of, and information about, the Code are available from: BERR Publications Orderline, Admail 528, London SW1W 8YT; and the internet at www.payontime.co.uk/downloads/DTI_BPP_ brochure.pdf

It is HSBC Holdings practice to organise payment to its suppliers through a central accounts function operated by its subsidiary, HSBC Bank. Included in the balance with HSBC Bank is the amount due to trade creditors which, at 31 December

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2007, represented 22 days average daily purchases of goods and services received from such creditors, calculated in accordance with the Companies Act 1985, as amended by Statutory Instrument 1997/571.

Donations

During the year, HSBC made charitable donations totalling US$101 million (2006: US$86.3 million). Of this amount, US$36.8 million (2006: US$32.8 million) was given for charitable purposes in the UK. No political donations were made during the year.

At the Annual General Meeting in 2007, shareholders renewed the authorities for HSBC Holdings and HSBC Bank to make EU political donations and incur EU political expenditure up to a maximum aggregate sum of £250,000 and £50,000 respectively as a precautionary measure in light of the wide definitions in The Political Parties, Elections and Referendums Act 2000. These authorities have not been used and will expire on the conclusion of the Annual General Meeting to be held in 2008.

Sustainability reporting

HSBC reports on its progress towards meeting the Group's environmental reduction targets and provides information for stakeholders in the annual *HSBC Sustainability Report* (previously called the *Corporate Responsibility Report*). The contents of the report are informed by feedback from stakeholder engagement forums, and are prepared using the Global Reporting Initiative guidelines. The report is verified by an external assurance provider to demonstrate to stakeholders that the information disclosed in the report is complete and covers material aspects of HSBC's business. The *HSBC Sustainability Report 2007* will be available at www.hsbc.com/sustainabilityreport from June 2008.

Dividends, shareholders and meetings

Dividends for 2007

First, second and third interim dividends for 2007, each of US$0.17 per ordinary share, were paid on 5 July 2007, 4 October 2007 and 16 January 2008 respectively. Note 12 on the Financial Statements gives more information on the dividends declared in 2007. On 3 March 2008, the Directors declared a fourth interim dividend for 2007 of US$0.39 per ordinary share in lieu of a final dividend, which will be payable on 7 May 2008 in cash in US dollars, or in sterling or Hong Kong dollars at exchange rates to be determined on 28 April 2008, with a scrip dividend alternative. As the fourth interim dividend

for 2007 was declared after the balance sheet date it has not been included as a creditor at 31 December 2007. The reserves available for distribution at 31 December 2007 are US$15,551 million.

A quarterly dividend of US$15.50 per 6.20 per cent non-cumulative US dollar preference share, Series A ('Series A dollar preference share'), equivalent to a dividend of US$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A dollar preference share, was paid on 15 March, 15 June, 17 September and 17 December 2007.

Dividends for 2008

The proposed timetable for interim dividends in respect of 2008 on the ordinary shares of US$0.50 is set out in the Shareholder Information section on page 454.

A quarterly dividend of US$15.50 per Series A dollar preference share (equivalent to a dividend of US$0.3875 per Series A American Depositary Share, each of which represents one -fortieth of a Series A dollar preference share) was declared on 13 February 2008 for payment on 17 March 2008.

Communication with shareholders

Communication with shareholders is given high priority. Extensive information about HSBCs activities is provided in the *Annual Report and Accounts* , *Annual Review* and the *Interim Report* which are sent to shareholders and are available on www.hsbc.com. There is regular dialogue with institutional investors and enquiries from individuals on matters relating to their shareholdings and the business of HSBC are welcomed and are dealt with in an informative and timely manner. All shareholders are encouraged to attend the Annual General Meeting or the informal meeting of shareholders held in Hong Kong to discuss the progress of HSBC.

Notifiable interests in share capital

As at 3 March 2008, the following disclosures of major holdings of voting rights have been made to the Company pursuant to the requirements of the Financial Services Authority Disclosure and Transparency Rule 5:

- Singularis Holdings Limited; AWAL Trust Company Limited; and Maan Abdulwahed Al-Sanea gave notice on 16 April 2007 that it had an indirect interest on 16 April 2007 in 360,055,575 HSBC Holdings ordinary shares, representing 3.11 per cent of the ordinary shares

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in issue at that date.

- Barclays PLC gave notice on 17 April 2007 that it had an indirect interest on 16 April 2007 in 518,233,657 HSBC Holdings ordinary shares, representing 4.47 per cent of the ordinary shares in issue at that date.

- Legal & General Group Plc gave notice on 14 August 2007 that it had a direct interest on 8 August 2007 in 480,363,459 HSBC Holdings ordinary shares, representing 4.08 per cent of the ordinary shares in issue at that date.

There are no notifiable interests in the equity share capital recorded in the register maintained under section 336 of the Securities and Futures Ordinance of Hong Kong.

In compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited at least 25 per cent of the total issued share capital of HSBC Holdings has been held by the public at all times during 2007 and up to the date of this Report.

Dealings in HSBC Holdings shares

Except for dealings as intermediaries by HSBC Bank, HSBC Financial Products (France) and The Hongkong and Shanghai Banking Corporation, which are members of a European Economic Area exchange, neither HSBC Holdings nor any subsidiary has bought, sold or redeemed any securities of HSBC Holdings during the year ended 31 December 2007.

Annual General Meeting

The Annual General Meeting of HSBC Holdings will be held at the Barbican Hall, Barbican Centre, London EC2 on 30 May 2008 at 11.00am.

An informal meeting of shareholders will be held at Level 28, 1 Queen's Road Central, Hong Kong on Tuesday 27 May 2008 at 4.30pm.

Resolutions to receive the *Annual Report and Accounts* , approve the Directors' Remuneration Report, re-elect Directors and reappoint KPMG Audit Plc as Auditor will be submitted to the Annual General Meeting. KPMG Audit Plc has expressed its willingness to continue in office and the Group Audit Committee and the Board have recommended that KPMG Audit Plc be reappointed. Resolutions will also be submitted to the Annual General Meeting to renew the authorities for the allotment of shares, the disapplication of pre-emption rights and the purchase of ordinary shares. In addition, resolutions will be proposed to amend The HSBC Share Plan and to seek approval for changes to the Articles of Association.

A live webcast of the Annual General Meeting will be available on www.hsbc.com. From shortly after the conclusion of the Meeting until 30 June 2008 a recording of the proceedings will be available on www.hsbc.com.

On behalf of the Board
S K Green, *Group Chairman* 3 March 2008

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Directors Remuneration Report

Remuneration committee / Principles / Executive Directors > Remuneration from 2008

Remuneration Committee

The Remuneration Committee meets regularly to consider human resource issues, particularly terms and conditions of employment, remuneration and retirement benefits. Within the authority delegated by the Board, the Committee is responsible for approving the remuneration policy of HSBC including the terms of bonus plans, share plans and other long-term incentive plans and for agreeing the individual remuneration packages of executive Directors and other senior Group employees. No Directors are involved in deciding their own remuneration.

Following each meeting the Committee reports to the Board on its activities. The terms of reference of the Committee are available at www.hsbc.com/boardcommittees.

The members of the Remuneration Committee throughout 2007 were Sir Mark Moody-Stuart (Chairman) and J D Coombe. At the conclusion of the Annual General Meeting on 25 May 2007 W K L Fung and S Hintze retired as members of the Committee and G Morgan became a member of the Committee.

There were eight meetings of the Remuneration Committee during 2007. The table on page 296 gives details of Directors attendance at these meetings.

In July 2007, following a competitive tender process, Mercer Limited, a firm of specialist human resources consultants, was appointed by the

Committee to provide independent advice on executive remuneration issues. As a global firm, Mercer also provides other remuneration consulting services to various parts of HSBC. Towers Perrin continues to provide remuneration data to the Remuneration Committee. Other consultants are used from time to time to advise on specific issues. During the year the Group Chief Executive provided regular briefings to the Remuneration Committee. The Committee received advice from the Group General Manager, Human Resources, being P Boyles until June 2007 and thereafter A Almeida, and the Head of Group Performance and Reward, J Beadle.

Overall principles

In carrying out its responsibilities, the Remuneration Committee applies the following key principles:

- to ensure that the total remuneration package (salary, bonus, long-term incentive awards and other benefits) is competitive in relation to comparable organisations in each of the markets in which HSBC operates;
- to offer fair and realistic salaries with a focus on variable pay, differentiated by performance;
- through awards of shares to recognise high performance, retain key talent and provide alignment with the interests of shareholders; and
- to follow a policy of moving progressively from defined benefit to defined contribution pension schemes.

The Committee also considers corporate performance on environmental, social and governance factors when determining the executive Directors remuneration. In addition, the Remuneration Committee has oversight that the incentive structure for senior management does not raise environmental, social and governance risks by inadvertently motivating irresponsible behaviour.

Executive Directors

Proposed changes to remuneration arrangements from 2008

In July 2007, the Remuneration Committee requested that Mercer conduct a comprehensive assessment of the remuneration arrangements of the executive Directors and other senior executives. The objective was to ensure close alignment with HSBCs business strategy, taking into account competitive market practice.

As part of this review, the Committee updated the remuneration comparator group to reflect more accurately the market in which the Company

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competes for executive talent. This group will comprise nine global financial services companies, namely Banco Santander, Bank of America, Barclays, BNP Paribas, Citigroup, Deutsche Bank, Royal Bank of Scotland, Standard Chartered and UBS. These companies were selected on the basis of their broadly similar business coverage, size and international scope.

While in general HSBC salaries for executive Directors were in the upper quartile of this comparator group, total cash (base salary and bonus) and total compensation (base salary, cash bonus and the expected value of long-term incentive awards) were generally at the lower quartile.

The Committee concluded that while the overall remuneration principles described above remain appropriate, the remuneration strategy should be refined by targeting base salary at the market median of the comparator group, while providing an opportunity for top quartile total compensation for higher levels of performance. At the same time, a greater proportion of total compensation will be share based, and shareholding requirements will be increased.

In order to achieve this, the following steps are proposed:

- For the executive Directors in place at the end of 2007, where base salaries are above market median no increases are being made in 2008. This applies to the Group Chairman, Group Chief Executive and Group Finance Director;
- The maximum annual bonus opportunity will be increased from 250 to 400 per cent of salary for the Group Chief Executive and Group Finance Director, with the criteria for bonus awards being made more specific and 40 per cent of any award being deferred into HSBC Restricted Shares;
- The performance measures and vesting conditions attached to long-term incentive awards of Performance Shares under The HSBC Share Plan will be amended in order to further align the reward of senior executives to the achievement of HSBCs strategy and the interests of its shareholders; and
- The required shareholding of senior executives under the share ownership guidelines will be increased to the equivalent of four to five times base salary to demonstrate further alignment with shareholders.

This proposed policy would generally apply to all executive Directors from 2008 onwards. Under the proposed arrangements, the performance-related proportion of the remuneration package will increase with the performance-related elements making up around 80 per cent of the remuneration package. Under the current arrangements, the performance-related proportion of the remuneration package is typically around 70 per cent of total compensation.

The arrangements for S T Gulliver, who has been appointed a Director with effect from 1 May 2008, will reflect the market practice in the Global Banking and Markets sector where a greater performance-related element is typical.

The net effect of these changes would mean, for example, that the Group Chief Executives total compensation, on an expected value basis, would be at market median of the comparator group, but with a significantly higher proportion of share-based compensation than the group.

As part of the Companys on-going commitment to shareholder engagement, the largest institutional shareholders, representing approximately 50 per cent of the share capital of HSBC Holdings, the Association of British Insurers and the National Association of Pension Funds, are being consulted on these proposals. The planned implementation of these changes will be as follows:

Salary

As stated above, in 2008, in view of the current competitive positioning of base salaries, the Remuneration Committee will not increase base salaries for the executive Directors in place at the end of 2007.

The base salaries for executive Directors appointed to the Board after the 2007 financial year will be set in light of the overall remuneration principles set out above.

Any future salary increases will be considered in the light of the remuneration strategy, which targets base salary at market median, and the market data from the remuneration comparator group.

A similar approach has been adopted for other senior executives across the Group.

Annual bonus

From the 2008 performance year, objectives will be set and assessed using a balanced scorecard. This will include financial and non-financial performance measures, with an emphasis on tangible, measurable targets to ensure the appropriate alignment with HSBCs strategy in the assessment of annual bonus

Directors Remuneration Report (continued)

Executive Directors > Current arrangements / Performance conditions

awards. Example measures for the Group Chief Executive are set out below:

Financial
- EPS
- ROE
- Cost efficiency ratio

Customer
- Customer recommendation
- Brand health

Process
- Operational losses
- Regulatory relationship

People
- Employee engagement
- Leadership

The Committee intends to provide significantly greater transparency in subsequent Reports regarding both the performance measures and the achievement against performance targets, together with a commentary on the resulting levels of bonus awards.

Long-term incentive plan

The long-term incentive plan (LTIP) was last reviewed in 2005 when, with the adoption of The HSBC Share Plan, a growth in earnings per share measure (EPS) was introduced alongside Total Shareholder Return (TSR) relative to a peer group of 28 banks.

The Committee is proposing changes to the performance measures and vesting conditions of the long-term incentive awards of Performance Shares under The HSBC Share Plan, the details of which will be described in the circular containing the Notice of the 2008 Annual General Meeting, which is expected to be sent to shareholders in April 2008, and submitted to shareholder vote at that Meeting.

Awards will be granted to executive Directors and other senior executives shortly after the Meeting. These will be made under the amended Plan subject to the proposed changes to the Plan receiving shareholder approval.

Current arrangements

Salary

The Committee reviews salary levels for executive Directors each year.

As described above, the Remuneration Committee will not increase base salaries for current executive Directors in 2008.

	2008	2007
	£000	£000
D J Flint	**700**	700
M F Geoghegan	**1,070**	1,070
S K Green	**1,250**	1,250

Annual cash bonus

The annual cash bonus for executive Directors is based upon individual performance as well as performance measured against a number of key financial targets for the Group, including financial (e.g. revenue growth, economic profit and cost efficiency). Annual bonus payments are not pensionable.

The Committee took into account the Group's absolute performance and relative performance compared to its peers in a challenging operating environment, in setting the overall bonus payment levels.

There were significant increases in profit before tax, earnings per share and improvements in cost efficiencies during 2007. During that year management moved effectively to resolve the issues identified in late 2006 in the United States in relation to consumer lending, and to anticipate and respond to the sector-wide liquidity crisis.

On this basis, the Remuneration Committee approved annual bonus payments for the following executive Directors in 2008 in respect of 2007 performance (payments made in 2007 in respect of 2006 performance are shown for reference):

	2008 **£000**	2007 £000
D J Flint	**800**	500
M F Geoghe gan	**2,140**	1,750

Chairman's variable compensation

The Committee has determined, at the request of the Chairman, that future variable compensation payments to the Chairman will be delivered exclusively through Performance Share awards given the key focus of the role of the Chairman in the formation and management of Group strategy.

The Remuneration Committee approved an annual bonus payment for the Chairman for 2008, in respect of 2007 performance, that was unchanged from the prior performance year as indicated in the table below (the payment made in 2007 in respect of 2006 performance is shown for reference):

	2008 **£000**	2007 £000
S K Green	**1,750**	1,750

Long-term incentive plan

Under The HSBC Share Plan, executive Directors, as with other participants in the Plan, are eligible to receive awards of Performance Shares with a face value at grant of up to a maximum of seven times

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salary. The individual awards received in any one year are based on market competitive information and individual performance. The face and expected

values of individual awards made in 2007 are set out in the table below (awards made in 2006 are shown for reference).

2007 awards

	Face value		Expected value[1]	
	2007 £000	2006 £000	**2007 £000**	2006 £000
D J Flint	**2,200**	1,600	**968**	704
M F Geoghegan[2]	**5,000**	2,000	**2,200**	880
S K Green[3]	**3,750**	2,500	**1,650**	1,100
Total	**10,950**	6,100	**4,818**	2,684

1 *44 per cent of the face value.*
2 *M F Geoghegan's 2006 award relates to his position as Chief Executive of HSBC Bank plc, prior to his current role as Group Chief Executive of HSBC Holdings.*
3 *S K Green's 2006 award relates to his position as Group Chief Executive.*

Vesting of the awards is subject to the performance conditions described in the next section being met. Shares released will include additional shares equivalent to the value of the dividends payable on the vested shares over the performance period.

Performance conditions

Arrangements from 2005 to 2007

Vesting of the awards of Performance Shares under The HSBC Share Plan is based on two independent measures, relative TSR and growth in EPS. The performance conditions are measured over a three-year performance period and awards forfeited to the extent that they have not been met. The vesting of 50 per cent of the awards is based on TSR and the remaining 50 per cent on growth in EPS.

TSR award

The comparator group of 28 banks for the TSR award comprises the largest banks in the world, on the basis of their market capitalisation, their geographic spread and the nature of their activities:

ABN AMRO
Banco Santander
Bank of America
Bank of New York
Barclays
BBVA
BNP Paribas
Citigroup
Crédit Agricole
Mitsubishi Tokyo Financial Group
Mizuho Financial Group
Morgan Stanley
National Australia Bank
Royal Bank of Canada
Royal Bank of Scotland
Société Générale
Standard Chartered
UBS

Credit Suisse Group	UniCredito Italiano
Deutsche Bank	US Bancorp
HBOS	Wachovia
JP Morgan Chase	Wells Fargo
Lloyds TSB	Westpac Banking Corporation

The extent to which the TSR award will vest will be determined on a sliding scale based on

HSBCs relative TSR ranking, measured over the three years, against the comparator group as shown below:

If HSBCs performance matches	**Proportion of TSR Award vesting** [1]
Banks ranking 1st to 7th	100%
Bank ranking 8th	90%
Bank ranking 9th	80%
Bank ranking 10th	70%
Bank ranking 11th	60%
Bank ranking 12th	50%
Bank ranking 13th	40%
Bank ranking 14th	30%
Banks ranking below 14th	nil

1 *Vesting will occur in a straight line where HSBCs performance falls between these incremental steps.*

EPS award

The method for calculating EPS growth has been summarised in narrative form in the 2005 and 2006 Directors Remuneration Reports, as well as in the circular containing the Notice of Annual General Meeting for 2005.

This years Report sets out more information (including a graph and an example) on the method of calculation of EPS growth in light of some questions from shareholders on the operation of this element. The Committee regrets if there has been any misunderstanding, but wishes to reassure shareholders that the method of calculation, which is set out in the rules of The HSBC Share Plan, has remained unchanged since the Plan was adopted. Further, before introducing the Plan in 2005, the Committee consulted extensively with major shareholders and their representative bodies in line with best practice, and the rules of the Plan including worked examples of the EPS calculation were available for inspection at the time.

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Directors Remuneration Report (continued)

Executive Directors > Performance conditions / TSR

The percentage of the conditional award vesting will depend upon the absolute growth in EPS achieved over the three years (the performance period). 30 per cent of the conditional shares will vest if the incremental EPS over the performance period is 24 per cent or more of EPS in the base year. The percentage of shares vesting will rise on a straight line proportionate basis to 100 per cent if HSBCs incremental EPS over the performance period is 52 per cent or more of EPS in the base year. In the interests of clarity, this has been set out in graphical form in the chart below.

For the EPS element of the award, the base measure shall be EPS for the financial year preceding that in which the award is made (the base year). Absolute growth in EPS will then be compared with the base year over three consecutive financial years commencing with the year in which the award is made. Incremental EPS will be calculated by expressing as a percentage of the EPS of the base year the difference each year of the three-year performance period between the EPS of that year and the EPS of the base year. These percentages will then be aggregated to arrive at the total incremental EPS for the performance period. As illustrated in the table below, an incremental EPS of 51 per cent over three years would equate to a compound annual growth rate of 8 per cent.

Percentage difference between:						Total
Year 1 EPS and Base Year EPS	+	Year 2 EPS and Base Year EPS	+	Year 3 EPS and Base year EPS	=	incremental EPS for the performance period
8%		17%		26%		51%

Illustration of incremental EPS of 51 per cent over three years.

If EPS in any of the Years 1, 2 or 3 is below the base year, then the percentage difference between that particular year and the base year is negative.

For this purpose, EPS means the profit attributable to the Shareholders (expressed in US dollars), excluding goodwill amortisation, divided by the weighted average number of Ordinary Shares in issue and held outside the Group during

the year in question. In the event that the published EPS for the base year is restated during the performance period to adjust for changes in accounting standards, that restated EPS will be used for the purposes of the EPS performance condition.

In addition, awards will not vest unless the Remuneration Committee is satisfied that HSBC Holdings financial performance has shown a sustained improvement in the period since the award date. In determining whether HSBC Holdings has achieved a sustained improvement in performance the Remuneration Committee will take account of all relevant factors but in particular comparisons against the comparator group in areas such as revenue growth and mix, cost efficiency, credit performance, cash return on cash invested, dividend performance and TSR.

If events occur which cause the Remuneration Committee to consider that a performance condition has become unfair or impractical in either direction, the right is reserved to the Remuneration Committee, if it considers it appropriate to do so, to amend, relax or waive the condition.

Awards will vest in full immediately in cases of death. In the event of redundancy, retirement on grounds of injury or ill health, early retirement by agreement, normal retirement and where a participant ceases to be employed by HSBC due to a company ceasing to be part of HSBC, awards will normally vest at the end of the vesting period on a time-apportioned basis to the extent that the TSR and EPS performance conditions have been satisfied. In the event of a change of control, awards will normally vest immediately and on a time-apportioned basis to the extent that the TSR performance condition has been satisfied. Awards will normally be forfeited if the participant is dismissed for cause or resigns from HSBC. In all these circumstances the Committee retains discretion to ensure fair and reasonable treatment.

Arrangements from 2002 to 2004

Between 2002 and 2004, awards of Performance Shares were made under the HSBC Holdings Restricted Share Plan 2000. Vesting was based on HSBC's relative TSR performance over a three-year period from the date of the award, with full vesting of awards and transfer of shares to participants being no earlier than the fifth anniversary of the date of award.

The initial performance period was three years from the date of award. Prior to 2004, awards were subject to re-testing on the fourth

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and fifth anniversaries of the date of award if the performance target was not met at the third anniversary. The awards made in 2004 had a three-year performance period with no re-testing.

The table below describes the outcome of the performance tests for the 2002, 2003 and 2004 awards:

	2002 award	**2003 award**	**2004 award**
First test (third anniversary)	March 2005, performance target met, awards vested in 2007	March 2006, performance target not met	March 2007, performance target not met, and therefore award forfeited
First re-test (fourth anniversary)	Already vested	March 2007, performance target not met	No re-test
Second test (fifth anniversary)	Already vested	March 2008	No re-test

In addition to these performance conditions, none of the outstanding awards will vest unless the Remuneration Committee is satisfied that, during the performance period, HSBC Holdings has achieved sustained growth. The Remuneration Committee retains discretion to recommend early release of shares awarded in certain circumstances, for example, retirement, redundancy or ill health. When events occur which cause the Remuneration Committee to consider that the performance conditions have become unfair or impractical, the right is reserved for the Committee to amend or substitute the performance conditions.

Funding

The Company's policy is to fund long-term incentive awards of Performance Shares and Restricted Shares under The HSBC Share Plan through employee benefit trusts which undertake market purchases of HSBC Holdings' shares. The dilution limits set out in the HSBC share plans comply with the Association of British Insurers' guidelines.

Total Shareholder Return

The graphs below show how HSBC has performed against the benchmark TSR used to determine vesting for the 2004 Performance Share awards and the FTSE 100 Index.

Graph 1: HSBC TSR and Benchmark TSR

Graph 2: HSBC TSR and FTSE 100 Index

Pursuant to the Directors' Remuneration Report Regulations 2002, Graph 2 shows HSBC's TSR performance against the FTSE 100 Index, for the five-year period ended 31 December 2007. The FTSE 100 has been chosen as this is a recognised broad equity market index of which HSBC Holdings is a member.

Pensions

The normal retirement age for executive Directors is 65. The pension entitlements earned by the executive Directors during the year are set out on page 330.

Share ownership guidelines

In line with a focus on highly leveraged variable pay, HSBC operates a formal share ownership policy, expressed as a number of shares, for the executive Directors and the Group Managing Directors. The Committee believes that material levels of share ownership by executives create a community of interest between the leadership team and shareholder. The executive Directors and Group Managing Directors are therefore required to build and retain the following shareholdings:

HSBC HOLDINGS PLC

Directors Remuneration Report (continued)

Executive Directors / Non-executive Directors / Directors emoluments

	Number of shares	
	to be held	**at 31 December 2007**
Group Chairman	300,000	**536,652**
Group Chief Executive	300,000	**385,189**
Group Finance Director	100,000	**112,781**
Group Managing Directors	75,000	1

1 *A majority of the Group Managing Directors exceed the expected holdings; where the holdings are below, the executives are within five years of their appointment and working towards the expected level.*

Under the guidelines, the shareholding is expected to be achieved within five years of the executives appointment or three years from the date of approval of the guidelines (May 2007), whichever is the later. All executive Directors and the majority of Group Managing Directors exceed the required shareholding. The Remuneration Committee will monitor compliance annually prior to approving any awards or vesting of Performance Shares. The Remuneration Committee will have full discretion in determining any penalties in case of non-compliance, which could include: a reduction of future awards of long-term incentives and/or an increase in the proportion of the annual bonus that is deferred into shares. Increases in the expected level of share ownership will be introduced as part of the refinements to reward strategy and structure from 2008 discussed above.

Service contracts

HSBCs policy is to employ executive Directors on one-year rolling contracts although longer initial terms may be approved by the Remuneration Committee if considered appropriate. The Remuneration Committee will, consistent with the best interests of the Group, seek to minimise termination payments.

S K Green, M F Geoghegan and D J Flint have rolling service contracts with a notice period of 12 months for either party save that D J Flints contract provides for nine months notice to be given by Mr Flint.

In the event of early termination of employment of S K Green, M F Geoghegan, or D J Flint, other than for cause, HSBC is entitled to make a payment in lieu of notice equal in the case of D J Flint, to base salary and pension entitlement and in the case of S K Green and M F Geoghegan to base salary, pension entitlements and other benefits.

In addition, on termination of employment by HSBC, other than for cause (or termination by either party within 12 months following a change of control), S K Green and M F Geoghegan will be eligible for a bonus calculated as not less than the

average of the previous two years of bonus payments received, pro-rated for any part year worked to termination.

The dates of executive Directors service contracts are as follows:

	Contract date
D J Flint	29 September 1995

M F Geoghegan	24 May 2007
S K Green	24 May 2007

Other directorships

Executive Directors, if so authorised by either the Nomination Committee or the Board, may accept appointments as non-executive directors of suitable companies which are not part of HSBC. Approval will not be given for executive Directors to accept a non-executive directorship of more than one FTSE 100 company. When considering a non-executive appointment, the Nomination Committee or Board will take into account the expected time commitment of such appointment. The time commitment for executive Directors external appointments will be reviewed as part of the annual Board review. Any remuneration receivable in respect of an external appointment is normally paid to HSBC, unless otherwise approved by the Remuneration Committee. D J Flint does not retain his fees as a non-executive Director of BP p.l.c.

Non-executive Directors

Non-executive Directors are appointed for fixed terms not exceeding three years, subject to their re-election by shareholders at Annual General Meetings. Non-executive directors have no service contract and are not eligible to participate in HSBCs share plans. Current non-executive Directors terms of appointment will expire as follows: in 2008, Lord Butler, Baroness Dunn and Sir Brian Moffat; in 2009, W K L Fung, S W Newton, S M Robertson and Sir Brian Williamson; in 2010, R A Fairhead, Sir Mark Moody-Stuart and G Morgan; and in 2011, J D Coombe, J L Dúran, J W J Hughes-Hallett and W S H Laidlaw. S A Catz and N R N Murthy were appointed non-executive Directors with effect from 1 May 2008. Subject to their re-election by shareholders at the Annual General Meeting in 2008, their terms of appointment will expire in 2011.

Fees

Non-executive Directors fees are regularly reviewed and compared with other large international companies. The current fee, which was approved by shareholders in 2006, is £65,000 per annum.

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A fee of £30,000 per annum is payable to the senior independent non-executive Director. In addition, non-executive Directors receive the following fees for service on Board Committees:

Chairman, Audit Committee	£50,000 p.a.
Member, Audit Committee	£20,000 p.a.

During 2007, seven meetings of the Group Audit Committee were held.

Chairman, Remuneration Committee	£40,000 p.a.
Member, Remuneration Committee	£20,000 p.a.

During 2007, eight meetings of the Remuneration Committee were held.

Chairman, Nomination Committee	£30,000 p.a.
Member, Nomination Committee	£20,000 p.a.

During 2007, two meetings of the Nomination Committee were held.

Chairman, Corporate Sustainability Committee	£30,000 p.a.
Member, Corporate Sustainability Committee	£20,000 p.a.

During 2007, five meetings of the Corporate Sustainability Committee were held.

Directors emoluments

The emoluments of the Directors of HSBC Holdings for 2007 were as follows:

	Fees £000	**Salary £000**	**Allowance[1] £000**	**Benefits in kind[2] £000**	**Bonuses[3] £000**	**Total 2007 £000**	Total 2006 £000
Executive Directors							
D J Flint		**679**	**374**	**25**	**800**	**1,878**	1,355
M F Geoghegan[4]		**1,040**	**520**	**61**	**1,915**	**3,536**	2,868
S K Green		**1,250**		**12**	**1,750**	**3,012**	2,934
Non-executive Directors							
Lord Butler	**103**					**103**	115
R K F Chien[5, 6]	**79**					**79**	200
J D Coombe	**105**					**105**	97
Baroness Dunn	**85**					**85**	85
R A Fairhead	**103**					**103**	85
W K L Fung[7]	**122**					**122**	136
J F Gil Diáz[8]							
S Hintze[5]	**44**					**44**	105
J W J Hughes-Hallett	**97**					**97**	77
Sir Brian Moffat	**110**					**110**	145
Sir Mark Moody-Stuart	**125**					**125**	125
G Morgan	**77**					**77**	16
S W Newton	**77**					**77**	65
S M Robertson	**94**					**94**	65
H Sohmen[5, 9]							
Sir Brian Williamson	**91**					**91**	85

Total[10]	**1,312**	**2,969**	**894**	**98**	**4,465**	**9,738**	11,485
Total (US$000) [10]	**2,626**	**5,943**	**1,790**	**196**	**8,938**	**19,493**	21,139

1 *Executive allowance paid to fund personal pension arrangements.*
2 *Benefits in kind for executive Directors include provision of company car, medical insurance, other insurance cover, accountancy advice and travel assistance.*
3 *These discretionary bonuses are in respect of 2007. See page 324 for comparison with 2006.*
4 *In return for the prior waiver of part of his bonus, an employer contribution has been made into a pension arrangement for M F Geoghegan equal to £225,000 (2006: £215,000) which would otherwise have been paid.*
5 *Retired as a Director on 25 May 2007.*
6 *Includes fees as non-executive Chairman of HSBC Private Equity (Asia) Limited and as a non-executive Director of The Hongkong and Shanghai Banking Corporation.*
7 *Includes fees as a non-executive Director of The Hongkong and Shanghai Banking Corporation.*
8 *Appointed as a Director on 2 January 2007 and retired as a Director on 5 March 2007. J F Gil Diáz elected to waive any fees payable to him by HSBC Holdings (£10,833).*
9 *H Sohmen elected to waive any fees payable to him by HSBC Holdings (2007: £27,083; 2006: £65,000).*
10 *Total emoluments for 2006 include the emoluments of Directors who retired in that year.*

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Directors Remuneration Report (continued)

Pensions / Share plans

Pensions

S K Green is entitled to receive benefits from an Employer-Funded Retirement Benefits Scheme (EFRBS). The benefits to which he is entitled from the HSBC Bank (UK) Pension Scheme but in respect of which he ceased membership on 5 April 2006, will be calculated based on completed service to the date of opting out and on pensionable salary calculated at the date employment with HSBC Holdings ceases. The intention of this arrangement is to provide benefits to Mr Green that would be broadly comparable to an accrual rate of one-thirtieth of pensionable salary for each year of pensionable service.

For M F Geoghegan an employer contribution was made to the HSBC Asia Holdings Pension Plan in respect of 2007 of £225,000 (2006: £215,000) arising entirely from a bonus sacrifice. There were no other employer contributions made to this plan. Mr Geoghegan receives an executive allowance of 50 per cent of annual basic salary to fund personal pension arrangements.

D J Flint receives an executive allowance of 55 per cent of annual basic salary to fund personal pension arrangements.

	Accrued annual pension at 31 December 2007 £000	Increase in accrued pension during 2007 £000	Increase in accrued pension during 2007, excluding any increase for inflation £000	Transfer value of accrued pension at 31 December 2006[1] £000	Transfer value of accrued pension at 31 December 2007[1] £000	Increase of transfer value of accrued pension (less personal contributions) in 2007[1] £000	Transfer value (less personal contributions) at 31 December 2007 relating to increase in accrued pensions during 2007, excluding any increase for inflation[1] £000
S K Green	**628**	**42**	**19**	**11,082**	**12,780**	**1,698**	**383**

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

The following unfunded pension payments, in respect of which provision has been made, were made during 2007 to five former Directors of HSBC Holdings:

	2007 £	2006 £
B H Asher	**93,812**	90,465
C F W de Croisset	**194,077**	178,344
R Delbridge	**134,934**	130,120
Sir Brian Pearse	**56,269**	54,261
Sir William Purves	**99,310**	95,767
	578,402	548,957

The payments in respect of R Delbridge and Sir Brian Pearse were made by HSBC Bank plc as former Directors of that bank. The payment in respect of C F W de Croisset was made by HSBC France as a former Director of that bank.

Share plans

At 31 December 2007, the undernamed Directors held Performance Share awards and options to acquire the number of HSBC Holdings ordinary shares set against their respective names.

The options under the HSBC Holdings Savings-Related Share Option Plan were awarded for nil consideration and are exercisable at a 20 per cent discount to the average market value of the ordinary shares on the five business days immediately preceding the invitation date. Under the Securities and Futures Ordinance of Hong Kong the options are categorised as unlisted physically settled equity derivatives. No options lapsed during the year and except as otherwise indicated, no options were awarded or exercised during the year. There are no performance criteria conditional upon which the outstanding options are exercisable.

The market value of the ordinary shares at 31 December 2007 was £8.42. The highest and lowest market values during the year were £9.64 and £8.03. Market value is the mid-market price derived from the London Stock Exchange Daily Official List on the relevant date.

Under the Securities and Futures Ordinance of Hong Kong, Performance Share awards under The HSBC Share Plan and the HSBC Holdings Restricted Share Plan 2000 are categorised as the interests of a beneficiary of a Trust.

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HSBC Holdings Savings-Related Share Option Plan
HSBC Holdings ordinary shares of US$0.50

	Date of award	Exercise price (£)	Exercisable from[1]	Exercisable until	Options at 1 January 2007	Options awarded during year	Options exercised during year	Options at 31 December 2007
D J Flint	2 May 2002	6.3224	1 Aug 2007	31 Jan 2008	2,617	—	2,617[2]	—
	24 Apr 2007	7.0872	1 Aug 2012	31 Jan 2013	—	2,310	—	2,310
S K Green	23 Apr 2003	5.3496	1 Aug 2008	31 Jan 2009	3,070	—	—	3,070

1 *May be advanced to an earlier date in certain circumstances, e.g. retirement.*
2 *Options over 2,617 shares were exercised on 11 September 2007. At the date of exercise, the market value per share was £8.82.*

The HSBC Share Plan
HSBC Holdings ordinary shares of US$0.50

	Date of award	Year in which awards may vest	Awards at 1 January 2007	Awards made during year[1]	Monetary value of awards made during year £000	Awards at 31 December 2007[2]
D J Flint	27 May 2005	2008	185,821	—	—	194,796
	6 Mar 2006	2009	167,220	—	—	175,296
	5 Mar 2007	2010	—	246,185	2,200	256,029
M F Geoghegan	27 May 2005	2008	247,761	—	—	259,728
	6 Mar 2006	2009	209,025	—	—	219,121
	5 Mar 2007	2010	—	559,513	5,000	581,884
S K Green	27 May 2005	2008	309,701	—	—	324,659
	6 Mar 2006	2009	261,280	—	—	273,900
	5 Mar 2007	2010	—	419,635	3,750	436,413

Vesting of these Performance Share awards is subject to the performance conditions describe d on page 325 being satisfied.
1 *At the date of the award, 5 March 2007, the market value (closing price) per share was £8.96. The Trustee of the Plan purchased the shares at a price of £8.936358.*
2 *Includes additional shares arising from scrip dividends.*

HSBC Holdings Restricted Share Plan 2000
HSBC Holdings ordinary shares of US$0.50

Monetary

	Date of award	Year in which awards may vest	Awards at 1 January 2007	Awards vested during year[1]	value of awards vested during year £000	Awards at 31 December 2007[1]
D J Flint	8 Mar 2002	2007	90,176	90,897[2]	830	—
	5 Mar 2003	2008	129,917	—	—	136,192
	4 Mar 2004	2009	136,357	—	—	—[3]
M F Geoghegan	8 Mar 2002	2007	45,089	45,449[2]	414	—
	5 Mar 2003	2008	60,630	—	—	63,558
	4 Mar 2004	2009	102,268	—	—	—[3]
S K Green	8 Mar 2002	2007	112,720	113,621[2]	1,036	—
	5 Mar 2003	2008	129,917	—	—	136,192
	4 Mar 2004	2009	187,490	—	—	—[3]

Vesting of these Performance Share awards is subject to the attainment of predetermined TSR targets over a three-year period from the date of the award. Full vesting and transfer of the shares will not generally occur until the fifth anniversary of the date of award. A benchmark for HSBC Holdings’ TSR, weighted by market capitalisation, was established which takes account of the TSR performance of: (1) a peer group of nine banks weighted by market capitalisation which were considered most relevant to HSBC in terms of size and international scope. For performance periods up to and including the one beginning in 2003, this group comprised ABN AMRO Holding N.V., The Bank of East Asia, Limited, Citigroup Inc., Deutsche Bank AG, JPMorgan Chase & Co., Lloyds TSB Group plc, Mitsubishi Tokyo Financial Group Inc., Oversea-Chinese Banking Corporation Limited and Standard Chartered PLC. To be more relevant to HSBC in terms of size and international scope, this peer group was amended for conditional awards made in 2004 by the replacement of Lloyds TSB Group plc,

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Directors Remuneration Report (continued)

Share plans / Statement of Directors Responsibilities

Oversea-Chinese Banking Corporation Ltd., Mitsubishi Tokyo Financial Group Inc. and The Bank of East Asia, Limited with Bank of America Corporation, The Royal Bank of Scotland Group plc, Banco Santander Central Hispano S.A. and UBS AG; (2) the five largest banks from each of the US, the UK, continental Europe and the Far East, other than any within (1) above, weighted by market capitalisation; and (3) the banking sector of the Morgan Stanley Capital International World Index, excluding any within (1) or (2) above, weighted by market capitalisation. By combining the weighted average TSR for each of the above three groups and weighting that average so that 50 per cent is applied to (1), 25 per cent is applied to (2) and 25 per cent is applied to (3), a single TSR benchmark for market comparison was determined. The benchmark was chosen to reward the delivery of sustained financial growth of HSBC Holdings and to align the interests of participants with those of shareholders. The extent to which each award will vest will be determined by reference to HSBC Holdings TSR measured against the TSR benchmark. If HSBC Holdings TSR over the performance period exceeds the benchmark TSR, awards with a value, at the date of grant, of up to 100 per cent of the individuals earnings (base salary and bonus in respect of the previous performance year), will vest. For higher value awards, the greater of 50 per cent of the award or the number of shares equating at the date of grant to 100 per cent of the individuals earnings, will vest at this level of performance. If HSBC Holdings TSR over the performance period places it within the upper quartile of the ranked list of the banks comprising the benchmark, these higher value awards will vest in full. For performance between the median and the upper quartile, vesting will be on a straight-line basis. If the upper quartile performance level is achieved at the third anniversary of the date of award then an additional award equal to 20 per cent of the initial Performance Share award will be made and will vest at the same time as the original award to which it relates.

1 *Includes additional shares arising from scrip dividends.*
2 *The performance conditions have been met and the shares have vested. At the date of vesting, 8 March 2007, the market value per share was £9.12. At the date of the award, 8 March 2002, the market value per share was £8.34.*
3 *The performance conditions for awards made in 2004 were not met and, under the rules of the Plan, the awards held by D J Flint (137,447 shares), M F Geoghegan (103,086 shares) and S K Green (188,990 shares) were forfeited on 4 April 2007.*

On behalf of the Board

3 March 2008

Sir Mark Moody-Stuart, *Chairman of Remuneration Committee*

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Statement of Directors Responsibilities in respect of the *Annual Report and Accounts 2007* and the Financial Statements

The following statement, which should be read in conjunction with the Auditors statement of their responsibilities set out in their report on pages 334 and 335, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.

The Directors are responsible for preparing the Annual Report, the consolidated financial statements of HSBC Holdings and its subsidiaries (the Group) and holding company financial statements for HSBC Holdings (the parent company) in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. The Directors are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the parent company financial statements on the same basis.

The Directors are also required to present additional information for US Shareholders. Accordingly these financial statements are framed to meet both UK and US requirements to give a consistent view to all shareholders.

The Group and parent company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Group and the parent company and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation. In addition, in order to meet certain US requirements, we are required to present our financial statements in accordance with IFRSs as adopted by the International Accounting Standards Board (IASB). Currently, there are no differences in application to HSBC between IFRS endorsed by the EU and IFRS issued by the IASB.

In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent; and
- state whether they have been prepared in accordance with IFRSs as adopted by the EU.

The Directors are required to prepare the financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the Group has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on the going concern basis.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985.

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

Under applicable law and regulations, the Directors also have responsibility for preparing a Directors Report, Directors Remuneration Report and the Corporate Governance statement on pages 289 to 332 that comply with that law and those regulations.

The Directors have responsibility for the maintenance and integrity of the Annual Report and Accounts as they appear on the company’s website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board 3 March 2008
R G Barber, *Secretary*

Report of Independent Registered Public Accounting Firm to the Board of Directors and shareholders of HSBC Holdings plc

We have audited the accompanying consolidated financial statements of HSBC Holdings plc and its subsidiary undertakings (together HSBC) on pages 337 to 452 which comprise the consolidated balance sheets as of 31 December 2007 and 2006, and the related consolidated income statements, consolidated cash flow statements and consolidated statements of recognized income and expense, for each of the years in the three-year period ended 31 December 2007, including the disclosures marked audited within the critical accounting policies on pages 132 to 134, th e Report of the Directors: The Management of Risk section on pages 192 to 288 and the Off-balance sheet arrangements and special purpose entities section on pages 183 to 191. We have also audited HSBCs internal control over financial reporting as of 31 December 2007, based on the framework for Directors internal control evaluation contained within the Combined Code (The Revised Turnbull Guidance), and the criteria established in *Internal ControlIntegrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). HSBCs management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Managements Assessment of Internal Controls. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the effectiveness of HSBC's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on assessed risk. Our audits also included performing other such procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HSBC as of 31 December 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended 31 December 2007, in conformity with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU) and IFRSs as issued by the International Accounting Standards Board (IASB). Also in our opinion, HSBC maintained, in all material respects, effective internal control over financial reporting as of 31 December 2007, based on the framework for Directors internal control evaluation contained within the Combined Code (The Revised Turnbull Guidance) and the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

KPMG Audit Plc
London, England
3 March 2008

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Financial Statements

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Consolidated income statement for the year ended 31 December 2007

	Notes	2007 US$m	2006 US$m	2005 US$m
Interest income		**92,359**	75,879	60,094
Interest expense		**(54,564)**	(41,393)	(28,760)
Net interest income		**37,795**	34,486	31,334
Fee income		**26,337**	21,080	17,486
Fee expense		**(4,335)**	(3,898)	(3,030)
Net fee income		**22,002**	17,182	14,456
Trading income excluding net interest income		**4,458**	5,619	3,656
Net interest income on trading activities		**5,376**	2,603	2,208
Net trading income		**9,834**	8,222	5,864
Net income from financial instruments designated at fair value	3	**4,083**	657	1,034
Gains less losses from financial investments		**1,956**	969	692
Gains arising from dilution of interests in associates	4	**1,092**	–	–
Dividend income		**324**	340	155
Net earned insurance premiums	5	**9,076**	5,668	5,436
Other operating income		**1,439**	2,546	2,733
Total operating income		**87,601**	70,070	61,704
Net insurance claims incurred and movement in liabilities to policyholders	6	**(8,608)**	(4,704)	(4,067)
Net operating income before loan impairment charges and other credit risk provisions		**78,993**	65,366	57,637
Loan impairment charges and other credit risk provisions		**(17,242)**	(10,573)	(7,801)
Net operating income	7	**61,751**	54,793	49,836
Employee compensation and benefits	8	**(21,334)**	(18,500)	(16,145)
General and administrative expenses	9	**(15,294)**	(12,823)	(11,183)
Depreciation and impairment of property, plant and equipment	23	**(1,714)**	(1,514)	(1,632)
Amortisation and impairment of intangible assets	22	**(700)**	(716)	(554)
Total operating expenses		**(39,042)**	(33,553)	(29,514)
Operating profit		**22,709**	21,240	20,322
Share of profit in associates and joint ventures	21	**1,503**	846	644
Profit before tax		**24,212**	22,086	20,966
Tax expense	11	**(3,757)**	(5,215)	(5,093)
Profit for the year		**20,455**	16,871	15,873
Profit attributable to shareholders of the parent company		**19,133**	15,789	15,081
Profit attributable to minority interests		**1,322**	1,082	792
		US$	US$	US$
Basic earnings per ordinary share	13	**1.65**	1.40	1.36
Diluted earnings per ordinary share	13	**1.63**	1.39	1.35
Dividends per ordinary share	12	**0.87**	0.76	0.69

The accompanying notes on pages 344 to 452, the audited sections of the Report of the Directors: The Management of Risk on pages 192 to 288, Critical accounting policies on pages 132 to 134 and Off-balance sheet arrangements and special purpose entities on pages 183 to 191 form an integral part of these financial statements.

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Financial Statements (continued)

Consolidated balance sheet at 31 December 2007

	Notes	2007 US$m	2006 US$m
ASSETS			
Cash and balances at central banks		**21,765**	12,732
Items in the course of collection from other banks		**9,777**	14,144
Hong Kong Government certificates of indebtedness		**13,893**	13,165
Trading assets	*16*	**445,968**	328,147
Financial assets designated at fair value	*17*	**41,564**	20,573
Derivatives	*18*	**187,854**	103,702
Loans and advances to banks	*33*	**237,366**	185,205
Loans and advances to customers	*33*	**981,548**	868,133
Financial investments	*19*	**283,000**	204,806
Interests in associates and joint ventures	*21*	**10,384**	8,396
Goodwill and intangible assets	*22*	**39,689**	37,335
Property, plant and equipment	*23*	**15,694**	16,424
Other assets	*25*	**39,493**	29,823
Current tax asset		**896**	380
Deferred tax asset	*11*	**5,284**	3,241
Prepayments and accrued income		**20,091**	14,552
Total assets		**2,354,266**	1,860,758
LIABILITIES AND EQUITY			
Liabilities			
Hong Kong currency notes in circulation		**13,893**	13,165
Deposits by banks	*33*	**132,181**	99,694
Customer accounts	*33*	**1,096,140**	896,834
Items in the course of transmission to other banks		**8,672**	12,625
Trading liabilities	*26*	**314,580**	226,608
Financial liabilities designated at fair value	*27*	**89,939**	70,211
Derivatives	*18*	**183,393**	101,478
Debt securities in issue	*28*	**246,579**	230,325
Retirement benefit liabilities	*8*	**2,893**	5,555
Other liabilities	*29*	**35,013**	28,019
Current tax liability		**2,559**	1,805
Liabilities under insurance contracts	*30*	**42,606**	17,670
Accruals and deferred income		**21,766**	16,310
Provisions	*31*	**1,958**	1,763
Deferred tax liability	*11*	**1,859**	1,096
Subordinated liabilities	*32*	**24,819**	22,672
Total liabilities		**2,218,850**	1,745,830
Equity			
Called up share capital	*38*	**5,915**	5,786
Share premium account	*39*	**8,134**	7,789
Other reserves	*39*	**33,014**	29,380
Retained earnings	*39*	**81,097**	65,397

Total shareholders equity		**128,160**	108,352
Minority interests	*37*	**7,256**	6,576
Total equity		**135,416**	114,928
Total equity and liabilities		**2,354,266**	1,860,758

The accompanying notes on pages 344 to 452, the audited sections of the Report of the Directors: The Management of Risk on pages 192 to 288, Critical accounting policies on pages 132 to 134 and Off-balance sheet arrangements and special purpose entities on pages 183 to 191 form an integral part of these financial statements.

S K Green, *Group Chairman*

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Consolidated statement of recognised income and expense for the year ended 31 December 2007

	2007 US$m	2006 US$m	2005 US$m
Available-for-sale investments:			
fair value gains/(losses) taken to equity	**756**	1,582	(400)
fair value gains transferred to income statement on disposal or impairment	**(1,740)**	(644)	(240)
Cash flow hedges:			
fair value gains/(losses) taken to equity	**625**	1,554	(92)
fair value gains transferred to income statement	**(1,886)**	(2,198)	(106)
Share of changes in equity of associates and joint ventures	**372**	20	161
Exchange differences	**5,946**	4,675	(4,257)
Actuarial gains/(losses) on defined benefit plans	**2,167**	(78)	(812)
	6,240	4,911	(5,746)
Tax on items taken directly to equity	**(226)**	(44)	437
Total income and expense taken to equity during the year	**6,014**	4,867	(5,309)
Profit for the year	**20,455**	16,871	15,873
Total recognised income and expense for the year	**26,469**	21,738	10,564
Effect of change in accounting policy			
IFRSs transition adjustment at 1 January 2005[1]			(8,824)
	26,469	21,738	1,740
Total recognised income and expense for the year attributable to:			
shareholders of the parent company	**24,801**	20,527	9,912
minority interests	**1,668**	1,211	652
	26,469	21,738	10,564

1 *For an explanation of the IFRSs transition adjustment at 1 January 2005, see Note 46 on the Financial Statements in the* Annual Report and Accounts 2005.

The accompanying notes on pages 344 to 452, the audited sections of the Report of the Directors: The Management of Risk on pages 192 to 288, Critical accounting policies on pages 132 to 134 and Off-balance sheet arrangements and special purpose entities on pages 183 to 191 form an integral part of these financial statements.

Financial Statements (continued)

Consolidated cash flow statement for the year ended 31 December 2007

	Notes	**2007 US$m**	2006 US$m	2005 US$m
Cash flows from operating activities				
Profit before tax		**24,212**	22,086	20,966
Adjustments for:				
– non-cash items included in profit before tax	*40*	**21,662**	14,956	11,404
– change in operating assets	*40*	**(176,538)**	(175,317)	(91,753)
– change in operating liabilities	*40*	**250,095**	237,378	72,212
– elimination of exchange differences[1]		**(18,563)**	(12,114)	2,580
– net gain from investing activities		**(2,209)**	(2,014)	(692)
– share of profits in associates and joint ventures		**(1,503)**	(846)	(644)
– dividends received from associates		**363**	97	114
– contribution paid to defined benefit plans		**(1,393)**	(547)	(2,547)
– tax paid		**(5,088)**	(4,946)	(4,619)
Net cash from operating activities		**91,038**	78,733	7,021
Cash flows from investing activities				
Purchase of financial investments		**(260,980)**	(286,316)	(378,103)
Proceeds from the sale and maturity of financial investments		**238,647**	273,774	368,696
Purchase of property, plant and equipment		**(2,720)**	(2,400)	(2,887)
Proceeds from the sale of property, plant and equipment		**3,178**	2,504	620
Proceeds from the sale of loan portfolios		**1,665**	2,048	–
Net purchase of intangible assets		**(950)**	(852)	(849)
Net cash outflow from acquisition of and increase in stake of subsidiaries		**(623)**	(1,185)	(1,662)
Net cash inflow from disposal of subsidiaries		**187**	62	705
Net cash outflow from acquisition of and increase in stake of associates		**(351)**	(585)	(2,569)
Net cash inflow from the consolidation of funds		**1,600**	–	–
Proceeds from disposal of associates		**69**	874	422
Net cash used in investing activities		**(20,278)**	(12,076)	(15,627)
Cash flows from financing activities				
Issue of ordinary share capital		**474**	1,010	690
Issue of preference shares		**–**	374	1,298
Net purchases and sales of own shares for market-making and investment purposes		**126**	46	(55)
Purchases of own shares to meet share awards and share option awards		**(636)**	(575)	(766)
On exercise of share options		**104**	173	277
Subordinated loan capital issued		**5,705**	5,948	2,093
Subordinated loan capital repaid		**(689)**	(903)	(1,121)
Dividends paid to shareholders of the parent company		**(6,003)**	(5,927)	(5,935)
Dividends paid to minority interests		**(718)**	(710)	(508)

Net cash used in financing activities		**(1,637)**	(564)	(4,027)
Net increase/(decrease) in cash and cash equivalents		**69,123**	66,093	(12,633)
Cash and cash equivalents at 1 January		**215,486**	141,307	160,956
Exchange differences in respect of cash and cash equivalents		**12,400**	8,086	(7,016)
Cash and cash equivalents at 31 December	*40*	**297,009**	215,486	141,307

1 *Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by- line basis, as details cannot be determined without unreasonable expense.*

The accompanying notes on pages 344 to 452, the audited sections of the Report of the Directors: The Management of Risk on pages 192 to 288, Critical accounting policies on pages 132 to 134 and Off-balance sheet arrangements and special purpose entities on pages 183 to 191 form an integral part of these financial statements.

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HSBC Holdings balance sheet at 31 December 2007

	Notes	**2007** **US$m**	2006 *(restated)* US$m
ASSETS			
Cash at bank and in hand:			
balances with HSBC undertakings		**360**	729
Derivatives	*18*	**2,660**	1,599
Loans and advances to HSBC undertakings	*33*	**17,242**	14,456
Financial investments		**3,022**	3,614
Investments in subsidiaries[1]	*24*	**69,411**	63,265
Property, plant and equipment		**1**	1
Other assets		**21**	25
Current tax assets		****	31
Deferred tax asset	*11*	**7**	35
Prepayments and accrued income		**224**	41
Total assets		**92,948**	83,796
LIABILITIES AND EQUITY			
Liabilities			
Amounts owed to HSBC undertakings	*33*	**2,969**	3,100
Financial liabilities designated at fair value	*27*	**18,683**	14,070
Derivatives	*18*	**44**	177
Other liabilities	*29*	**1,405**	1,517
Current tax liabilities		**322**	
Accruals and deferred income		**150**	111
Subordinated liabilities	*32*	**8,544**	8,423
Total liabilities		**32,117**	27,398
Equity			
Called up share capital	*38*	**5,915**	5,786
Share premium account		**8,134**	7,789
Merger reserve and other reserves		**28,942**	28,942
Other reserves		**3,631**	3,293
Retained earnings		**14,209**	10,588
Total equity		**60,831**	56,398
Total equity and liabilities		**92,948**	83,796

1 *On 1 January 2007, HSBC Holdings adopted IFRIC 11. Comparative information has been restated accordingly. See Note 1a.*

The accompanying notes on pages 344 to 452, the audited sections of the Report of the Directors: The Management of Risk on pages 192 to 288, Critical accounting policies on pages 132 to 134 and Off-balance sheet arrangements and special purpose entities on pages 183 to 191 form an integral part of these financial statements.

S K Green, *Group Chairman*

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Financial Statements (continued)

HSBC Holdings statement of changes in total equity for the year ended 31 December 2007

	2007 **US$m**	2006 *(restated)* US$m
Called up share capital		
At 1 January	**5,786**	5,667
Shares issued in connection with the early settlement of HSBC Finance 8.875 per cent Adjustable Conversion-Rate Equity Security Units	–	2
Shares issued under employee share plans	**17**	38
Shares issued in lieu of dividends	**112**	79
At 31 December	**5,915**	5,786
Share premium account		
At 1 January	**7,789**	6,896
Shares issued under employee share plans	**460**	975
Shares issued in lieu of dividends and amounts arising thereon	**(115)**	(82)
At 31 December	**8,134**	7,789
Merger reserve and other reserves		
At 1 January and 31 December	**28,942**	28,942
Other reserves		
Available-for-sale fair value reserve		
At 1 January	**246**	337
Fair value changes taken to equity[1]	**246**	(121)
Tax on items taken directly to equity[1]	**(10)**	30
At 31 December	**482**	246
Share-based payment reserve[2]		
At 1 January	**2,111**	1,535
Exercise and lapse of share options and vesting of share awards	**(751)**	(623)
Cost of share-based payment arrangements	**29**	58
Equity investments granted to employees of subsidiaries under employee share plans	**818**	1,143
Other movements	**(239)**	(2)
At 31 December	**1,968**	2,111
Other paid-in capital		
At 1 January	**936**	650
Exercise and lapse of share options	**245**	286
At 31 December	**1,181**	936

Total other reserves at 31 December	**3,631**	3,293
Retained earnings		
At 1 January	**10,588**	9,501
Profit for the year attributable to shareholders	**9,499**	7,139
Dividends to shareholders of the parent company	**(10,241)**	(8,769)
Amounts arising on shares in lieu of dividends	**4,354**	2,528
Own shares adjustments	**16**	157
Tax on share based payments	**(7)**	9
Exchange differences and other movements[1]	****	23
At 31 December[3]	**14,209**	10,588

1 *The total net income/(expense) taken directly to equity during the year was US$229 million (2006: US$(59) million).*

2 *On 1 January 2007, HSBC Holdings adopted IFRIC 11. Comparative information has been restated accordingly. See Note 1a.*

3 *Retained earnings include 30,706,713 (US$554 million) of own shares held to fund employee share plans (2006: 35,639,856, US$544 million).*

The accompanying notes on pages 344 to 452, the audited sections of the Report of the Directors: The Management of Risk on pa ges 192 to 288, Critical accounting policies on pages 132 to 134 and Off-balance sheet arrangements and special purpose entities on pages 183 to 191 form an integral part of these financial statements.

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HSBC Holdings cash flow statement for the year ended 31 December 2007

	Notes	2007 US$m	2006 US$m
Cash flows from operating activities			
Profit before tax		**9,598**	6,974
Adjustments for:			
non-cash items included in profit before tax	40	**10**	58
change in operating assets	40	**(4,059)**	(1,827)
change in operating liabilities	40	**179**	1,056
elimination of exchange differences[1]		**(26)**	(29)
net gain from investing activities		**(12)**	(8)
tax received		**268**	219
Net cash from operating activities		**5,958**	6,443
Cash flows from investing activities			
Net cash outflow from acquisition of and increase in stake of subsidiaries		**(5,133)**	(4,440)
Net cash used in investing activities		**(5,133)**	(4,440)
Cash flows from financing activities			
Issue of ordinary share capital		**474**	1,010
Purchases of own shares to meet share awards and share option awards		**(96)**	(46)
On exercise of share options		**72**	127
Subordinated loan capital issued		**4,359**	2,806
Dividends paid		**(6,003)**	(5,927)
Net cash used in financing activities		**(1,194)**	(2,030)
Net increase/(decrease) in cash and cash equivalents		**(369)**	(27)
Cash and cash equivalents at 1 January		**729**	756
Cash and cash equivalents at 31 December	40	**360**	729

1 *Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.*

The accompanying notes on pages 344 to 452, the audited sections of the Report of the Directors: The Management of Risk on pages 192 to 288, Critical accounting policies on pages 132 to 134 and Off-balance sheet arrangements and special purpose entities on pages 183 to 191 form an integral part of these financial statements.

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HSBC HOLDINGS PLC

Notes on the Financial Statements

Note 1

1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as published by the International Accounting Standards Board ('IASB') if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2007, there were no unendorsed standards effective for the year ended 31 December 2007 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 2007 are prepared in accordance with IFRSs as issued by the IASB.

IFRSs comprise accounting standards issued by the IASB and its predecessor body and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

On 1 January 2007, HSBC adopted the following IFRIC interpretations:

- IFRIC 10 'Interim Financial Reporting and Impairment', which had no significant effect on the consolidated financial statements of HSBC Holdings; and
- IFRIC 11 'Group and Treasury Share Transactions' ('IFRIC 11'). On application of this interpretation, HSBC Holdings recognises all share-based payment transactions as equity-settled in its separate financial statements. The adoption of IFRIC 11 had no effect on the consolidated financial statements of HSBC. However, in the separate financial statements of HSBC Holdings, the effect was to increase both 'Investments in subsidiaries' and 'Share-based payment reserve' by US$909 million in 2006. This change in accounting policy was made in accordance with the transitional provisions of IFRIC 11, which state that IFRIC 11 shall be applied retrospectively in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', subject to the transitional provisions of IFRS 2 'Share-based Payment'.

(b) Differences between IFRSs and Hong Kong Financial Reporting Standards

As stated in Note 46, there are no significant differences between IFRSs and Hong Kong Financial Reporting Standards. The Notes on the Financial Statements, taken together with the Report of the Directors, include the aggregate of all disclosures necessary to satisfy IFRSs and Hong Kong reporting requirements.

(c) Presentation of information

Disclosures under IFRS 4 and IFRS 7 relating to the nature and extent of risks have been included in the audited sections of the 'Report of the Directors: The Management of Risk' on pages 192 to 288.

Capital disclosures under IAS 1 'Presentation of Financial Statements' have been included in the audited sections of 'Capital management and allocation' on pages 282 to 288.

Disclosures relating to 'Off-balance sheet arrangements and special purpose entities' are set out below on pages 183 to 191 and are also audited.

In publishing the parent company financial statements here together with the Group financial statements, HSBC Holdings has taken advantage of the exemption in section 230 of the Companies Act 1985 not to present its individual income statement and related notes that form a part of these financial statements.

HSBC has taken advantage of the exemption under Regulation 7 of the Partnerships and Unlimited Companies (Accounts) Regulations 1993 from certain partnerships that are consolidated by HSBC presenting their own individual financial statements under IFRSs.

The functional currency of HSBC Holdings plc is the US dollar, which is also the presentational currency of the consolidated financial statements of HSBC.

(d) Comparative information

As required by US public company reporting requirements, these consolidated financial statements include two years of comparative information for the consolidated income statement, consolidated cash flow statement, consolidated statement of recognised income and expense and related notes on the financial statements.

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(e) Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future may differ from those reported. In this regard, management believes that the critical accounting policies where judgement is necessarily applied are those which relate to loan impairment, goodwill impairment and the valuation of financial instruments (see ‘Critical Accounting Policies’ on pages 132 to 134 which form an integral part of these financial statements).

Further information about key assumptions concerning the future, and other key sources of estimation uncertainty, are set out in these notes on the financial statements.

(f) Consolidation

The consolidated financial statements of HSBC comprise the financial statements of HSBC Holdings and its subsidiaries made up to 31 December, with the exception of the banking and insurance subsidiaries of HSBC Bank Argentina, whose financial statements are made up to 30 June annually to comply with local regulations. Accordingly, HSBC uses their audited interim financial statements, drawn up to 31 December annually.

Newly acquired subsidiaries are consolidated from the date that HSBC gains control. The purchase method of accounting is used to account for the acquisition of subsidiaries by HSBC. The cost of an acquisition is measured at the fair value of the consideration given at the date of exchange, together with costs directly attributable to that acquisition. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair value of HSBC’s share of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of HSBC’s share of the identifiable assets, liabilities and contingent liabilities of the business acquired, the difference is recognised immediately in the income statement.

Entities that are controlled by HSBC are consolidated until the date that control ceases.

In the context of Special Purpose Entities (‘SPEs’), the following circumstances may indicate a relationship in which, in substance, HSBC controls and, consequently, consolidates an SPE:

- the activities of the SPE are being conducted on behalf of HSBC according to its specific business needs so that HSBC obtains benefits from the SPE’s operation;
- HSBC has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an ‘autopilot’ mechanism, HSBC has delegated these decision-making powers;
- HSBC has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE; or
- HSBC retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

HSBC performs a re-assessment of consolidation whenever there is a change in the substance of the relationship between HSBC and an SPE.

All intra-HSBC transactions are eliminated on consolidation.

The consolidated financial statements of HSBC also include the attributable share of the results and reserves of joint ventures and associates. These are based on financial statements made up to 31 December, with the exception of the Bank of Communications, Ping An Insurance and Industrial Bank which are included on the basis of financial statements made up for the twelve months to 30 September. These are equity accounted three months in arrears in order to meet the requirements of the Group’s reporting timetable. HSBC has taken into account changes in the period from 1 October to 31 December that would have materially affected its results.

(g) Future accounting developments

Standards and Interpretations issued by the IASB and endorsed by the EU

IFRS 8 Operating Segments (IFRS 8), which replaces IAS 14 Segment Reporting (IAS 14), was issued on 30 November 2006 and is effective for annual periods beginning on or after 1 January 2009. This standard specifies how an entity should report information about its operating segments, based on information about the

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Notes on the Financial Statements (continued)

Notes 1 and 2

components of the entity that the chief operating decision maker uses to make operating decisions. HSBC currently presents two sets of segments in accordance with IAS 14, one geographical and one based on customer groups, which reflect the way the businesses of the Group are managed. HSBC expects to adopt IFRS 8 with effect from 1 January 2009, and will accordingly present segmental information which reflects the operating segments used to make operating decisions at that time.

Standards and Interpretations issued by the IASB but not endorsed by the EU

The IASB issued a revised IAS 23 ‘Borrowing Costs’ on 29 March 2007, which is applicable for annual periods beginning on or after 1 January 2009. The revised standard eliminates the option of recognising borrowing costs immediately as an expense, to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. HSBC does not expect adoption of the revised standard to have a significant effect on the consolidated financial statements.

IFRIC 12 ‘Service Concession Arrangements’ (‘IFRIC 12’) was issued on 30 November 2006 and is effective for annual periods beginning on or after 1 January 2008. IFRIC 12 provides guidance on service concession arrangements by which a government or other public sector entity grants contracts for the supply of public services to private sector operators. IFRIC 12 addresses how service concession operators should apply existing IFRSs to account for the obligations they undertake and the rights they receive in service concession arrangements. IFRIC 12 is unlikely to have a significant effect on HSBC.

IFRIC 13 ‘Customer Loyalty Programmes’ (‘IFRIC 13’) was issued on 28 June 2007 and is effective for annual periods beginning on or after 1 July 2008. IFRIC 13 addresses how companies that grant their customers loyalty award credits (often called ‘points’) when buying goods or services should account for their obligation to provide free or discounted goods and services, if and when the customers redeem the points. IFRIC 13 requires companies to allocate some of the proceeds of the initial sale to the award credits and recognise these proceeds as revenue only when they have fulfilled their obligations to provide goods or services. HSBC is currently assessing the effect of this interpretation on the consolidated financial statements.

IFRIC 14 ‘IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction’ (‘IFRIC 14’) was issued on 5 July 2007 and is effective for annual periods beginning on or after 1 January 2008. IFRIC 14 provides guidance regarding the circumstances under which refunds and future reductions in contributions from a defined benefit plan can be regarded as available to an entity for the purpose of recognising a net defined benefit asset. Additionally, in jurisdictions where there is both a minimum funding requirement and restrictions over the amounts that companies can recover from the plan, either as refunds or reductions in contributions, additional liabilities may need to be recognised. HSBC is currently assessing the effect of this interpretation on the consolidated financial statements.

A revised IAS 1 ‘Presentation of Financial Statements’, which is applicable for annual periods beginning on or after 1 January 2009, was issued on 6 September 2007. The revised standard aims to improve users’ ability to analyse and compare information given in financial statements. Adoption of the revised standard will have no effect on the results reported in HSBC’s consolidated financial statements but will change the presentation of the results and financial position of HSBC in certain respects.

The IASB issued an amendment to IFRS 2 ‘Share-based Payment’ on 17 January 2008. The amendment, which is applicable for annual periods beginning on or after 1 January 2009, clarifies that vesting conditions comprise only service conditions and performance conditions. It also specifies the accounting treatment for a failure to meet a non-vesting condition. Adoption of the amendment is unlikely to have a significant effect on HSBC’s consolidated financial statements.

A revised IFRS 3 Business Combinations and an amended IAS 27 Consolidated and Separate Financial Statements, were issued on 10 January 2008. The revisions to the standards apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual financial reporting period beginning on or after 1 July 2009. The main changes under the standards are that:

- acquisition-related costs are recognised as expenses in the income statement in the period they are incurred;
- equity interests held prior to control being obtained are remeasured to fair value at the time control is obtained, and any gain or loss is recognised in the income statement;

- changes in a parents ownership interest in a subsidiary that do not result in a change of control are treated as transactions between equity holders and reported in equity; and

- An option is available, on a transaction-by-transaction basis, to measure any non-controlling interests (previously referred to as minority interests) in the entity acquired either at fair value, or at the non-controlling interests proportionate share of the net identifiable assets of the entity acquired.

- The effect that the changes will have on the results and financial position of HSBC will depend on the incidence and timing of business combinations occurring on or after 1 January 2010.

- The IASB issued amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements, Puttable Financial Instruments and Obligations Arising on Liquidation, on 14 February 2008. The amendments are applicable for annual periods beginning on or after 1 January 2009. HSBC is currently assessing the effect of the amendments, if any, on the consolidated financial statements.

2 Summary of significant accounting policies

(a) Interest income and expense

Interest income and expense for all financial instruments except for those classified as held for trading or designated at fair value (other than debt securities issued by HSBC and derivatives managed in conjunction with such debt securities issued) are recognised in Interest income and Interest expense in the income statement using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, HSBC estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by HSBC that are an integral part of the effective interest rate of a financial instrument, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment.

(b) Non-interest income

HSBC earns **fee income** from a diverse range of services provided to its customers. Fee income is accounted for as follows:

– income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement for the acquisition of shares or other securities);

– income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and

– income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in Interest income (Note 2a).

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends.

Net income from financial instruments designated at fair value includes all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss. Interest income and expense and dividend income arising on these financial instruments are also included, except for debt securities issued and derivatives managed in conjunction with debt securities issued. Interest on these instruments is presented in Interest expense.

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for equity securities.

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Notes on the Financial Statements (continued)

Note 2

(c) Segment reporting

HSBC is organised into five geographical regions, Europe, Hong Kong, Rest of Asia-Pacific, North America and Latin America, and manages its business through four customer groups: Personal Financial Services; Commercial Banking; Global Banking and Markets; and Private Banking. The main items reported in the Other segment are the income and expenses of wholesale insurance operations, certain property activities, unallocated investment activities including hsbc.com, centrally held investment companies and HSBCs holding company and financing operations. Segment income and expenses include transfers between geographical regions and transfers between customer groups. These transfers are conducted on arms length terms and conditions.

In HSBCs segmental analysis of the income statement by customer groups and global businesses, net trading income comprises all gains and losses from changes in the fair value of financial asse ts and financial liabilities classified as held for trading, together with third party and intra-segment interest income and interest expense, and dividends received; in the consolidated income statement, intra-segment interest income and expense are eliminated.

(d) Determination of fair value

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

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

Factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate, when fair values are calculated using valuation techniques. Valuation techniques incorporate assumptions that other market participants would use in their valuations, including assumptions about interest rate yield curves, exchange rates, volatilities, and prepayment and default rates. Where a portfolio of financial instruments has quoted prices in an active market, the fair value of the instruments are calculated as the product of the number of units and quoted price and no block discounts are made.

If the fair value of a financial asset measured at fair value becomes negative, it is recorded as a financial liability until its fair value becomes positive, at which time it is recorded as a financial asset.

The fair values of financial liabilities are measured using quoted market prices where available, or using valuation techniques. These fair values include market participants assessments of th e appropriate credit spread to apply to HSBCs liabilities. The amount of change during the period, and cumulatively, in the fair value of designated financial liabilities and loans and advances that is attributable to changes in their credit spread is determined as the amount of change in the fair value that is not attributable to changes in market conditions that give rise to market risk.

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(e) Loans and advances to banks and customers

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

For certain leveraged finance and syndicated lending activities, HSBC may commit to underwrite loans on fixed contractual terms for specified periods of time, where the drawdown of the loan is contingent upon certain future events outside the control of HSBC. Where the loan arising from the lending commitment is expected to be held for trading, the commitment to lend is recorded as a trading derivative. Where it is not HSBC's intention to trade the loan, a provision is only recorded where it is probable that HSBC will incur a loss as a result of the loan commitment. This may occur, for example, where a loss of principal is probable or the interest rate charged on the loan is lower than the cost of funding. On inception of the loan, the hold portion is recorded at its fair value. Where this fair value is lower than the cash amount advanced (for example, due to the rate of interest charged on the loan being below the market rate of interest), the write down is charged to the income statement. The write down will be recovered over the life of the loan, through the recognition of interest income using the effective interest rate method, unless the loan is impaired. The write down is recorded as a reduction to other operating income.

(f) Impairment of loans and advances

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment allowances are calculated on individual loans and on groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

Individually assessed loans and advances

For all loans that are considered individually significant, HSBC assesses on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

– HSBC's aggregate exposure to the customer;

– the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;

– the amount and timing of expected receipts and recoveries;

– the likely dividend available on liquidation or bankruptcy;

– the extent of other creditors' commitments ranking ahead of, or *pari passu* with, HSBC and the likelihood of other creditors continuing to support the company;

– the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

– the realisable value of security (or other credit mitigants) and likelihood of successful repossession;

– the likely deduction of any costs involved in recovery of amounts outstanding;

–

the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency; and

– when available, the secondary market price of the debt.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's current carrying amount.

Notes on the Financial Statements (continued)

Note 2

Collectively assessed loans and advances

Impairment is assessed on a collective basis in two circumstances:

- to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses that HSBC has incurred as a result of events occurring before the balance sheet date, which HSBC is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identified losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);

- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and

- management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio.

Homogeneous groups of loans and advances
Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans that are not considered individually significant, because individual loan as sessment is impracticable. Losses in these groups of loans are recorded on an individual basis when individual loans are written off, at which point they are removed from the group. Two alternative methods are used to calculate allowances on a collective basis:

- When appropriate empirical information is available, HSBC utilises roll rate methodology. This methodology employs statistical analyses of historical data and experience of delinquency and default to estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date which HSBC is not able to identify on an individual loan basis, and that can be reliably estimated. Under this methodology, loans are grouped into ranges according to the number of days past due, and statistical analysis is used to estimate the likelihood that loans in each range will progress through the various stages of delinquency and ultimately prove irrecoverable. 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. Current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.

- In other cases, when the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, HSBC adopts a formulaic approach which allocates progressively higher percentage loss rates the longer a customer's loan is overdue. Loss rates are based on 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, such that the most recent trends in the portfolio risk factors are not fully reflected in the statistical models.

These additional portfolio risk factors may include recent loan portfolio growth and product mix, unemployment rates, bankruptcy trends, geographic concentrations, loan product features (such as the ability of borrowers to repay adjustable-rate loans where reset interest rates give rise to increases in interest charges), economic conditions such as national and local trends in housing markets and interest rates, portfolio seasoning, account management policies and practices, current levels of write-offs, changes in laws and regulations and other items which can affect customer payment patterns on outstanding loans, such as natural disasters. These risk factors, where relevant, are taken into account when calculating the appropriate level of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Write-off of loans and advances

A loan (and the related impairment allowance account) is normally written off, either partially or in full, when there is no realistic prospect of recovery of the principal amount and, for a collateralised loan, when the proceeds from realising the security have been received.

Reversals of impairment

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

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans as part of an orderly realisation are recorded as assets held for sale and reported in ‘Other assets’. The asset acquired is recorded at the lower of its fair value (less costs to sell) and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the income statement, in ‘Other operating income’. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write down, is also recognised in ‘Other operating income’, together with any realised gains or losses on disposal.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as new loans for measurement purposes once the minimum number of payments required under the new arrangements have been received. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due. The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

(g) Trading assets and trading liabilities

Treasury bills, debt securities, equity shares, loans, deposits, debt securities in issue, and short positions in securities are classified as held for trading if they have been acquired principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date, when HSBC enters into contractual arrangements with counterparties to purchase or sell securities, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently, their fair values are remeasured, and all gains and losses from changes therein are recognised in the income statement in ‘Net trading income’ as they arise.

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(h) Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated by management. HSBC may designate financial instruments at fair value when the designation:

- eliminates or significantly reduces valuation or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases. Under this criterion, the main classes of financial instruments designated by HSBC are:

  Long-term debt issues. The interest payable on certain fixed rate long-term debt securities issued has been matched with the interest on receive fixed/pay variable interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities issued were accounted for at amortised cost, because the related derivatives are measured at fair value with changes in the fair value recognised in the income statement. By designating the long-term debt at fair value, the movement in the fair value of the long-term debt will also be recognised in the income statement.

  Financial assets and financial liabilities under investment contracts . Liabilities to customers under linked contracts are determined based on the fair value of the assets held in the linked funds, with changes recognised in the income statement. If no designation was made for the assets relating to the customer liabilities they would be classified as available-for-sale and the changes in fair value would be recorded directly in equity. These financial instruments are managed on a fair value basis and management information is also prepared on this basis.

  Designation at fair value of the financial assets and liabilities under investment contracts allows the changes in fair values to be recorded in the income statement and presented in the same line.

- applies to groups of financial assets, financial liabilities or combinations thereof that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. Under this criterion, certain financial assets held to meet liabilities under insurance contracts are the main class of financial instrument so designated. HSBC has documented risk management and investment strategies designed to manage such assets at fair value, taking into consideration the relationship of assets to liabilities in a way that mitigates market risks. Reports are provided to management on the fair value of the assets. Fair value measurement is also consistent with the regulatory reporting requirements under the appropriate regulations for these insurance operations.

- relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments, including certain debt issues and debt securities held.

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised when HSBC enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognised when sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken directly to the income statement.

Subsequently, the fair values are remeasured, and gains and losses from changes therein are recognised in Net income from financial instruments designated at fair value.

(i) Financial investments

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value (Note 2h), are classified as available-for-sale or held-to-maturity. Financial investments are recognised on trade date, when HSBC enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

(i) Available-for-sale securities are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in equity in the Available-for-sale reserve (Note 39) until the securities are either sold or impaired. When available-for- sale securities are sold, cumulative gains or losses previously recognised in equity are recognised in the income statement as Gains less losses from financial investments.

Interest income is recognised on available-for-sale securities using the effective interest rate method, calculated over the asset's expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the income statement when the right to receive payment has been established.

At each balance sheet date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of assets. This usually arises when circumstances are such that an adverse effect on future cash flows from the asset or group of assets can be reliably estimated. If an available-for-sale security is impaired, the cumulative loss (measured as the difference between the asset's acquisition cost (net of any principal repayments and amortisation) and its current fair value, less any impairment loss on that asset previously recognised in the income statement) is removed from equity and recognised in the income statement. Reversals of impairment losses are subject to contrasting treatments depending on the nature of the instrument concerned:

- if the fair value of a debt instrument classified as available-for-sale increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement;

- impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(ii) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that HSBC positively intends, and is able, to hold until maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses.

(j) Sale and repurchase agreements (including stock lending and borrowing)

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to sell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

Securities borrowed are not recognised on the balance sheet. If they are sold on to third parties, an obligation to return the securities is recorded as a trading liability and measured at fair value, and any gains or losses are included in 'Net trading income'.

(k) Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange- traded derivatives are obtained from quoted market prices. Fair values of over-the-counter derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

Derivatives may be embedded in other financial instruments, for example, a convertible bond with an embedded conversion option. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a stand-alone derivative if they were contained in a separate contract; and the combined contract is not held for trading or designated at fair value. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are

Notes on the Financial Statements (continued)

Note 2

with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains and losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement. When derivatives are designated as hedges, HSBC classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ("fair value hedges"); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ("cash flow hedges"); or (iii) a hedge of a net investment in a foreign operation ("net investment hedges"). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value, cash flow or net investment hedge provided certain criteria are met.

Hedge accounting

At the inception of a hedging relationship, HSBC documents the relationship between the hedging instruments and the hedged items, its risk management objective and its strategy for undertaking the hedge. HSBC also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the hedging instruments, primarily derivatives, that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items. Interest on designated qualifying hedges is included in "Net interest income".

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the hedged assets, liabilities or group thereof that are attributable to the hedged risk.

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

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity within the cash flow hedging reserve. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity until the forecast transaction is eventually recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges. A gain or loss on the effective portion of the hedging instrument is recognised in equity; a gain or loss on the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement on the disposal of the foreign operation.

Hedge effectiveness testing

To qualify for hedge accounting, HSBC requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness), and demonstrate actual effectiveness (retrospective effectiveness) on an ongoing basis.

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The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method an HSBC entity adopts for assessing hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness to be achieved, the changes in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent.

Hedge ineffectiveness is recognised in the income statement in Net trading income.

Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of derivatives that do not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in Net trading income, except where derivatives are managed in conjunction with financial instruments designated at fair value (other than derivatives managed in conjunction with debt securities issued by the Group), in which case gains and losses are reported in Net income from financial instruments designated at fair value. The interest on derivatives managed in conjunction with debt securities issued by the Group which are designated at fair value is recognised in Interest expense. All other gains and losses on these derivatives are reported in Net income from financial instruments designated at fair value.

(l) Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual right to receive cash flows from the assets has expired; or when HSBC has transferred its contractual right to receive the cash flows of the financial assets, and either:

- substantially all the risks and rewards of ownership have been transferred; or
- HSBC has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled or expires.

(m) Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(n) Subsidiaries, associates and joint ventures

HSBC classifies investments in entities which it controls as subsidiaries. Where HSBC is a party to a contractual arrangement whereby, together with one or more parties, it undertakes an economic activity that is subject to joint control, HSBC classifies its interest in the venture as a joint venture. HSBC classifies investments in entities over which it has significant influence, and that are neither subsidiaries nor join t ventures, as associates. For the purpose of determining this classification, control is considered to be the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

HSBC Holdings investments in subsidiaries are stated at cost less any impairment losses. Reversals of impairment losses are recognised in the income statement if there has been a change in the estimates used to determine the recoverable amount of the investment.

Investments in associates and interests in joint ventures are recognised using the equity method. Under this method, such investments are initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in HSBCs share of net assets.

Profits on transactions between HSBC and its associates and joint ventures are eliminated to the extent of HSBC's interest in the respective associates or joint ventures. Losses are also eliminated to the extent of HSBC's interest in the associates or joint ventures unless the transaction provides evidence of an impairment of the asset transferred.

Notes on the Financial Statements (continued)

Note 2

(o) Goodwill and intangible assets

(i) Goodwill arises on business combinations, including the acquisition of subsidiaries, and on the acquisition of interests in joint ventures and associates, when the cost of acquisition exceeds the fair value of HSBCs share of the identifiable assets, liabilities and contingent liabilities acquired. If HSBCs interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business is greater than the cost of acquisition, the excess is recognised immediately in the income statement.

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Goodwill is allocated to cash-generating units for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually, and whenever there is an indication that the cash-generating unit may be impaired, by comparing the present value of the expected future cash flows from a cash-generating unit with the carrying amount of its net assets, including attributable goodwill. Goodwill is stated at cost less accumulated impairment losses. Impairment losses are charged to the income statement.

Goodwill on acquisitions of interests in joint ventures and associates is included in Interests in associates and joint ventures.

At the date of disposal of a business, attributable goodwill is included in HSBCs share of net assets in the calculation of the gain or loss on disposal.

(ii) Intangible assets include the value of in-force long-term insurance business, computer software, trade names, mortgage servicing rights, customer lists, core deposit relationships, credit card customer relationships and merchant or other loan relationships. Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

– Intangible assets that have an indefinite useful life, or are not yet ready for use, are tested for impairment annually. This impairment test may be performed at any time during the year, provided it is performed at the same time every year. An intangible asset recognised during the current period is tested before the end of the current year.

– Intangible assets that have a finite useful life, except for the value of in-force long-term insurance business, are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected useful life. The amortisation of mortgage servicing rights is included within Net fee income.

For the accounting policy governing the value of in-force long-term insurance business (see Note 2x).

(iii) Intangible assets are amortised over their finite useful lives, generally on a straight line basis, as follows:

Trade names	10 years
Mortgage servicing rights	generally between 5 and 12 years

Internally generated software	between 3 and 5 years
Purchased software	between 3 and 5 years
Customer/merchant relationships	between 3 and 10 years
Other	generally 10 years

(p) Property, plant and equipment

Land and buildings are stated at historical cost, or fair value at the date of transition to IFRSs (deemed cost), less any impairment losses and depreciation calculated to write off the assets over their estimated useful lives as follows:

– freehold land is not depreciated;

– freehold buildings are depreciated at the greater of two per cent per annum on a straight-line basis or over their remaining useful lives; and

– leasehold buildings are depreciated over the unexpired terms of the leases, or over their remaining useful lives.

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Equipment, fixtures and fittings (including equipment on operating leases where HSBC is the lessor) are stated at cost less any impairment losses and depreciation calculated on a straight-line basis to write off the assets over their useful lives, which run to a maximum of 35 years but are generally between 5 years and 20 years.

Property, plant and equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

HSBC holds certain properties as investments to earn rentals or for capital appreciation, or both. Investment properties are included in the balance sheet at fair value with changes therein recognised in the income statement in the period of change. Fair values are determined by independent professional valuers who apply recognised valuation techniques.

(q) Finance and operating leases

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. When HSBC is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in ‘Loans and advances to banks’ or ‘Loans and advances to customers’ as appropriate. The finance income receivable is recognised in ‘Net interest income’ over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

When HSBC is a lessee under finance leases, the leased assets are capitalised and included in ‘Property, plant and equipment’ and the corresponding liability to the lessor is included in ‘Other liabilities’. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised in ‘Net interest income’ over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When acting as lessor, HSBC includes the assets subject to operating leases in ‘Property, plant and equipment’ and accounts for them accordingly. Impairment losses are recognised to the extent that residual values are not fully recoverable and the carrying value of the equipment is thereby impaired. When HSBC is the lessee, leased assets are not recognised on the balance sheet. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in ‘General and administrative expenses’ and ‘Other operating income’, respectively.

(r) Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

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

Deferred tax relating to actuarial gains and losses on post-employment benefits is recognised directly in equity. Deferred tax relating to fair value remeasurement of available-for-sale investments and cash flow hedging instruments which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

Notes on the Financial Statements (continued)

Note 2

(s) Pension and other post-employment benefits

HSBC operates a number of pension and other post-employment benefit plans throughout the world. These plans include both defined benefit and defined contribution plans and various other post-employment benefits such as post-employment health-care.

Payments to defined contribution plans and state-managed retirement benefit plans, where HSBCs obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as they fall due.

The defined benefit pension costs and the present value of defined benefit obligations are calculated at the reporting date by the schemes actuaries using the Projected Unit Credit Method. The net charge to the income statement mainly comprises the current service cost, plus the unwinding of the discount rate on plan liabilities, less the expected return on plan assets, and is presented in operating expenses. Past service costs are charged immediately to the income statement to the extent that the benefits have vested, and are otherwise recognised on a straight-line basis over the average period until the benefits vest. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred), as well as the effects of changes in actuarial assumptions. Actuarial gains and losses are recognised in Shareholders equity and presented in the Statement of Recognised Income and Expense in the period in which they arise.

The defined benefit liability recognised in the balance sheet represents the present value of defined benefit obligations adjusted for unrecognised past service costs and reduced by the fair value of plan assets. Any net defined benefit surplus is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

The costs of obligations arising from other defined post-employment benefits plans, such as defined benefit health-care plans, are accounted for on the same basis as defined benefit pension plans.

(t) Share-based payments

The cost of share-based payment arrangements with employees is measured by reference to the fair value of equity instruments on the date they are granted, and recognised as an expense on a straight-line basis over the vesting period, with a corresponding credit to the Share-based payment reserve. The fair value of equity instruments that are made available immediately, with no vesting period attached to the award, are expensed immediately.

Fair value is determined by using appropriate valuation models, taking into account the terms and conditions upon which the equity instruments were granted. Market performance conditions are reflected as an adjustment to the fair value of equity instruments at the date of grant, so that an award is treated as vesting irrespective of whether the market performance condition is satisfied, provided all other conditions are satisfied.

Vesting conditions, other than market performance conditions, are not factored into the initial estimate of the fair value at the grant date. They are taken into account by adjusting the number of equity instruments included in the measurement of the transaction, so that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. On a cumulative basis, no expense is recognised for equity instruments that do not vest because of a failure to satisfy non-market performance or service conditions.

Where an award has been modified, as a minimum the expense of the original award continues to be recognised as if it had not been modified. Where the effect of a modification is to increase the fair value of an award or increase the number of equity instruments, the incremental fair value of the award or incremental fair value of the extra equity instruments is recognised in addition to the expense of the original grant, measured at the date of modification, over the remaining vesting period.

A cancellation that occurs during the vesting period is treated as an acceleration of vesting, and recognised immediately for the amount that would otherwise have been recognised for services over the vesting period.

Where HSBC Holdings enters into share-based payment arrangements involving employees of subsidiaries, the cost is recognised in ‘Investment in subsidiaries’ and credited to the ‘Share-based payment reserve’ over the vesting period. Where the cost is recharged to the subsidiary, it is recognised as an inter-company debtor, not as an investment in subsidiary. Where a subsidiary has funded the share-based payment arrangement, ‘Investment

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in subsidiaries' is reduced upon exercise by the number of equity instruments exercised multiplied by their grant date fair value.

(u) Foreign currencies

Items included in the financial statements of each of HSBC's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements of HSBC are presented in US dollars, which is the Group's presentation currency.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognised directly in equity if the gain or loss on the non-monetary item is recognised directly in equity. Any exchange component of a gain or loss on a non- monetary item is recognised directly in the income statement if the gain or loss on the non-monetary item is recognised in the income statement.

In the consolidated financial statements, the assets, including related goodwill where applicable, and liabilities of branches, subsidiaries, joint ventures and associates whose functional currency is not US dollars, are translated into the Group's presentation currency at the rate of exchange ruling at the balance sheet date. The results of branches, subsidiaries, joint ventures and associates whose functional currency is not US dollars are translated into US dollars at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net investments, and exchange differences arising from retranslation of the result for the reporting period from the average rate to the exchange rate prevailing at the period end, are recognised in equity in the 'Foreign exchange reserve'. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of the separate financial statements. In consolidated financial statements these exchange differences are recognised in the 'Foreign exchange reserve' in shareholders' equity. On disposal of a foreign operation, exchange differences relating thereto and previously recognised in reserves are recognised in the income statement.

(v) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events, and a reliable estimate can be made of the amount of the obligation.

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of HSBC. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(w) Financial guarantee contracts

Liabilities under financial guarantees contracts which are not classified as insurance contracts, are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.

HSBC Holdings has issued financial guarantees to other Group entities. Where it has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, HSBC may elect to account for guarantees as an insurance contract. This election is made on a contract by contract basis, but the election for each contract is irrevocable. Where these guarantees have been classified as insurance contracts, they are measured and recognised as insurance liabilities.

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Notes on the Financial Statements (continued)

Note 2

(x) Insurance contracts

Through its insurance subsidiaries, HSBC issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which HSBC accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

While investment contracts with discretionary participation features are financial instruments, they continue to be treated as insurance contracts as permitted by IFRS 4.

Insurance contracts are accounted for as follows:

Premiums

Gross insurance premiums for non-life insurance business are reported as income over the term of the insurance contracts based on the proportion of risks borne during the accounting period. The unearned premium (the proportion of the business underwritten in the accounting year relating to the period of risk after the balance sheet date) is calculated on a daily or monthly pro rata basis.

Premiums for life insurance contracts are accounted for when receivable, except in unit-linked insurance contracts where premiums are accounted for when liabilities are established.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance contracts to which they relate.

Claims and reinsurance recoveries

Gross insurance claims for non-life insurance contracts include paid claims and movements in outstanding claims liabilities.

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration. Claims arising during the year include maturities, surrenders and death claims.

Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

Reinsurance recoveries are accounted for in the same period as the related claim.

Liabilities under insurance contracts

Outstanding claims liabilities for non-life insurance contracts are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claim- handling costs and a reduction for the expected value of salvage and other recoveries. Liabilities for claims incurred but not reported are made on an estimated basis, using appropriate statistical techniques.

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles.

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared with the carrying value of the liability. When a shortfall is identified it is charged immediately to the income statement.

Present value of in-force long-term insurance business

The value placed on insurance contracts that are classified as long-term insurance business and are in force at the balance sheet date is recognised as an asset.

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The PVIF long-term insurance business is determined by discounting future cash flows expected to emerge from business currently in force using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses and a risk discount rate that reflects the risk premium attributable to the respective long-term insurance business. Movements in the PVIF long-term insurance business are included in ‘Other operating income’ on a gross of tax basis.

Future profit participation

Where contracts provide discretionary profit participation benefits to policyholders, insurance liabilities include the net unrealised gains recognised in connection with the assets backing the contracts to the extent that policyholders will benefit from such gains. This benefit may arise from the contractual terms, regulation, or past distribution policy. The corresponding movement in liability is recognised in equity or in the income statement in the same proportion to the net unrealised gains on the assets. In the case of net unrealised losses, a deferred participating asset is recognised only to the extent that its recoverability is highly probable.

(y) Investment contracts

Customer liabilities under linked and certain non-linked investment contracts and the corresponding financial assets are designated at fair value. Movements in fair value are recognised in ‘Net income from financial investments designated at fair value’. Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Liabilities under linked investment contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

Investment management fees receivable are recognised in the income statement over the period of the provision of the investment management services, in ‘Net fee income’.

The incremental costs directly related to the acquisition of new investment contracts or renewing existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

(z) Debt securities issued and deposits by customers and banks

Financial liabilities are recognised when HSBC enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the consideration received net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss and financial guarantees, is at amortised cost, using the effective interest rate method to amortise the difference between proceeds net of directly attributable transaction costs and the redemption amount over the expected life of the debt.

(aa) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

HSBC Holdings plc shares held by HSBC are recognised in ‘Total shareholders’ equity’ as a deduction from retained earnings until they are cancelled. When such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in ‘Total shareholders’ equity’, net of any directly attributable incremental transaction costs and related income tax effects.

(ab) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months’ maturity from the date of acquisition, and include cash and balances at central banks, treasury bills and other eligible bills, loans and advances to banks, items in the course of collection from or in transmission to other banks, and certificates of deposit.

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Notes on the Financial Statements (continued)

Notes 3, 4 and 5

3 Net income from financial instruments designated at fair value

Net income from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value, including liabilities under investment contracts;
- all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities designated at fair value; and
- interest income, interest expense and dividend income in respect of:

  financial assets and liabilities designated at fair value; and

  derivatives managed in conjunction with the above,

except for interest arising on HSBCs issued debt securities, together with the interest element of derivatives managed in conjunction with them, which are recognised in Interest expense.

	2007 **US$m**	2006 US$m	2005 US$m
Net income/(expense) arising on:			
financial assets held to meet liabilities under insurance and investment contracts	**2,056**	1,552	1,760
other financial assets designated at fair value	**581**	217	90
derivatives managed in conjunction with financial assets designated at fair value	**(18)**	57	17
	2,619	1,826	1,867
liabilities to customers under investment contracts	**(940)**	(1,008)	(1,126)
HSBCs issued debt securities[1]	**336**	(277)	1,795
derivatives managed in conjunction with HSBCs issued debt securities	**2,476**	242	(1,392)
other financial liabilities designated at fair value	**(395)**	(125)	(112)
derivatives managed in conjunction with other financial liabilities designated at fair value	**(13)**	(1)	2
	1,464	(1,169)	(833)
Net income from financial instruments designated at fair value	**4,083**	657	1,034

1 *Gains and losses from changes in the fair value of HSBCs issued debt securities may arise from changes in HSBCs own credit spread. In 2007 HSBC recognised a US$3,055 million gain on changes in the fair value of these in struments arising from changes in HSBC own credit spread (2006: loss US$388 million).*

4 Gains from dilution of interests in associates

During 2007, certain HSBC associates issued new shares. HSBC did not subscribe for any of the shares issued under these offers and, as a result, its interests in the associates’ equity decreased. The assets of each associate substantially increased as a result of the new share issues and, as a consequence, the transactions resulted in an increase in HSBC’s share of the associates’ underlying net assets, notwithstanding the reduction in the Group’s proportionate ownership interests. This increase represents gains from dilution of the Group’s interests in the associates, and is presented in the income statement.

	Year ended 31 December 2007		
	Gains arising from dilution of HSBC’s interests	**HSBC’s interests after issue of new shares**	HSBC’s interests before issue of new shares
	US$m	**%**	%
Associates			
Industrial Bank[1]	**187**	**12.78**	15.98
Ping An Insurance	**485**	**16.78**	19.90
Bank of Communications[2]	**404**	**18.60**	19.90
Financiera Independencia S.A. de C.V.	**11**	**18.68**	19.90
Vietnam Technological and Commercial Joint Stock Bank	**5**	**14.44**	15.00
Gains arising from dilution of interests in associates	**1,092**		

1 *Investment held through Hang Seng Bank, a 62.14 per cent owned subsidiary of HSBC. The dilution gains therefore include a minority interest of US$71 million.*
2 *Subsequent to the dilution of its interests in Bank of Communications, HSBC increased its holding from 18.60 per cent to 19.01 per cent at 31 December 2007 (Note 21).*

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The dilution does not affect the classification of the Group’s investments as “Investments in associates” as the Group continues to retain significant influence (see Note 21).

5 Net earned insurance premiums

	Non-life insurance US$m	Life insurance (non-linked) US$m	Life insurance (linked) US$m	Investment contracts with discretionary participation features US$m	Total US$m
2007					
Gross written premiums	**1,853**	**4,892**	**2,350**	**1,890**	**10,985**
Movement in unearned premiums	**2**	**14**	**—**	**—**	**16**
Gross earned premiums	**1,855**	**4,906**	**2,350**	**1,890**	**11,001**
Gross written premiums ceded to reinsurers	**(385)**	**(357)**	**(1,166)**	**—**	**(1,908)**
Reinsurers’ share of movement in unearned premiums	**(22)**	**—**	**5**	**—**	**(17)**
Reinsurers’ share of gross earned premiums	**(407)**	**(357)**	**(1,161)**	**—**	**(1,925)**
Net earned insurance premiums	**1,448**	**4,549**	**1,189**	**1,890**	**9,076**
2006					
Gross written premiums	1,824	3,640	848	8	6,320
Movement in unearned premiums	122	14	(1)	—	135
Gross earned premiums	1,946	3,654	847	8	6,455
Gross written premiums ceded to reinsurers	(451)	(274)	(14)	—	(739)
Reinsurers’ share of movement in unearned premiums	(48)	—	—	—	(48)
Reinsurers’ share of gross earned premiums	(499)	(274)	(14)	—	(787)
Net earned insurance premiums	1,447	3,380	833	8	5,668
2005					
Gross written premiums	2,364	3,441	768	12	6,585
Movement in unearned premiums	(225)	2	(210)	—	(433)
Gross earned premiums	2,139	3,443	558	12	6,152
Gross written premiums ceded to reinsurers	(479)	(277)	(20)	—	(776)
Reinsurers’ share of movement in unearned premiums	60	—	—	—	60

Reinsurers share of gross earned premiums	(419)	(277)	(20)		(716)
Net earned insurance premiums	1,720	3,166	538	12	5,436

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Notes on the Financial Statements (continued)

Notes 6, 7and 8

6 Net insurance claims incurred and movement in liabilities to policyholders

	Non-life insurance US$m	Life insurance (non-linked) US$m	Life insurance (linked) US$m	Investment contracts with discretionary participation features US$m	Total US$m
2007					
Claims, benefits and surrenders paid	**1,017**	**940**	**790**	**1,080**	**3,827**
Movement in liabilities	**82**	**2,437**	**2,096**	**1,108**	**5,723**
Gross claims incurred and movement in liabilities	**1,099**	**3,377**	**2,886**	**2,188**	**9,550**
Reinsurers’ share of claims, benefits and surrenders paid	**(207)**	**(169)**	**(45)**	**–**	**(421)**
Reinsurers’ share of movement in liabilities	**36**	**518**	**(1,075)**	**–**	**(521)**
Reinsurers’ share of claims incurred and movement in liabilities	**(171)**	**349**	**(1,120)**	**–**	**(942)**
Net insurance claims incurred and movement in liabilities to policyholders	**928**	**3,726**	**1,766**	**2,188**	**8,608**
2006					
Claims, benefits and surrenders paid	889	814	495	–	2,198
Movement in liabilities	10	2,207	651	6	2,874
Gross claims incurred and movement in liabilities	899	3,021	1,146	6	5,072
Reinsurers’ share of claims, benefits and surrenders paid	(228)	(154)	(9)	–	(391)
Reinsurers’ share of movement in liabilities	57	(54)	20	–	23
Reinsurers’ share of claims incurred and movement in liabilities	(171)	(208)	11	–	(368)
Net insurance claims incurred and movement in	728	2,813	1,157	6	4,704

liabilities to policyholders					
2005					
Claims, benefits and surrenders paid	966	621	357	—	1,944
Movement in liabilities	72	1,683	445	9	2,209
Gross claims incurred and movement in liabilities	1,038	2,304	802	9	4,153
Reinsurers’ share of claims, benefits and surrenders paid	(146)	(111)	(11)	—	(268)
Reinsurers’ share of movement in liabilities	2	191	(11)	—	182
Reinsurers’ share of claims incurred and movement in liabilities	(144)	80	(22)	—	(86)
Net insurance claims incurred and movement in liabilities to policyholders	894	2,384	780	9	4,067

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7 Net operating income

Net operating income is stated after the following items of income, expense, gains and losses:

	2007	2006	2005
	US$m	US$m	US$m
Income			
Interest recognised on impaired financial assets	**404**	284	120
Fees earned on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**15,140**	11,182	9,077
Fees earned on trust and other fiduciary activities where HSBC holds or invests assets on behalf of its customers	**3,695**	2,909	2,912
Income from listed investments	**10,944**	7,304	6,819
Income from unlisted investments	**10,429**	9,192	5,001
Expense			
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**(50,876)**	(38,158)	(26,627)
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**(1,923)**	(1,826)	(1,357)
Fees payable relating to trust and other fiduciary activities where HSBC holds or invests assets on behalf of its customers	**(163)**	(103)	(238)
Gains/(losses)			
Gain/(loss) on disposal or settlement of loans and advances	**64**	24	(12)
Net impairment loss on loans and advances	**(17,177)**	(10,547)	(7,860)
Net (charge)/reversal of impairment allowances in respect of available-for-sale financial investments	**(86)**	(21)	42
Gains on disposal of property, plant and equipment, intangible assets and non-financial investments	**213**	781	703

8 Employee compensation and benefits

	2007	2006	2005
	US$m	US$m	US$m
Wages and salaries	**18,535**	16,186	14,008
Social security costs	**1,587**	1,194	1,072
Post-employment benefits	**1,212**	1,120	1,065
	21,334	18,500	16,145

The average number of persons employed by HSBC during the year was as follows:

	2007	2006	2005
Europe	**86,918**	84,170	82,638
Hong Kong	**27,702**	27,328	25,699

Rest of Asia-Pacific	**83,103**	68,182	50,605
North America	**58,117**	57,654	51,518
Latin America	**66,442**	58,863	54,825
Total	**322,282**	296,197	265,285

Post-employment benefit plans

Income statement charge

	2007 US$m	2006 US$m	2005 US$m
Defined benefit pension plans	**694**	602	618
HSBC Bank (UK) Pension Scheme	**490**	342	410
Other plans	**204**	260	208
Defined contribution plans	**485**	456	389
	1,179	1,058	1,007
Defined benefit healthcare plans	**33**	62	58
	1,212	1,120	1,065

Notes on the Financial Statements (continued)

Note 8

Net liabilities recognised on balance sheet in respect of defined benefit plans

	2007 US$m	2006 US$m
Defined benefit pension plans	**1,968**	4,553
HSBC Bank (UK) Pension Scheme	**808**	3,745
Other plans	**1,160**	808
Defined benefit healthcare plan	**925**	1,002
	2,893	5,555

HSBC pension plans

HSBC operates some 196 pension plans throughout the world, covering 86 per cent of HSBCs employees, with a total pension cost of US$1,179 million (2006: US$1,058 million; 2005: US$1,007 million), of which US$626 million (2006: US$668 million; 2005: US$546 million) relates to plans outside the UK.

Progressively, HSBC has been moving to defined contribution plans for all new employees. The pension cost for defined contribution plans, which cover 49 per cent of HSBCs employees, was US$485 million (2006: US$456 million; 2005: US$389 million).

Both HSBCs and, where relevant and appropriate, the trustees long-term investment objectives for defined benefit plans are:

- to limit the risk of the assets failing to meet the liability of the plans over the long-term; and
- to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of the defined benefit plans.

Both HSBC and, where relevant and appropriate, the trustees, consider that the investment policy should be consistent with meeting their mutual overall long-term investment objectives. In pursuit of these long-term objectives, a benchmark is established for the allocation of the defined benefit plan assets between asset classes. In addition, each permitted asset class has its own benchmarks, such as stock market or property valuation indices and desired levels of out-performance where relevant. This is intended to be revi ewed at least triennially within 18 months of the date at which the actuarial valuation is made, or more frequently if circumstances or local legislation so require. The process generally involves an extensive asset and liability review.

The Groups defined benefit plans, which cover 37 per cent of HSBCs employees, are predominantly funded plans with assets which, in the case of most of the larger plans, are held in trust or similar funds separate from HSBC. The plans are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the defined benefit obligations and related current service costs vary according to the economic conditions of the countries in which they are situated.

The largest plan exists in the UK, where the HSBC Bank (UK) Pension Scheme covers employees of HSBC Bank plc and certain other employees of HSBC. This plan comprises a funded defined benefit plan (the principal plan) which is closed to new entrants, and a defined contribution plan which was established on 1 July 1996 for new employees.

The principal plan holds a diversified portfolio of investments to meet future cash flow liabilities arising from accrued benefits as they fall due to be paid. The Trustee of the principal plan is required to produce a written

Statement of Investment Principles (SIP). The SIP sets out the principles governing how decisions about investments are made.

In 2006, HSBC and the Trustee of the principal plan agreed to change the investment strategy in order to reduce the investment risk. This involved switching from a largely equity-based strategy to a strategy largely based on holding bonds together with a more diverse range of investments. The principal plan committed to undertake a programme including entering into swap arrangements whereby the principal plan is committed to making LIBOR related interest payments in exchange for cash flows paid into the plan, based on a projection of the future benefit payments from the principal plan. The asset allocation for this strategy is:

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	%
Equities	15.0
Bonds	50.0
Alternative assets[1]	10.0
Property	10.0
Cash	15.0
	100.0

1 *Alternative assets include emerging market bonds, loans, and infrastructure assets* .

At 31 December 2007, this strategy was substantially in place and details of the swap arrangements are included in Note 44.

The latest actuarial investigation of the principal plan was made at 31 December 2005, by C G Singer, Fellow of the Institute of Actuaries, of Watson Wyatt Limited. At that date, the market value of the HSBC Bank (UK) Pension Scheme's assets was US$18,072 million (including assets relating to the defined benefit plan, the defined contribution plan, and additional voluntary contributions). The market value of the plan assets represented 89 per cent of the amount expected to be required, on the basis of the assumptions adopted, to provide the benefits accrued to members after allowing for expected future increases in earnings, and the resulting deficit amounted to US$2,065 million. The method adopted for this investigation was the projected unit method. The expected cash flows from the plan were projected by reference to the Retail Price Index ('RPI') swap break-even curve at 31 December 2005. Salary increases were assumed to be 1 per cent per annum above RPI and inflationary pension increases, subject to a minimum of 0 per cent and a maximum of 5 per cent, were assumed to be in line with RPI. The projected cash flows were discounted at the LIBOR swap curve at 31 December 2005 plus a margin for the expected return on the investment strategy of 110 basis points per annum. The mortality experience of the plan's pensioners over the three year period since the previous valuation was analysed and the mortality assumption set on the basis of this with allowances for medium cohort improvements on the PA92 series of tables from the valuation date.

In anticipation of the results of the 2005 investigation, on 22 December 2005 HSBC Bank plc made an additional contribution of US$1,746 million to the principal plan in order to reduce the deficit of the plan. Following receipt of the valuation results, HSBC agreed with the Trustee to meet a schedule of additional future funding payments, as set out below:

	US$m[1]	£m
2007	587	300
2012	933	465
2013	933	465
2014	933	465

1 *The payment schedule has been agreed with the Trustee in pounds sterling and the equivalent US dollar amounts are shown at the exchange rate effective as at 31 December 2007, or as at the date of payment in respect of the contribution made during the period.*

HSBC considers that the contributions set out above are sufficient to meet the deficit as at 31 December 2005 over the agreed period. HSBC Bank plc made the contribution of US$587 million in March 2007

HSBC also decided to make ongoing contributions to the principal plan in respect of the accrual of benefits of defined benefit section members at the rate of 36 per cent of pensionable salaries from 1 January 2007, until the completion of the next actuarial valuation, due at 31 December 2008. During 2006 HSBC paid contributions at the rate of 20 per cent of pensionable salaries. A further 2 per cent of pensionable salaries is being paid over the period 1 January 2007 to 31 December 2014 to make good the difference in contributions during 2006.

As part of the 31 December 2005 valuation, calculations were also carried out as to the amount of assets that might be needed to meet the liabilities if the plan was discontinued and the members' benefits bought out with an insurance company (although in practice this may not be possible for a plan of this size) or the Trustee continued to run the plan without the support of HSBC. The amount required under this approach is estimated to be US$26,700 million as at 31 December 2005. In estimating the solvency position for this purpose, a more prudent assumption about future mortality was made than for the assessment of the ongoing position and it was assumed that the Trustee would alter the investment strategy to be an appropriately matched portfolio of cash and interest and inflation swaps. An explicit allowance for expenses was also included.

The benefits payable from the defined benefit plan are expected to be as shown in the chart below:

Notes on the Financial Statements (continued)

Note 8

In Hong Kong, the HSBC Group Hong Kong Local Staff Retirement Benefit Scheme covers employees of The Hongkong and Shanghai Banking Corporation and certain other employees of HSBC Group. The scheme comprises a funded defined benefit scheme (which provides a lump sum on retirement but is now closed to new members) and a defined contribution scheme. The latter was established on 1 January 1999 for new employees. The latest valuation of the defined benefit plan was made at 31 December 2006 and was performed by Estella Chiu, Fellow of the Society of Actuaries of the United States of America, of HSBC Life (International) Limited, a subsidiary of HSBC Holdings. At the valuation date, the market value of the defined benefit scheme's assets was US$1,109 million. On an ongoing basis, the actuarial value of the scheme's assets represented 119 per cent of the actuarial present value of the benefits accrued to members, after allowing for expected future increases in salaries, and the resulting surplus amounted to US$174 million. On a wind-up basis, the scheme's assets represented 126 per cent of the members' vested benefits, based on current salaries, and the resulting surplus amounted to US$228 million. The attained age method has been adopted for the valuation and the major assumptions used in this valuation were a discount rate of 4 per cent per annum and long-term salary increases of 3 per cent per annum (with short-term deviation from 2007 to 2008).

The HSBC North America (U.S.) Retirement Income Plan was formed with effect from the close of business on 31 December 2004 by the merger of the HSBC Bank USA Pension Plan and the Household International Retirement Income Plan. This plan covers employees of HSBC Bank USA, HSBC Finance, and certain other employees of HSBC USA. It comprises a final average pay plan (now closed to new participants) and a cash balance plan. All new employees participate in the cash balance plan. The most recent actuarial valuation of the plan was made at 1 January 2007 by Pedro Nebres, Fellow of the Society of Actuaries and John P. Ennenbach, Enrolled Actuary, of Mercer. Both are members of the American Academy of Actuaries. At that date, the market value of the merged plan's assets was US$2,577 million and the actuarial value of assets was US$2,504 million. The actuarial value of the assets represented 119 per cent of the benefits accrued to members, after allowing for expected future increases in earnings. The resulting surplus amounted to US$407 million. The method employed for this valuation was the projected unit credit method and the main assumptions used were a discount rate of 8 per cent per annum and average salary increases of 3.75 per cent per annum.

The HSBC Bank (UK) Pension Scheme, The HSBC Group Hong Kong Local Staff Retirement Benefit Scheme, and the HSBC North America (U.S.) Retirement Income Plan cover 33 per cent of HSBC's employees.

HSBC healthcare benefits plans

HSBC also provides post-employment healthcare benefits under plans in the UK, the US, Canada, Mexico, France and Brazil, the majority of which are unfunded. Post-employment healthcare benefits plans are accounted for in the same manner as defined benefit pension plans. The plans are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the defined benefit obligation and related current service cost vary according to the economic conditions of the countries in which they are situated. Total healthcare cost was US$33 million (2006: US$62 million; 2005: US$58 million).

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Post-employment defined benefit plans principal actuarial financial assumptions

The principal actuarial financial assumptions used to calculate the Groups obligations under its defined benefit pension and post-employment healthcare plans at 31 December 2007, were as follows. These assumptions will also form the basis for measuring periodic costs under the plans in 2008:

	Discount rate %	Inflation rate %	Rate of increase for pensions[1] %	Rate of pay increase %	Healthcare cost trend: Initial rate %	Healthcare cost trend: Ultimate rate %	Healthcare cost trend: Year of ultimate rate
UK	**5.8**	**3.3**	**3.3**	**4.3**	**7.3**	**7.3**	**n/a**
Hong Kong	**3.45**	**n/a**	**n/a**	**5.02**	**n/a**	**n/a**	**n/a**
US	**6.55**	**2.5**	**n/a**	**3.75**	**9.6**	**5.0**	**2014**
Jersey	**5.8**	**3.3**	**3.3**	**5.05**	**n/a**	**n/a**	**n/a**
Mexico	**7.88**	**3.5**	**2.0**	**4.5**	**6.0**	**6.0**	**n/a**
Brazil	**10.75**	**4.5**	**4.5**	**4.5**	**10.5**	**5.5**	**2017**
France	**5.5**	**2.0**	**2.0**	**3.0**	**6.0**	**6.0**	**n/a**
Canada	**5.43**	**2.5**	**n/a**	**3.86**	**9.0**	**4.9**	**2012**
Switzerland	**3.3**	**1.5**	**n/a**	**2.38**	**n/a**	**n/a**	**n/a**
Germany	**5.5**	**2.0**	**2.0**	**3.0**	**n/a**	**n/a**	**n/a**

1 *Rate of increase for pensions in payment and deferred pension.*

The principal actuarial financial assumptions used to calculate the Groups obligations under its defined benefit pension and post-employment healthcare plans at 31 December 2006, were as follows. These assumptions also formed the basis for measuring periodic costs under the plans in 2007:

	Discount rate %	Inflation rate %	Rate of increase for pensions[1] %	Rate of pay increase %	Healthcare cost trend: Initial rate %	Healthcare cost trend: Ultimate rate %	Healthcare cost trend: Year of ultimate rate
UK	5.1	3.0	3.0	4.0	7.0	7.0	n/a
Hong Kong	3.75	n/a	n/a	3.0	n/a	n/a	n/a
US	5.9	2.5	n/a	3.75	10.5	5.0	2014
Jersey	5.1	3.0	3.0	4.75	n/a	n/a	n/a
Mexico	8.0	3.5	2.0	4.0	6.75	6.75	n/a
Brazil	10.75	4.5	4.5	4.5	11.0	5.5	2016
France	4.5	2.0	2.0	3.0	6.0	6.0	n/a
Canada	5.19	2.5	n/a	3.47	9.9	4.9	2012
Switzerland	2.25	1.5	n/a	2.25	n/a	n/a	n/a
Germany	4.5	2.0	2.0	3.0	n/a	n/a	n/a

1 *Rate of increase for pensions in payment and deferred pension.*

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Notes on the Financial Statements (continued)

Note 8

The principal actuarial financial assumptions used to calculate the Group□s obligations under its defined benefit pension and post-employment healthcare plans at 31 December 2005, were as follows. These assumptions also formed the basis for measuring periodic costs under the plans in 2006:

	Discount rate %	Inflation rate %	Rate of increase for pensions[1] %	Rate of pay increase %	Healthcare cost trend: Initial rate %	Healthcare cost trend: Ultimate rate %	Healthcare cost trend: Year of ultimate rate
UK	4.75	2.7	2.7	3.7[2]	6.7	6.7	n/a
Hong Kong	4.2	n/a	n/a	5.0	n/a	n/a	n/a
US	5.7	2.5	n/a	3.75	10.4	5.0	2013
Jersey	4.75	2.7	2.7	4.45	n/a	n/a	n/a
Mexico	8.90	3.75	3.75	4.5	7.3	7.3	n/a
Brazil	11.75	5.5	5.5	5. 5	12.5	6.5	2016
France	4.1	2.0	2.0	3.0	6.0	6.0	n/a
Canada	5.25	2.5	n/a	3. 0	7.3	4.5	2009
Switzerland	2.25	1.5	n/a	2.25	n/a	n/a	n/a
Germany	4.0	2.0	2.0	3.0	n/a	n/a	n/a

1 *Rate of increase for pensions in payment and deferred pension.*
2 *The 2005 rate of pay increase assumptions disclosed have been increased from 3.2 per cent to 3.7 per cent to reflect an age-related promotional salary scale that was included in the obligation calculation but not in the disclosed assumption.*

HSBC determines the discount rates to be applied to its obligations in consultation with the plans□ local actuaries, on the basis of current average yields of high quality (AA rated or equivalent) debt instruments, with maturities consistent with those of the defined benefit obligations. The expected return on plan assets represents the best estimate of long-term future asset returns, which takes into account historical market returns plus additional factors such as the current rate of inflation and interest rates.

Mortality assumptions are increasingly significant in measuring the Group□s obligations under its defined benefit pension and post-employment healthcare plans, particularly given the maturity of the plans. The mortality tables and average life expectancy at 65 used at 31 December 2007 were as follows:

Mortality table	**Life expectancy at age 65 for a male member currently:**		**Life expectancy at age 65 for a female member currently:**	
	Aged 65	**Aged 45**	**Aged 65**	**Aged 45**

UK	PA92[1]	**20.4**	**21.7**	**23.4**	**24.6**
Hong Kong	n/a	**n/a**	**n/a**	**n/a**	**n/a**
US	RP 2000 fully generational	**19.1**	**20.6**	**21.1**	**22.0**
Jersey	PA92[2]	**21.9**	**23.0**	**24.8**	**25.8**
Mexico	EMSSA-97	**16.5**	**16.5**	**19.9**	**19.9**
Brazil	RP 2000 fully generational	**19.1**	**20.6**	**21.1**	**22.0**
France	TG 05	**22.9**	**25.7**	**26.4**	**29.3**
Canada pension plans	Between UP94 C2015 and UP94 C2027	**19.0 and 20.0**	**19.0 and 20.0**	**21.6 and 22.1**	**21.6 and 22.1**
Canada healthcare plan	UP94 C2025	**19.8**	**19.8**	**22.0**	**22.00**
Switzerland	BVG 2005 (3% load)	**17.9**	**17.9**	**21.0**	**21.0**
Germany	Heubeck 2005 G	**18.1**	**20.8**	**22.2**	**24.9**

1 *PA92 with standard improvements to 2005 and medium cohort improvements thereafter.*
2 *PA92 year of birth with medium cohort improvements.*

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The mortality tables and average life expectancy at 65 used at 31 December 2006 were as follows:

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
UK	PA92[1]	20.3	21.6	23.3	24.6
Hong Kong	n/a	n/a	n/a	n/a	n/a
US	RP 2000 projected to 2005	18.7	18.7	20.9	20.9
Jersey	PA92[1]	20.3	21.6	23.3	24.6
Mexico	GAM83	16.6	16.6	16.6	16.6
Brazil	RP 2000 imp 2006	18.9	20.5	21.0	21.9
France	TG 05	22.8	25.6	26.3	29.1
Canada pension plans	Between UP94 C2015 and UP94 C2027	19.0 and 20.0	19.0 and 20.0	21.6 and 22.1	21.6 and 22.1
Canada healthcare plan	UP94 C2025	19.8	19.8	22.0	22.0
Switzerland	EVK2000 and BVG2000	17.6 and 17.8	17.6 and 17.8	20.4 and 21.1	20.4 and 21.1
Germany	Heubeck 2005 G	18.1	20.8	22.2	24.9

1 *PA92 with standard improvements to 2005 and medium cohort improvements thereafter.*

Actuarial assumption sensitivities

The discount rate is sensitive to changes in market conditions arising during the reporting period. The mortality rates used are sensitive to experience from the plan member profile. The following table shows the effect of changes in these and the other key assumptions on the principal plan:

	HSBC Bank (UK) Pension Scheme	
	2007 US$m	2006 US$m
Discount rate		
Change in pension obligation at year end from a 25bps increase	**(989)**	(1,086)
Change in pension obligation at year end from a 25bps decrease	**1,063**	1,147
Change in 2008 pension cost from a 25bps increase	**(20)**	(20)
Change in 2008 pension cost from a 25bps decrease	**20**	22
Rate of inflation		
Change in pension obligation at year end from a 25bps increase	**1,063**	1,147
Change in pension obligation at year end from a 25bps decrease	**(989)**	(1,086)
Change in 2008 pension cost from a 25bps increase	**82**	88
Change in 2008 pension cost from a 25bps decrease	**(76)**	(77)
Rate of increase for pensions in payment and deferred pensions		
Change in pension obligation at year end from a 25bps increase	**823**	909
Change in pension obligation at year end from a 25bps decrease	**(758)**	(872)
Change in 2008 pension cost from a 25bps increase	**60**	57
Change in 2008 pension cost from a 25bps decrease	**(56)**	(55)
Rate of pay increase		
Change in pension obligation at year end from a 25bps increase	**240**	287

Change in pension obligation at year end from a 25bps decrease	**(231)**	(275)
Change in 2008 pension cost from a 25bps increase	**22**	31
Change in 2008 pension cost from a 25bps decrease	**(20)**	(27)
Mortality		
Change in pension obligation from each additional year of longevity assumed	**683**	756

Notes on the Financial Statements (continued)

Note 8

The following table shows the effect of changes in the discount rate and in mortality rates on plans other than the principal plan:

	Other plans	
	2007 US$m	2006 US$m
Change in defined benefit obligation at year end from a 25bps increase in discount rate	**(312)**	(276)
Change in 2008 defined benefit charge from a 25bps increase in discount rate	**(8)**	(5)
Increase in defined benefit obligation from each additional year of longevity assumed	**137**	167

Defined benefit pension plans

The calculation of the net liability under the Group's defined benefit pension plans is set out below together with the expected rates of return and plan assets used to measure the net defined benefit pension costs in each subsequent year.

	HSBC Bank (UK) Pension Scheme			
	2007		2006	
	Expected rates of return %	**Value US$m**	Expected rates of return %	Value US$m
Fair value of plan assets		**22,704**		20,587
Equities	**8.3**	**4,580**	8.0	5,046
Bonds	**6.1**	**15,341**	5.3	12,189
Property	**7.3**	**1,878**	7.0	2,056
Other	**5.1**	**905**	4.3	1,296
Defined benefit obligation		**(23,512)**		(24,332)
Present value of funded obligations		**(23,512)**		(24,332)
Present value of unfunded obligations		**–**		–
Net liability		**(808)**		(3,745)

	Other plans			
	2007		2006	
	Expected rates of		Expected rates of	

	return[1] %	**Value US$m**	return[1] %	Value US$m
Fair value of plan assets		**7,768**		7,116
Equities	**8.3**	**3,439**	8.1	3,209
Bonds	**5.4**	**3,452**	5.7	3,302
Property	**7.3**	**111**	7.0	138
Other	**5.7**	**766**	4.6	467
Defined benefit obligation		**(8,873)**		(7,916)
Present value of funded obligations		**(8,453)**		(7,534)
Present value of unfunded obligations		**(420)**		(382)
Effect of limit on plan surpluses		**(55)**		(9)
Unrecognised past service cost		**–**		1
Net liability		**(1,160)**		(808)

1 *The expected rates of return are weighted on the basis of the fair value of the plan assets.*

Plan assets include US$86 million (2006: US$87 million) of equities issued by HSBC and US$572 million (2006: US$188 million) of other assets issued by HSBC. The fair value of plan assets includes derivatives entered into with the HSBC Bank (UK) Pension Scheme with a positive fair value of US$248 million at 31 December 2007 (2006: US$273 million negative fair value) and US$63 million positive fair value (2006: US$14 million positive fair value) in respect of The HSBC International Staff Retirements Benefit Scheme. Further details of these swap arrangements are included in Note 44.

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Changes in the present value of defined benefit obligations

	HSBC Bank (UK) Pension Scheme		Other plans	
	2007 US$m	2006 US$m	**2007 US$m**	2006 US$m
At 1 January	**24,332**	20,587	**7,916**	7,102
Current service cost	**454**	456	**347**	304
Interest cost	**1,247**	1,055	**398**	366
Contributions by employees	**–**	–	**37**	28
Actuarial (gains)/losses	**(2,395)**	30	**475**	211
Benefits paid	**(632)**	(696)	**(529)**	(386)
Past service cost – vested immediately	**–**	–	**6**	9
Acquisitions	**–**	–	**–**	10
Reduction in liabilities resulting from curtailments	**–**	–	**(63)**	(5)
Liabilities extinguished on settlements	**–**	–	**(16)**	(21)
Exchange differences	**506**	2,900	**302**	298
At 31 December	**23,512**	24,332	**8,873**	7,916

Changes in the fair value of plan assets

	HSBC Bank (UK) Pension Scheme		Other plans	
	2007 US$m	2006 US$m	**2007 US$m**	2006 US$m
At 1 January	**20,587**	17,396	**7,116**	6,356
Expected return on plan assets	**1,211**	1,169	**486**	421
Contributions by HSBC	**1,058**	240	**211**	193
– normal	**471**	240	**199**	160
– special	**587**	–	**12**	33
Contributions by employees	**–**	–	**37**	28
Experience gains	**29**	–	**157**	203
Benefits paid	**(632)**	(696)	**(467)**	(343)
Assets distributed on curtailments	**–**	–	**–**	(4)
Assets distributed on settlements	**–**	–	**(17)**	(14)
Exchange differences	**451**	2,478	**245**	276
At 31 December	**22,704**	20,587	**7,768**	7,116

The actual return on plan assets for the year ended 31 December 2007 was US$1,883 million (2006: US$1,793 million). HSBC expects to make US$671 million of contributions to defined benefit pension plans during 2008.

Benefits expected to be paid from the plans to retirees over each of the next five years, and in aggregate for the five years thereafter, are:

	2008 US$m	2009 US$m	2010 US$m	2011 US$m	2012 US$m	2013-2017 US$m
HSBC Bank (UK) Pension Scheme	712	726	770	801	853	5,419
Other significant plans	446	448	467	504	548	3,084

Total expense recognised in the income statement in ‘Employee compensation and benefits’

	HSBC Bank (UK) Pension Scheme			Other plans		
	2007 US$m	2006 US$m	2005 US$m	**2007 US$m**	2006 US$m	2005 US$m
Current service cost	**454**	456	383	**347**	304	283
Interest cost	**1,247**	1,055	981	**398**	366	333
Expected return on plan assets	**(1,211)**	(1,169)	(954)	**(486)**	(421)	(401)
Past service cost	**—**	—	—	**7**	11	(3)
(Gains)/losses on curtailments	**—**	—	—	**(63)**	—	(4)
(Gains)/losses on settlements	**—**	—	—	**1**	—	—
Total expense	**490**	342	410	**204**	260	208

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Notes on the Financial Statements (continued)

Note 8

Summary

	HSBC Bank (UK) Pension Scheme			
	2007 US$m	2006 US$m	2005 US$m	2004 US$m
Defined benefit obligation	**(23,512)**	(24,332)	(20,587)	(19,988)
Fair value of plan assets	**22,704**	20,587	17,396	15,105
Net deficit	**(808)**	(3,745)	(3,191)	(4,883)
Experience gains/(losses) on plan liabilities	**(64)**	540	70	401
Experience gains on plan assets	**29**	–	1,623	506
Gains/(losses) from changes in actuarial assumptions	**2,459**	(570)	(2,038)	(1,357)
Total net actuarial gains/(losses)	**2,424**	(30)	(345)	(450)

	Other plans			
	2007 US$m	2006 US$m	2005 US$m	2004 US$m
Defined benefit obligation	**(8,873)**	(7,916)	(7,102)	(6,501)
Fair value of plan assets	**7,768**	7,116	6,356	5,823
Net deficit	**(1,105)**	(800)	(746)	(678)
Experience losses on plan liabilities	**(354)**	(167)	(113)	(42)
Experience gains on plan assets	**157**	203	78	3
Losses from changes in actuarial assumptions	**(121)**	(44)	(393)	(243)
Total net actuarial gains/(losses)	**(318)**	(8)	(428)	(282)

Actuarial gains and losses represent experience adjustments on plan assets and liabilities as well as adjustments arising from changes in actuarial assumptions. Total cumulative actuarial gains recognised in equity at 31 December 2007 were US$563 million (2006: US$1,543 million cumulative losses).

The total effect of the limit on plan surpluses recognised within actuarial losses in equity during 2007 was a US$42 million loss excluding exchange differences of US$4 million (2006: US$2 million loss and exchange difference of nil).

Defined benefit healthcare plans

	2007	2006
	Expected	Expected

	rates of return[1] %	**Value US$m**	rates of return [1] %	Value US$m
Fair value of plan assets		**146**		133
Equities	**13.0**	**44**	14.5	40
Bonds	**7.9**	**102**	8.5	93
Defined benefit obligation		**(1,038)**		(1,106)
Present value of funded obligations		**(191)**		(219)
Present value of unfunded obligations		**(847)**		(887)
Unrecognised past service cost		**(33)**		(29)
Net liability		**(925)**		(1,002)

1 *The expected rates of return are weighted on the basis of the fair value of the plan assets.*

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Changes in the present value of defined benefit obligations

	2007 **US$m**	2006 US$m
At 1 January	**1,106**	1,004
Current service cost	**25**	19
Interest cost	**67**	64
Contributions by employees	**2**	2
Actuarial (gains)/losses	**(109)**	37
Benefits paid	**(54)**	(52)
Past service cost:		
vested immediately	**(2)**	1
unvested benefits	**(2)**	
Reduction in liabilities resulting from curtailments	**(42)**	(9)
Liabilities extinguished on settlements	**(2)**	(1)
Exchange differences	**49**	41
At 31 December	**1,038**	1,106

Changes in the fair value of plan assets

	2007 **US$m**	2006 US$m
At 1 January	**133**	107
Expected return on plan assets	**13**	11
Contributions by HSBC	**19**	39
Experience gains/(losses)	**(6)**	(1)
Benefits paid	**(11)**	(20)
Assets distributed on curtailments	****	(1)
Assets distributed on settlements	**(2)**	
Exchange differences	****	(2)
At 31 December	**146**	133

The actual return on plan assets for the year ended 31 December 2007 was US$7 million (2006: US$10 million).

HSBC expects to make US$18 million (2006: US$19 million) of contributions to post-employment healthcare benefit plans during 2008. Benefits expected to be paid from the plans to retirees over each of the next five years, and in aggregate for the five years thereafter, are:

	2008 US$m	2009 US$m	2010 US$m	2011 US$m	2012 US$m	2013-2017 US$m
Significant plans	50	52	54	56	58	309

Total expense recognised in the income statement in Employee compensation and benefits

	2007 **US$m**	2006 US$m	2005 US$m
Current service cost	**25**	19	18
Interest cost	**67**	64	63
Expected return on plan assets	**(13)**	(11)	(10)
Past service cost	**(4)**	(1)	(13)
Losses on curtailments	**(42)**	(8)	

Losses on settlements	—	(1)	—
Total expense	**33**	62	58

Notes on the Financial Statements (continued)

Notes 8 and 9

Summary

	2007 US$m	2006 US$m	2005 US$m	2004 US$m
Defined benefit obligation	**(1,038)**	(1,106)	(1,004)	(982)
Fair value of plan assets	**146**	133	107	79
Net deficit	**(892)**	(973)	(897)	(903)
Experience gains/(losses) on plan liabilities	**15**	(12)	19	(15)
Experience gains/(losses) on plan assets	**(6)**	(1)	1	
Gains/(losses) from changes in actuarial assumptions	**94**	(25)	(63)	20
Total net actuarial gains/(losses)	**103**	(38)	(43)	5

Actuarial gains and losses represent experience adjustments on plan assets and liabilities as well as adjustments arising from changes in actuarial assumptions. Total cumulative net actuarial gains recognised in equity at 31 December 2007 were US$27 million (2006: US$76 million cumulative losses).

The actuarial assumptions of the healthcare cost trend rates have a significant effect on the amounts recognised. A one percentage point change in assumed healthcare cost trend rates would have the following effects on amounts recognised in 2007:

	2007		2006	
	1% increase US$m	**1% decrease US$m**	1% increase US$m	1% decrease US$m
Increase/(decrease) of the aggregate of the current service cost and interest cost	**14**	**(10)**	8	(6)
Increase/(decrease) of defined benefit obligation	**110**	**(100)**	103	(111)

HSBC Holdings

Employee compensation and benefit expense in respect of HSBC Holdings employees in 2007 amounted to US$257 million (2006: US$193 million). The average number of persons employed by HSBC Holdings during 2007 was 595 (2006: 505).

Employees of HSBC Holdings who are members of defined benefit pension plans are principally members of either the HSBC Bank (UK) Pension Scheme or the HSBC International Staff Retirement Benefit Scheme. HSBC Holdings pays contributions to plans in accordance with schedules determined by the Trustees following consultation with qualified actuaries.

Directors emoluments

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

	2007	2006	2005
	US$000	US$000	US$000
Fees	**2,626**	2,660	2,100
Salaries and other emoluments	**7,929**	7,774	12,869
Bonuses	**8,938**	10,705	13,264
	19,493	21,139	28,233
Gains on the exercise of share options	**13**	3	17
Vesting of Long-Term Incentive awards	**4,563**	18,975	24,221

In addition, there were payments under retirement benefit agreements with former Directors of US$1,183,960 (2006: US$996,098). The provision at 31 December 2007 in respect of unfunded pension obligations to former Directors amounted to US$18,491,117 (2006: US$17,759,454).

During the year, aggregate contributions to pension schemes in respect of Directors were US$545,854 (2006: US$889,241), including US$460,564 (2006: US$395,740) arising from a Director's waiver of bonus.

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee. Details of Directors' remuneration, share options and conditional

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awards under the Restricted Share Plan 2000 and The HSBC Share Plan are included in the Directors Remuneration Report on pages 322 to 332.

9 Auditors remuneration

Auditors remuneration in relation to the statutory audit amounted to US$52.3 million (2006: US$44.7 million; 2005: US$47.0 million). The following fees were payable by HSBC to the Groups principal auditor, KPMG Audit Plc and its associates (together KPMG):

	2007 US$m	2006 US$m	2005 US$m
Audit fees for HSBC Holdings statutory audit[1]	**3.0**	2.7	3.0
fees relating to current year	**3.0**	2.7	2.8
fees relating to prior year			0.2
Fees payable to KPMG for other services provided to HSBC	**79.1**	64.1	79.6
Audit-related services:			
audit of HSBCs subsidiaries, pursuant to legislation[2]	**45.2**	40.4	42.5
other services pursuant to legislation[3]	**19.4**	15.4	29.2
Tax services[4]	**2.9**	2.0	2.6
Other services:			
services relating to information technology[5]	**0.4**	0.6	
services related to corporate finance transactions[6]	**1.8**	1.6	0.3
all other services[7]	**9.4**	4.1	5.0
Total fees payable	**82.1**	66.8	82.6

1 *Fees payable to KPMG Audit Plc for the statutory audit of the consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings. They exclude amounts payable for the statutory audit of HSBC Holdings subsidiaries which have been included in Fees payable to KPMG for other services provided to HSBC.*
2 *Including fees payable to KPMG for the statutory audit of HSBCs subsidiaries.*
3 *Including services for assurance and other services that relate to statutory and regulatory filings, including comfort letters and interim reviews. Other services pursuant to legislation included fees paid to KPMG in respect of work relating to preparation for reporting under section 404 of the Sarbanes-Oxley Act of US$1.6 million (2006: US$2.2 million; 2005: US$11.7 million). Other accounting firms were paid a total of US$2.5 million (2006: US$8.3 million; 2005: US$16.7 million) for work on this project.*
4 *Including tax compliance services and tax advisory services.*
5 *Including advice on IT security and business continuity and performing agreed-upon IT testing procedures.*
6 *Including fees payable to KPMG for transaction-related work, including US debt issuances.*
7 *Including other assurance and advisory services such as translation services, ad-hoc accounting advice and review of financial models.*

No fees were payable by HSBC to KPMG for the following types of services: internal audit services, valuation and actuarial services, services related to litigation, and services related to recruitment and remuneration. The following fees were payable by HSBCs associated pension schemes to KPMG:

	2007 US$000	2006 US$000	2005 US$000
Audit fees	**612**	581	550
Tax services	**14**	23	17
All other services	**36**	23	5

Total fees payable	**662**	627	572

No fees were payable by HSBCs associated pension schemes to KPMG for the following types of services: other services pursuant to legislation, services relating to information technology, internal audit services, valuation and actuarial services, services related to litigation, services related to recruitment and remuneration, and services related to corporate finance transactions.

In addition to the above, KPMG estimate they have been paid fees of US$3.4 million (2006: US$2.1 million; 2005: US$4.5 million) by parties other than HSBC but where HSBC is connected with the contracting party and therefore may be involved in appointing KPMG. These fees arise from services such as auditing mutual funds managed by HSBC and reviewing the financial position of corporate concerns which borrow from HSBC.

Fees payable to KPMG for non-audit services for HSBC Holdings are not disclosed separately because such fees are disclosed on a consolidated basis for HSBC Group.

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10 Share-based payments

During 2007, US$870 million was charged to the income statement in respect of share-based payment transactions settled in equity (2006: US$854 million; 2005: US$540 million). This expense, which was computed from the fair values of the share-based payment transactions when contracted, arose under employee share awards made in accordance with HSBCs reward structures.

Calculation of fair values

Fair values of share options/awards, measured at the date of grant of the option/award, are calculated using a binomial lattice model methodology that is based on the underlying assumptions of the Black-Scholes model. When modelling options/awards with vesting dependent on HSBCs Total Shareholder Return (TSR) over a period, the TSR performance targets are incorporated into the model using Monte Carlo simulation. The expected life of options depends on the behaviour of option holders, which is incorporated into the option model on the basis of historic observable data. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

The significant weighted average assumptions used to estimate the fair value of the options granted were as follows:

	HSBC Holdings Group Share Option Plan	**1-year Savings-Related Share Option Plan**	**3-year Savings-Related Share Option Plans**	**5-year Savings-Related Share Option Plans**	**The HSBC Share Plan**
2007					
Risk-free interest rate[1] (%)		**5.6**	**5.5**	**5.4**	
Expected life[2] (years)		**1**	**3**	**5**	
Expected volatility[3] (%)		**17**	**17**	**17**	
Share price at grant date (£)		**9.24**	**9.24**	**9.24**	
2006					
Risk-free interest rate[1] (%)		4.7	4.8	4.7	
Expected life[2] (years)		1	3	5	
Expected volatility[3] (%)		17	17	17	
Share price at grant date (£)		9.54	9.54	9.54	
2005					
Risk-free interest rate[1] (%)	4.6		4.3	4.3	4.3
Expected life[2] (years)	7.8		3	5	5
Expected volatility[3] (%)	20		20	20	20
Share price at grant date (£)	8.30		8.68	8.68	8.37

1 *The risk-free rate was determined from the UK gilts yield curve for the HSBC Holdings Group Share Option Plan awards and UK Savings-Related Share Option Plans. A similar yield curve was used for the International Savings-Related Share Option Plans.*
2 *Expected life is not a single input parameter but a function of various behavioural assumptions.*
3 *Expected volatility is estimated by considering both historic average share price volatility and implied volatility derived from traded options over HSBC shares of similar maturity to those of the employee*

options.

Expected dividends are incorporated into the valuation model for options and shares, where applicable. The expected US dollar denominated dividend growth was determined to be 10 per cent for the first 3 years (2006: 9 per cent for first year) and 8 per cent thereafter (2006: 8 per cent), in line with consensus analyst forecasts.

The HSBC Share Plan

The HSBC Share Plan was adopted by HSBC Holdings in 2005. Under this plan, performance share awards, restricted share awards and share option awards may be made. The aim of the HSBC Share Plan is to align the interests of executives with the creation of shareholder value and recognise individual performance and potential. Awards are also made under this plan for recruitment and retention purposes.

Performance share awards

Performance shares are awarded to executive Directors and other senior executives after taking into account individual performance in the previous year. Each award is divided into two equal parts for testing attainment against pre-determined benchmarks. One half of the award is subject to a TSR measure, based on HSBCs ranking against a comparator group of 28 major banks; the other half is subject to an earnings per share target. For each element of the

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award, shares are released to the employee on a sliding scale from 30 to 100 per cent of the award, depending on the scale of achievement against the benchmarks, providing that the minimum criteria for each performance measure has been met and subject to the Remuneration Committee being satisfied that HSBCs financial performance has shown a sustained improvement in the period since the award date. The shares vest after three years to the extent that the vesting conditions are satisfied.

	2007 Number (000s)	2006 Number (000s)
Outstanding at 1 January	**10,367**	5,077
Additions during the year	**3,263**	5,312
Forfeited in the year	**(1,312)**	(22)
Outstanding at 31 December	**12,318**	10,367

The weighted average fair value of shares awarded by HSBC for performance share awards in 2007 was US$13.24 (2006: US$13.31) .

Restricted share awards

Restricted shares are awarded to other employees on the basis of their performance, potential and retention requirements, to aid recruitment or as a part-deferral of annual bonuses. Shares are awarded without corporate performance conditions and generally vest between one and three years from the date of award, providing the employees have remained continually employed by HSBC for this period.

	2007 Number (000s)	2006 Number (000s)
Outstanding at 1 January	**43,420**	5,106
Additions during the year	**52,790**	41,440
Released in the year	**(8,781)**	(1,685)
Forfeited in the year	**(8,173)**	(1,441)
Outstanding at 31 December	**79,256**	43,420

The weighted average fair value of shares awarded by HSBC for restricted share awards in 2007 was US$17.92 (2006: US$17.65) .

Share options

Share options were granted in 2005 under The HSBC Share Plan to employees in France on the basis of their performance in the previous year. The share options are subject to the corporate performance conditions, which consist of an absolute earnings per share measure and a TSR measure based on HSBC Holdings ranking against a comparator group of 28 major banks. The options may vest after three years and are exercisable up to the tenth anniversary of the date of grant, after which they will lapse.

2007		2006	
Number (000s)	**Weighted average exercise price £**	Number (000s)	Weighted average exercise price £

Outstanding at 1 January	**628**	**8.84**	628	8.84
Forfeited in the year	**(104)**	**8.79**	—	—
Outstanding at 31 December	**524**	**8.85**	628	8.84

No options were granted in 2007 (2006: nil). The weightedaverage remaining contractual life of options outstanding at the balance sheet date was 2.4 years (2006: 3.3 years). The exercise price range of options outstanding at the balance sheet date was £8.79 - £9.17. None of these options were exercisable at the balance sheet date.

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Savings-related share option plans

Savings-related share option plans invite eligible employees to enter into savings contracts to save up to £250 per month (or its equivalent in US dollars, Hong Kong dollars or euros), with the option to use the savings to acquire shares. The aim of the plans is to align the interests of all employees with the creation of shareholder value. The options are exercisable within three months following the first anniversary of the commencement of a one-year savings contract or within six months following either the third or the fifth anniversaries of the commencement of three-year or five-year savings contracts, respectively. The exercise price is set at a 20 per cent (2006: 20 per cent) discount to the market value immediately preceding the date of invitation (except for the one-year options granted under the US sub-plan where a 15 per cent discount is applied).

	2007		2006	
	Number	**Weighted average exercise price**	Number	Weighted average exercise price
	(000’s)	**£**	(000’s)	£
Outstanding at 1 January	**87,837**	**6.58**	98,416	6.07
Granted in the year	**30,105**	**7.43**	22,627	7.63
Exercised in the year	**(17,951)**	**6.58**	(25,336)	5.61
Forfeited in the year	**(10,252)**	**6.58**	(7,870)	6.26
Outstanding at 31 December	**89,739**	**6.83**	87,837	6.58

The weighted average fair value of options granted during the year was US$4.24 (2006: US$3.45) . The exercise price range and weighted average remaining contractual life for options outstanding at the balance sheet date were as follows:

	2007	2006
Exercise price range (£)	**5.35 – 7.93**	5.35 – 7.93
Weighted average remaining contractual life (years)	**1.67**	1.76
Of which exercisable:		
Number (000’s)	**541**	671
Weighted average exercise price (£)	**6.44**	5.35

The weighted average share price at the date the share options were exercised was US$17.93 (2006: US$17.55) .

HSBC Holdings Restricted Share Plan 2000

Performance share awards made under the HSBC Holdings Restricted Share Plan 2000 (the ‘Restricted Share Plan’)

Performance share awards under the Restricted Share Plan were granted to senior executives from 2000 to 2004. The aim of the plan was to align the interests of executives with the creation of shareholder value. This was achieved by setting certain TSR targets against a peer group of major banks which would normally have to be attained in order for the awards to vest. In addition to these performance conditions, none of the outstanding awards will vest unless the Remuneration Committee is satisfied that, during the performance period, HSBC has achieved sustained growth. Following adoption of The HSBC Share Plan in 2005, no further awards will be made under this Plan other than from reinvested scrip dividends.

	2007 Number (000's)	2006 Number (000's)
Outstanding at 1 January	**12,328**	14,970
Additions during the year[1]	**301**	520
Released in the year	**(2,332)**	(3,050)
Forfeited in the year	**(5,486)**	(112)
Outstanding at 31 December	**4,811**	12,328

1 *Additions during the year comprised reinvested scrip dividends.*

The weighted average remaining vesting period as at 31 December 2007 was 0.2 years (2006: 1.5 years).

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Restricted share awards made under the Restricted Share Plan

Restricted share awards under the Restricted Share plan were granted to eligible employees from 2000 to 2005, after taking into account the employees performance in the previous year, their potential and retention requirements. Restricted shares were also awarded as part-deferral of annual bonuses or for recruitment purposes. Shares were awarded without corporate performance conditions and generally vest between one and three years from the date of award, providing the employees have remained continuously employed by HSBC for the period.

	2007 Number (000s)	2006 Number (000s)
Outstanding at 1 January	**38,670**	58,427
Additions during the year[1]	**199**	1,499
Released in the year	**(17,156)**	(19,224)
Forfeited in the year	**(2,414)**	(2,032)
Outstanding at 31 December	**19,299**	38,670

1 *Additions during the year comprised reinvested scrip dividends.*

The weighted average remaining vesting period as at 31 December 2007 was 0.3 years (2006: 0.8 years).

HSBC Holdings Group Share Option Plan

The HSBC Holdings Group Share Option Plan was a long-term incentive plan under which certain HSBC employees between 2000 and 2005 were awarded share options. The aim of the plan was to align the interests of those higher performing employees with the creation of shareholder value. This was achieved by setting certain TSR targets which would normally have to be attained in order for the awards to vest. Options were granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions. Options granted after May 2005 are made under The HSBC Share Plan.

	2007		2006	
	Number (000s)	**Weighted average exercise price £**	Number (000s)	Weighted average exercise price £
Outstanding at 1 January	**168,786**	**8.09**	209,982	8.06
Exercised in the year	**(8,351)**	**7.64**	(37,817)	7.80
Forfeited in the year	**(8,222)**	**8.02**	(3,379)	8.29
Outstanding at 31 December	**152,213**	**8.15**	168,786	8.09

The number of options, weighted average exercise price, and weighted average remaining contractual life of options outstanding at the balance sheet date, analysed by exercise price range, were as follows:

	2007		2006	
Exercise price range (£)			6.00 8.00	8.01 10.00

	6.00 8.00	**8.01 10.00**		
Number (000s)	**29,312**	**122,901**	34,903	131,725
Weighted average exercise price (£)	**6.92**	**8.44**	6.92	8.40
Weighted average remaining contractual life (years)	**5.33**	**5.34**	4.74	7.17
Of which exercisable:				
Number (000s)	**29,312**	**61,650**	34,903	66,104
Weighted average exercise price (£)	**6.92**	**8.59**	6.92	8.58

The weighted average share price at the date the share options were exercised was US$18.08 (2006: US$17.65) .

In 2006, after consideration of the performance and shareholder returns over the period between 2003 and 2005, the Remuneration Committee exercised its discretion to waive the TSR performance condition in respect of the awards made under this plan in 2003. As a result, a charge of US$135 million was recognised in 2006, reflecting the incremental fair value granted measured at the date the performance condition was waived. This was measured using a binomial lattice model methodology that is based on the underlying assumptions of the Black-Scholes model, as

Notes on the Financial Statements (continued)

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described above in Calculation of fair values. A risk-free interest rate of 4.3 per cent was used, with all other inputs to the model consistent with those used to value the other share options and awards made during 2006.

HSBC Holdings Executive Share Option Scheme

The HSBC Holdings Executive Share Option Scheme was a long-term incentive plan under which certain senior HSBC employees were awarded share options before the adoption of the HSBC Holdings Group Share Option Plan in 2000. The aim of the plan was to align the interests of those higher performing senior employees with the creation of shareholder value. This was achieved by setting certain TSR targets to be attained in order for the awards to vest. Options were granted at market value and were exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions. No awards have been made under this plan since 2000 and the remaining unexercised options are summarised below:

	2007		2006	
	Number (000s)	**Weighted average exercise price £**	Number (000s)	Weighted average exercise price £
Outstanding at 1 January	**22,037**	**6.82**	32,255	6.78
Exercised in the year	**(3,377)**	**6.65**	(9,767)	6.69
Forfeited in the year	**(421)**	**6.84**	(451)	5.94
Outstanding at 31 December	**18,239**	**6.85**	22,037	6.82

The weighted average share price at the date the share options were exercised was US$18.08 (2006: US$17.65).

The number of options, weighted average exercise price and weighted average remaining contractual life of options outstanding at the balance sheet date, analysed by exercise price range, were as follows:

	2007	2006	
Exercise price range (£)	**6.01 7.87**	2.17 6.00	6.01 7.87
Number (000s)	**18,239**	188	21,849
Weighted average exercise price (£)	**6.85**	5.02	6.84
Weighted average remaining contractual life (years)	**1.66**		2.64
Of which exercisable:			
Number (000s)	**18,239**	188	21,849
Weighted average exercise price (£)	**6.85**	5.02	6.84

HSBC France and subsidiary company plans

Before its acquisition by HSBC in 2000, HSBC France and certain of its subsidiaries operated employee share plans under which share options were granted over their respective shares.

Options over HSBC France shares granted between 1994 and 1999 vested upon announcement of HSBC s agreement to acquire HSBC France and were therefore included in the valuation of HSBC France.

HSBC France granted 909,000 options in 2000 after the public announcement of the acquisition and these options did not vest as a result of the change in control. The options were subject to continued employment and vested on 1 January 2002. The HSBC France shares obtained on exercise of the options are exchangeable for HSBCs ordinary shares of US$0.50 each in the same ratio as the Exchange Offer for HSBC France shares (13 ordinary shares of US$0.50 for each HSBC France share). Options were granted at market value and are exercisable within 10 years of the date of grant.

	2007		2006	
	Number (000s)	**Exercise price**	Number (000s)	Exercise price
Outstanding at 1 January	**646**	**142.5**	766	142.5
Exercised in the year	**(44)**	**142.5**	(120)	142.5
Outstanding and exercisable at 31 December	**602**	**142.5**	646	142.5

The remaining contractual life for options outstanding at the balance sheet date was 2.3 years (2006: 3.3 years)

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The weighted average share price at the date the share options were exercised was US$18.08 (2006: US$17.64) .

At the date of its acquisition in 2000, certain of HSBC France's subsidiary companies also operated employee share option plans under which options could be granted over their respective shares. On exercise of certain of these options, the subsidiary shares are exchanged for HSBC ordinary shares. The total number of HSBC ordinary shares exchanged under such arrangements in 2007 was 113,240 (2006: 356,491).

HSBC Finance Corporation

Upon acquisition, HSBC Finance share options previously granted were converted to share options over HSBC ordinary shares of US$0.50 each at a rate of 2.675 HSBC share options (the same ratio as the Exchange Offer for HSBC Finance) for each HSBC Finance share option. Options granted under HSBC Finance's own share option schemes prior to the announcement of the acquisition by HSBC in November 2002 vested as options over HSBC shares upon acquisition by HSBC. Options granted after the announcement of the acquisition in November 2002 but prior to its completion on 28 March 2003 generally vest equally over four years and expire ten years from the date of grant.

Information with respect to share options granted under HSBC Finance's pre-acquisition scheme is as follows:

	2007		2006	
	Number (000's)	**Exercise price US$**	Number (000's)	Exercise price US$
HSBC Finance share options outstanding at 1 January	**3,126**	**10.66**	6,358	10.66
Exercised in the year	**(671)**	**10.66**	(3,219)	10.66
Forfeited in the year	**–**	**10.66**	(13)	10.66
Outstanding and exercisable at 31 December	**2,455**	**10.66**	3,126	10.66

The remaining contractual life for options outstanding at the balance sheet date was 4.9 years (2006: 5.9 years). The weighted average share price at the date the share options were exercised was US$18.08 (2006: US$17.65) .

11 Tax expense

	2007 US$m	2006 US$m	2005 US$m
Current tax			
UK corporation tax charge – on current year profit	**1,372**	772	663
UK corporation tax charge – adjustments in respect of prior years	**(46)**	(122)	29
Overseas tax – on current year profit	**3,976**	4,600	4,103
Overseas tax – adjustments in respect of prior years	**(97)**	(48)	(110)
	5,205	5,202	4,685
Deferred tax			
Origination and reversal of temporary differences	**(1,247)**	(51)	506
Effect of changes in tax rates	**(35)**	–	8
Adjustments in respect of prior years	**(166)**	64	(106)
	(1,448)	13	408
Tax expense	**3,757**	5,215	5,093

The UK corporation tax rate applying to HSBC Holdings and its subsidiaries was 30 per cent (2006: 30 per cent; 2005: 30 per cent). Overseas tax included Hong Kong profits tax of US$1,137 million (2006: US$751 million; 2005: US$639 million). Subsidiaries in Hong Kong provided for Hong Kong profits tax at the rate of 17.5 per cent (2006: 17.5 per cent; 2005: 17.5 per cent) on the profits for the year assessable in Hong Kong. Other overseas subsidiaries and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

The following table reconciles the tax expense which would apply if all profits had been taxed at the UK corporation tax rate:

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	2007		2006		2005	
	US$m	**%**	US$m	%	US$m	%
Analysis of tax expense						
Taxation at UK corporation tax rate of 30% (2006 and 2005: 30%)	**7,264**	**30.0**	6,626	30.0	6,290	30.0
Effect of taxing overseas profits in principal locations at different rates	**(1,460)**	**(6.0)**	(568)	(2.6)	(342)	(1.6)
Tax-free gains	**(296)**	**(1.2)**	(199)	(0.9)	(220)	(1.0)
Adjustments in respect of prior period liabilities	**(309)**	**(1.3)**	(106)	(0.5)	(187)	(0.9)
Low income housing tax credits[1]	**(107)**	**(0.4)**	(108)	(0.5)	(110)	(0.5)
Effect of profit in associates and joint ventures	**(450)**	**(1.9)**	(253)	(1.1)	(193)	(0.9)
Effect of previously unrecognised temporary differences[2]	**(485)**	**(2.0)**	(122)	(0.6)	(147)	(0.8)
Release of deferred tax consequent on restructuring of Group interests	**(359)**	**(1.5)**	–	–	–	–
Impact of gains arising from dilution of interests in associates[3]	**(253)**	**(1.0)**	–	–	–	–
Other items	**212**	**0.8**	(55)	(0.2)	2	–
Overall tax expense	**3,757**	**15.5**	5,215	23.6	5,093	24.3

1 *Low income housing tax credits arise in the US and are designed to encourage the provision of rental housing for low income households.*
2 *The effect of previously unrecognised temporary differences principally relates to the recognition of capital losses.*
3 *The gains arising from the dilution of HSBC's interests in associates are not subject to tax and, as such, there is a reconciling item which reduces the effective tax rate (see note 21).*

In addition to the amount charged to the income statement, the aggregate amount of current and deferred tax, relating to items that are taken directly to total equity, was a US$226 million reduction in total equity (2006: US$44 million reduction in total equity; 2005: US$437 million increase in total equity).

The 2007 Finance Act reduction in the UK corporation tax rate from 30 per cent to 28 per cent, enacted in 2007 but commencing in 2008, resulted in a one off re-measurement of deferred tax assets and liabilities. It gave rise to a credit to the Group's tax charge of US$28 million.

Deferred taxation
HSBC

	2007	2006
	US$m	US$m
At 1 January	**2,145**	2,135
Income statement credit/(charge)	**1,448**	(13)
Equity:		
– available-for-sale investments	**(8)**	(2)
– cash flow hedges	**470**	321
– share-based payments	**(65)**	(42)

actuarial gains and losses	**(642)**	(324)
Foreign exchange and other adjustments	**77**	70
At 31 December	**3,425**	2,145
Asset	**5,284**	3,241
Liability	**(1,859)**	(1,096)
	3,425	2,145

The amount of deferred taxation accounted for in the Group balance sheet, before netting off balances within countries, comprised the following deferred tax liabilities and assets:

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	2007	2006
	US$m	US$m
Deferred tax assets		
Retirement benefits	**822**	1,599
Loan impairment allowances	**4,484**	2,775
Unused tax losses	**272**	180
Accelerated capital allowances	**97**	91
Available-for-sale investments	**77**	–
Cash flow hedges	**570**	139
Share-based payments	**326**	194
Other short term timing differences	**900**	462
Other timing differences	–	80
	7,548	5,520
Deferred tax liabilities		
Assets leased to customers	**1,285**	1,676
Revaluation of property	**507**	469
Accelerated capital allowances	**206**	171
Other short-term timing differences	**202**	–
Provision for tax on profit remitted from overseas	**102**	112
Available-for-sale investments	**198**	384
Cash flow hedges	**96**	34
Other timing differences	**1,527**	529
	4,123	3,375
Net deferred tax asset/(liability)	**3,425**	2,145

After netting off balances within countries, the balances as disclosed in the accounts are as follows:

	2007	2006
	US$m	US$m
Deferred tax assets	**5,284**	3,241
Deferred tax liabilities	**(1,859)**	(1,096)
	3,425	2,145

The amount of temporary differences for which no deferred tax asset is recognised in the balance sheet is US$923 million (2006: US$1,067 million). Of this amount, US$750 million (2006: US$876 million) has no expiry date and US$173 million (2006: US$191 million) is scheduled to expire within 10 years.

Deferred tax is not recognised in respect of the Group's investments in subsidiaries, branches, associates and interests in joint ventures where remittance is not contemplated or where no additional tax is expected to arise. The aggregate amount of temporary differences associated with such investments is US$29,947 million (2006: US$22,424 million; 2005: US$15,367 million).

HSBC Holdings

	Deferred tax asset/(liability)	
	2007	2006
	US$m	US$m

Temporary differences:		
short-term timing differences	**1**	1
fair valued assets and liabilities	**(14)**	10
share-based payments	**20**	24
	7	35

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12 Dividends

Dividends to shareholders of the parent company were as follows:

	2007			2006			2005		
	Per share US$	**Total US$m**	**Settled in scrip US$m**	Per share US$	Total US$m	Settled in scrip US$m	Per share US$	Total US$m	Settled in scrip US$m
Dividends declared on ordinary shares									
In respect of previous year:									
– fourth interim dividend	**0.360**	**4,161**	**2,116**	0.310	3,513	1,542	0.270	3,007	431
In respect of current year:									
– first interim dividend	**0.170**	**1,986**	**712**	0.150	1,712	248	0.140	1,563	677
– second interim dividend	**0.170**	**1,997**	**912**	0.150	1,724	515	0.140	1,574	311
– third interim dividend	**0.170**	**2,007**	**614**	0.150	1,730	223	0.140	1,585	392
	0.870	**10,151**	**4,354**	0.760	8,679	2,528	0.690	7,729	1,811
Quarterly dividends on preference share capital									
March dividend	**15.50**	**22**		15.50	22		–	–	
June dividend	**15.50**	**23**		15.50	23		–	–	
September dividend	**15.50**	**22**		15.50	22		–	–	
December dividend	**15.50**	**23**		15.50	23		14.29	21	
	62.00	**90**		62.00	90		14.29	21	

The Directors declared after the end of the year a fourth interim dividend in respect of the financial year ended 31 December 2007 of US$0.39 per ordinary share, a distribution of US$4,628 million. The fourth interim dividend will be payable on 7 May 2008 to shareholders on the Register at the close of business on 25 March 2008. No liability is recorded in the financial statements in respect of the fourth interim dividend for 2007.

13 Earnings per share

Basic earnings per ordinary share was calculated by dividing the earnings of US$19,043 million (2006: US$15,699 million; 2005: US$15,060 million) by the weighted average number of ordinary shares, excluding own shares held, outstanding in 2007 of 11,545 million (2006: 11,210 million; 2005: 11,038 million).

	2007	2006	2005
	US$m	US$m	US$m
Profit attributable to shareholders of the parent company	**19,133**	15,789	15,081
Dividend payable on preference shares classified as equity	**(90)**	(90)	(21)
Profit attributable to the ordinary shareholders of the parent company	**19,043**	15,699	15,060

Diluted earnings per ordinary share was calculated by dividing the basic earnings, which require no adjustment for the effects of dilutive potential ordinary shares (including share options outstanding not yet exercised), by the weighted average number of ordinary shares outstanding, excluding own shares held, plus the weighted average number of ordinary shares that would be issued on ordinary conversion of dilutive potential ordinary shares in 2007 of 11,661 million (2006: 11,320 million; 2005: 11,171 million). The effect of dilutive share options and share awards on the weighted average number of ordinary shares in issue was as follows:

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	Number of shares (millions)		
	2007	2006	2005
Average number of shares in issue	**11,545**	11,210	11,038
Dilutive share options and share awards	**116**	110	133
Savings-related Share Option Plan	**20**	27	22
Executive Share Option Scheme	**5**	10	11
Group Share Option Plan	**16**	28	14
Restricted and performance share awards	**67**	32	70
HSBC France share options	**5**	8	10
HSBC Finance share options	**3**	5	6
Average number of shares in issue assuming dilution	**11,661**	11,320	11,171

Of the total number of employee share options and share awards existing at 31 December 2007, 19 million were anti-dilutive (2006: 20 million; 2005: 121 million).

14 Segmental analysis

In the following segmental analysis, the benefit of shareholders funds impacts the analysis only to the extent that these funds are actually allocated to businesses in the segment by way of intra-HSBC capital and funding structures.

By geographical region

Geographical information is classified by the location of the principal operations of the subsidiary, or, for The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East, HSBC Finance and HSBC Bank USA, by the location of the branch responsible for reporting the results or advancing the funds. Due to the nature of HSBCs structure, the analysis of profits shown below includes intra-HSBC items between geographical regions with the elimination shown in a separate column. The Rest of Asia-Pacific geographical segment includes the Middle East, India and Australasia. Shared costs are included in segments on the basis of the actual recharges made.

Total assets

	At 31 December 2007		At 31 December 2006	
	US$m	**%**	US$m	%
Europe	**1,184,315**	**50.3**	828,701	44.6
Hong Kong	**332,691**	**14.1**	272,428	14.6
Rest of Asia-Pacific	**228,112**	**9.7**	167,668	9.0
North America	**510,092**	**21.7**	511,190	27.5
Latin America	**99,056**	**4.2**	80,771	4.3
	2,354,266	**100.0**	1,860,758	100.0

Total liabilities

	At 31 December 2007		At 31 December 2006	
	US$m	**%**	US$m	%

Europe	**1,126,508**	**50.7**	778,635	44.7
Hong Kong	**317,316**	**14.3**	258,028	14.8
Rest of Asia-Pacific	**210,499**	**9.5**	161,388	9.2
North America	**478,323**	**21.6**	477,310	27.3
Latin America	**86,204**	**3.9**	70,469	4.0
	2,218,850	**100.0**	1,745,830	100.0

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Profit before tax

	Year ended 31 December 2007						
	Europe US$m	**Hong Kong US$m**	**Rest of Asia-Pacific US$m**	**North America US$m**	**Latin America US$m**	**Intra-HSBC items US$m**	**Total US$m**
Interest income	33,144	12,580	10,158	30,183	9,471	(3,177)	92,359
Interest expense	(25,398)	(7,097)	(6,015)	(15,336)	(3,895)	3,177	(54,564)
Net interest income	7,746	5,483	4,143	14,847	5,576	–	37,795
Fee income	10,973	3,860	2,709	6,733	2,647	(585)	26,337
Fee expense	(2,542)	(498)	(463)	(923)	(494)	585	(4,335)
Net fee income	8,431	3,362	2,246	5,810	2,153	–	22,002
Trading income/(expense) excluding net interest income .	3,003	1,270	1,202	(1,289)	272	–	4,458
Net interest income on trading activities	3,940	(28)	441	747	276	–	5,376
Net trading income	6,943	1,242	1,643	(542)	548	–	9,834
Net income from financial instruments designated at fair value	1,226	676	111	1,750	320	–	4,083
Gains less losses from financial investments	1,326	94	38	245	253	–	1,956
Gains arising from dilution of interests in associates	–	–	1,081	–	11	–	1,092
Dividend income	171	31	8	105	9	–	324
Net earned insurance premiums .	4,010	2,797	226	449	1,594	–	9,076
Other operating income	1,193	845	798	360	228	(1,985)	1,439
Total operating income	31,046	14,530	10,294	23,024	10,692	(1,985)	87,601
Net insurance claims incurred and movement in liabilities to policyholders	(3,479)	(3,208)	(253)	(241)	(1,427)	–	(8,608)
Net operating income before loan impairment charges and other credit risk provisions	27,567	11,322	10,041	22,783	9,265	(1,985)	78,993
Loan impairment charges and other credit risk provisions	(2,542)	(231)	(616)	(12,156)	(1,697)	–	(17,242)
Net operating income[1]	25,025	11,091	9,425	10,627	7,568	(1,985)	61,751

Total operating expenses (excluding depreciation and amortisation)	**(15,451)**	**(3,510)**	**(4,572)**	**(10,037)**	**(5,043)**	**1,985**	**(36,628)**
Depreciation of property, plant and equipment	**(848)**	**(180)**	**(159)**	**(317)**	**(210)**	—	**(1,714)**
Amortisation of intangible assets	**(226)**	**(90)**	**(33)**	**(202)**	**(149)**	—	**(700)**
Total operating expenses	**(16,525)**	**(3,780)**	**(4,764)**	**(10,556)**	**(5,402)**	**1,985**	**(39,042)**
Operating profit	**8,500**	**7,311**	**4,661**	**71**	**2,166**	—	**22,709**
Share of profit in associates and joint ventures	**95**	**28**	**1,348**	**20**	**12**	—	**1,503**
Profit before tax	**8,595**	**7,339**	**6,009**	**91**	**2,178**	—	**24,212**
Other disclosures:							
Capital expenditure incurred[2]	**1,722**	**441**	**277**	**833**	**599**	—	**3,872**
Investment in associates and joint ventures	**158**	**155**	**9,867**	**127**	**77**	—	**10,384**

1 *Net operating income:*

External	**23,772**	**10,168**	**8,456**	**11,784**	**7,571**	—	**61,751**
Inter-segment	**1,253**	**923**	**969**	**(1,157)**	**(3)**	**(1,985)**	—

2 *Expenditure incurred on property, plant and equipment and intangible assets.*

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	Year ended 31 December 2006						
	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	North America US$m	Latin America US$m	Intra-HSBC items US$m	Total US$m
Interest income	25,249	11,097	7,693	27,959	7, 289	(3,408)	75,879
Interest expense	(16,960)	(6,412)	(4,646)	(13,691)	(3,092)	3,408	(41,393)
Net interest income	8,289	4,685	3,047	14,268	4,197	–	34,486
Fee income	9,583	2,448	1,912	5,611	1,975	(449)	21,080
Fee expense	(2,475)	(392)	(290)	(845)	(345)	449	(3,898)
Net fee income	7,108	2,056	1,622	4, 766	1,630	–	17,182
Trading income excluding net interest income	2,842	924	935	617	301	–	5,619
Net interest income/(expense) on trading activities	1,687	(307)	246	741	236	–	2,603
Net trading income	4,529	617	1,181	1,358	537	–	8,222
Net income/(expense) from financial instruments designated at fair value	144	260	79	(63)	237	–	657
Gains less losses from financial investments	624	162	41	58	84	–	969
Dividend income	183	61	5	85	6	–	340
Net earned insurance premiums	1,298	2,628	174	492	1,076	–	5,668
Other operating income	1,428	834	765	922	91	(1,494)	2,546
Total operating income	23,603	11,303	6,914	21,886	7,858	(1,494)	70,070
Net insurance claims incurred and movement in liabilities to policyholders	(531)	(2,699)	(192)	(259)	(1,023)	–	(4,704)
Net operating income before loan impairment charges and other credit risk provisions	23,072	8,604	6,722	21,627	6,835	(1,494)	65,366
Loan impairment charges and other credit risk provisions	(2,155)	(172)	(512)	(6,796)	(938)	–	(10,573)
Net operating income[1]	20,917	8,432	6,210	14,831	5,897	(1,494)	54,793
Total operating expenses (excluding depreciation and amortisation)	(12,811)	(3,002)	(3,412)	(9, 669)	(3,923)	1,494	(31,323)
Depreciation of property, plant and equipment	(762)	(171)	(124)	(284)	(173)	–	(1,514)
Amortisation of intangible assets	(298)	(96)	(12)	(240)	(70)	–	(716)
Total operating expenses	(13,871)	(3,269)	(3,548)	(10,193)	(4 ,166)	1, 494	(33,553)
Operating profit	7,046	5,163	2,662	4, 638	1,731	–	21,240
Share of profit/(loss) in associates and joint ventures	(72)	19	865	30	4	–	846
Profit before tax	6,974	5,182	3,527	4, 668	1,735	–	22,086

Other disclosures:

Capital expenditure incurred[2]	1,508	324	235	899	2,017	—	4,983
Investment in associates and joint ventures	1,321	128	6,322	541	84	—	8,396
1 *Net operating income:*							
External	*19,664*	*7,970*	*5,592*	*15,694*	*5,873*	—	*54,793*
Inter-segment	*1,253*	*462*	*618*	*(863)*	*24*	*(1,494)*	—

2 *Expenditure incurred on property, plant and equipment and intangible assets.*

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Notes on the Financial Statements (continued)

Note 14

	Year ended 31 December 2005						
	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	North America US$m	Latin America US$m	Intra-HSBC items US$m	Total US$m
Interest income	21,023	7,419	5,673	22,189	6,133	(2,343)	60,094
Interest expense	(12,802)	(3,355)	(3,261)	(8,894)	(2,791)	2,343	(28,760)
Net interest income	8,221	4,064	2,412	13,295	3,342	–	31,334
Fee income	8,081	1,967	1,619	4,605	1,481	(267)	17,486
Fee expense	(1,782)	(293)	(279)	(653)	(290)	267	(3,030)
Net fee income	6,299	1,674	1,340	3,952	1,191	–	14,456
Trading income excluding net interest income	1,660	773	753	250	220	–	3,656
Net interest income/(expense) on trading activities	1,376	(227)	107	635	317	–	2,208
Net trading income	3,036	546	860	885	537	–	5,864
Net income/(expense) from financial instruments designated at fair value	362	(6)	58	434	186	–	1,034
Gains less losses from financial investments	439	108	18	47	80	–	692
Dividend income	63	41	5	41	5	–	155
Net earned insurance premiums .	1,599	2,334	155	477	871	–	5,436
Other operating income	1,603	805	335	642	286	(938)	2,733
Total operating income	21,622	9,566	5,183	19,773	6,498	(938)	61,704
Net insurance claims incurred and movement in liabilities to policyholders	(818)	(2,059)	(166)	(232)	(792)	–	(4,067)
Net operating income before loan impairment charges and other credit risk provisions	20,804	7,507	5,017	19,541	5,706	(938)	57,637
Loan impairment charges and other credit risk provisions	(1,929)	(146)	(134)	(4,916)	(676)	–	(7,801)
Net operating income[1]	18,875	7,361	4,883	14,625	5,030	(938)	49,836
Total operating expenses (excluding depreciation and amortisation)	(11,493)	(2,586)	(2,648)	(8,276)	(3,263)	938	(27,328)
Depreciation of property, plant and equipment	(912)	(168)	(107)	(307)	(138)	–	(1,632)
Amortisation of intangible assets	(234)	(113)	(7)	(175)	(25)	–	(554)

Total operating expenses	(12,639)	(2,867)	(2,762)	(8,758)	(3,426)	938	(29,514)
Operating profit	6,236	4,494	2,121	5,867	1,604	—	20,322
Share of profit in associates and joint ventures	120	23	453	48	—	—	644
Profit before tax	6,356	4,517	2,574	5,915	1,604	—	20,966
Other disclosures:							
Capital expenditure incurred[2]	1,892	249	191	1,826	315	—	4,473
Investment in associates and joint ventures	1,733	108	5,362	43	3	—	7,249
1 *Net operating income:*							
External	*18,300*	*7,001*	*4,636*	*14,860*	*5,039*	*—*	*49,836*
Inter-segment	*575*	*360*	*247*	*(235)*	*(9)*	*(938)*	*—*

2 *Expenditure incurred on property, plant and equipment and intangible assets .*

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By customer group

HSBC's operations include a number of shared support services and head office functions. The costs of these functions are allocated to customer groups, where appropriate, on a systematic and consistent basis. In addition, a number of income and expense items include the effect of financial transactions entered into in the ordinary course of business between customer groups co-operating within the integrated HSBC Group. The following analysis includes inter-segment amounts within each customer group with the elimination shown in a separate column.

Profit before tax

	Year ended 31 December 2007						
	Personal Financial Services US$m	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Intra-HSBC items US$m**	**Total US$m**
Net interest income/(expense)	**29,069**	**9,055**	**4,430**	**1,216**	**(542)**	**(5,433)**	**37,795**
Net fee income	**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	**178**	**296**	**3,267**	**534**	**126**	**5,433**	**9,834**
Net income/(expense) from financial instruments designated at fair value	**1,333**	**22**	**(164)**	**(1)**	**2,893**	–	**4,083**
Gains less losses from financial investments	**351**	**90**	**1,313**	**119**	**83**	–	**1,956**
Gains arising from dilution in 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 incurred and movement in liabilities to policyholders	**(8,147)**	**(391)**	**(70)**	–	–	–	**(8,608)**
Net operating income[1]	**43,239**	**13,950**	**15,210**	**3,548**	**6,958**	**(3,912)**	**78,993**
Loan impairment charges and other	**(16,172)**	**(1,007)**	**(38)**	**(14)**	**(11)**	–	**(17,242)**

credit risk provisions							
Net operating income[2]	**27,067**	**12,943**	**15,172**	**3,534**	**6,947**	**(3,912)**	**61,751**
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**
Capital expenditure incurred[3]	**1,335**	**527**	**942**	**73**	**995**	—	**3,872**

1 Net operating income before loan impairment charges and other credit risk provisions.

2 Net operating income:

External	**21,059**	**11,442**	**23,595**	**2,144**	**3,511**	—	**61,751**
Inter-segment	**6,008**	**1,501**	**(8,423)**	**1,390**	**3,436**	**(3,912)**	—

3 *Expenditure incurred on property, plant and equipment and intangible assets.*

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	Year ended 31 December 2006						
	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Intra-HSBC items US$m	Total US$m
Net interest income/(expense)	26,076	7,514	3,168	1,011	(625)	(2,658)	34,486
Net fee income	8,762	3,207	3,718	1,323	172	–	17,182
Trading income/(expense) excluding net interest income .	391	204	4,890	362	(228)	–	5,619
Net interest income/(expense) on trading activities	220	20	(379)	2	82	2,658	2,603
Net trading income/(expense)	611	224	4,511	364	(146)	2,658	8,222
Net income/(expense) from financial instruments designated at fair value	739	(22)	20	1	(81)	–	657
Gains less losses from financial investments	78	44	534	166	147	–	969
Dividend income	31	6	235	5	63	–	340
Net earned insurance premiums .	5,130	258	73	–	207	–	5,668
Other operating income	782	250	1,378	61	3,254	(3,179)	2,546
Total operating income	42,209	11,481	13,637	2,931	2,991	(3,179)	70,070
Net insurance claims incurred and movement in liabilities to policyholders	(4,365)	(96)	(62)	–	(181)	–	(4,704)
Net operating income[1]	37,844	11,385	13,575	2,931	2,810	(3,179)	65,366
Loan impairment (charges)/recoveries and other credit risk provisions	(9,949)	(697)	119	(33)	(13)	–	(10,573)
Net operating income[2]	27,895	10,688	13,694	2,898	2,797	(3,179)	54,793
Operating expenses	(18,818)	(4,979)	(7,991)	(1,685)	(3,259)	3, 179	(33,553)
Operating profit/(loss)	9,077	5,709	5,703	1, 213	(462)	–	21,240
Share of profit in associates and joint ventures	380	288	103	1	74	–	846
Profit/(loss) before tax	9,457	5,997	5,806	1, 214	(388)	–	22,086

Capital expenditure incurred[3]	2,150	1,083	1,021	45	684		4,983

1 *Net operating income before loan impairment (charges)/recoveries and other credit risk provisions.*
2 *Net operating income:*

External	*23,238*	*9,692*	*20,034*	*1,661*	*168*		*54,793*
Inter-segment	*4,657*	*996*	*(6,340)*	*1,237*	*2,629*	*(3,179)*	

3 *Expenditure incurred on property, plant and equipment and intangible assets .*

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	Year ended 31 December 2005						
	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Intra-HSBC items US$m	Total US$m
Net interest income/(expense)	23,351	6,310	3,001	848	(472)	(1,704)	31,334
Net fee income	7,313	2,876	2,967	1,080	220	—	14,456
Trading income/(expense) excluding net interest income .	360	150	2,919	317	(90)	—	3,656
Net interest income/(expense) on trading activities	214	(3)	306	—	(13)	1,704	2,208
Net trading income/(expense)	574	147	3,225	317	(103)	1,704	5,864
Net income/(expense) from financial instruments designated at fair value	574	(12)	67	(1)	406	—	1,034
Gains less losses from financial investments	19	9	475	45	144	—	692
Dividend income	16	9	79	9	42	—	155
Net earned insurance premiums	4,864	236	76	—	260	—	5,436
Other operating income	729	327	1,621	68	2,634	(2,646)	2,733
Total operating income	37,440	9,902	11,511	2,366	3,131	(2,646)	61,704
Net insurance claims incurred and movement in liabilities to policyholders	(3,716)	(118)	(54)	—	(179)	—	(4,067)
Net operating income[1]	33,724	9,784	11,457	2,366	2,952	(2,646)	57,637
Loan impairment (charges)/recoveries and other credit risk provisions	(7,537)	(547)	272	12	(1)	—	(7,801)
Net operating income[2]	26,187	9,237	11,729	2,378	2,951	(2,646)	49,836
Operating expenses	(16,427)	(4,453)	(6,838)	(1,466)	(2,976)	2, 646	(29,514)
Operating profit/(loss)	9,760	4,784	4,891	912	(25)	—	20,322
Share of profit in associates and joint ventures	144	177	272	—	51	—	644
Profit before tax	9,904	4,961	5,163	912	26	—	20,966
Capital expenditure incurred[3]	1,583	411	1,783	102	594	—	4,473

1 *Net operating income before loan impairment (charges)/recoveries and other credit risk provisions.*

2 *Net operating income:*

External	*25,000*	*8,258*	*13,998*	*1,668*	*912*	*—*	*49,836*
Inter-segment	*1,187*	*979*	*(2,269)*	*710*	*2,039*	*(2,646)*	*—*

3 *Expenditure incurred on property, plant and equipment and intangible assets.*

Total assets

	At 31 December 2007		At 31 December 2006	
	US$m	**%**	US$m	%
Personal Financial Services	**588,473**	**25.0**	546,568	29.4
Commercial Banking	**261,893**	**11.1**	213,450	11.5
Global Banking and Markets	**1,375,240**	**58.4**	994,436	53.5
Private Banking	**88,510**	**3.8**	73,026	3.9
Other	**40,150**	**1.7**	33,278	1.7
Total assets	**2,354,266**	**100.0**	1,860,758	100.0

15 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies in Note 2 describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category as defined in IAS 39 and by balance sheet heading.

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Notes 15

HSBC

	At 31 December 2007							
	Held for trading US$m	Designated at fair value US$m	Held-to-maturity securities US$m	Loans and receivables US$m	Available-for-sale securities US$m	Financial assets and liabilities at amortised cost US$m	Derivatives designated as fair value hedging instruments US$m	Derivatives designated as cash flow hedging instruments US$m
Financial assets								
Cash and balances at central banks	—	—	—	—	—	**21,765**	—	—
Items in the course of collection from other banks	—	—	—	—	—	**9,777**	—	—
Hong Kong Government certificates of indebtedness	—	—	—	**13,893**	—	—	—	—
Trading assets	**445,968**	—	—	—	—	—	—	—
Financial assets designated at fair value	—	**41,564**	—	—	—	—	—	—
Derivatives	**182,604**	—	—	—	—	—	**335**	**4,915**
Loans and advances to banks	—	—	—	**237,366**	—	—	—	—
Loans and advances to customers	—	—	—	**981,548**	—	—	—	—
Financial investments	—	—	**9,768**	—	**273,232**	—	—	—
Other assets	—	—	—	**14**	**28**	**25,084**	—	—
Accrued income	—	—	—	—	—	**20,091**	—	—
Total financial assets	**628,572**	**41,564**	**9,768**	**1,232,821**	**273,260**	**76,717**	**335**	**4,915**
Financial liabilities								
	—	—	—	**13,893**	—	—	—	—

Hong Kong currency notes in circulation								
Deposits by banks	—	—	—	—	—	**132,181**	—	—
Customer accounts	—	—	—	—	—	**1,096,140**	—	—
Items in the course of transmission to other banks	—	—	—	—	—	**8,672**	—	—
Trading liabilities	**314,580**	—	—	—	—	—	—	—
Financial liabilities designated at fair value	—	**89,939**	—	—	—	—	—	—
Derivatives	**181,009**	—	—	—	—	—	**403**	**1,981**
Debt securities in issue	—	—	—	—	—	**246,579**	—	—
Other liabilities	—	—	—	—	—	**32,892**	—	—
Accruals	—	—	—	—	—	**19,572**	—	—
Subordinated liabilities	—	—	—	—	—	**24,819**	—	—
Total financial liabilities	**495,589**	**89,939**	—	**13,893**	—	**1,560,855**	**403**	**1,981**

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HSBC

	At 31 December 2006								
	Held for trading US$m	Designated at fair value US$m	Held-to-maturity securities US$m	Loans and receivables US$m	Available-for-sale securities US$m	Financial assets and liabilities at amortised cost US$m	Derivatives designated as fair value hedging instruments US$m	Derivatives designated as cash flow hedging instruments US$m	Tot US$
Financial assets									
Cash and balances at central banks	—	—	—	—	—	12,732	—	—	12,73
Items in the course of collection from other banks	—	—	—	—	—	14,144	—	—	14,14
Hong Kong Government certificates of indebtedness	—	—	—	13,165	—	—	—	—	13,16
Trading assets	328,147	—	—	—	—	—	—	—	328,14
Financial assets designated at fair value	—	20,573	—	—	—	—	—	—	20,57
Derivatives	99,752	—	—	—	—	—	201	3,749	103,70
Loans and advances to banks	—	—	—	185,205	—	—	—	—	185,20
Loans and advances to customers	—	—	—	868,133	—	—	—	—	868,13
Financial investments	—	—	9,371	—	195,435	—	—	—	204,80
Other assets	—	—	—	—	—	23,305	—	—	23,30
Accrued income	—	—	—	—	—	12,735	—	—	12,73
Total financial assets	427,899	20,573	9,371	1,0 66,503	195,435	62,916	201	3,749	1,786,64
Financial liabilities									
Hong Kong currency notes in circulation	—	—	—	13,165	—	—	—	—	13,16
Deposits by banks	—	—	—	—	—	99,694	—	—	99,69
Customer accounts	—	—	—	—	—	896,834	—	—	896,83
Items in the course of	—	—	—	—	—	12,625	—	—	12,62

transmission to other banks									
Trading liabilities	226,608	—	—	—	—	—	—	—	226,60
Financial liabilities designated at fair value	—	70,211	—	—	—	—	—	—	70,21
Derivatives	99,790	—	—	—	—	—	315	1,373	101,47
Debt securities in issue	—	—	—	—	—	230,325	—	—	230,32
Other liabilities	—	—	—	—	—	25,676	—	—	25,67
Accruals	—	—	—	—	—	15,057	—	—	15,05
Subordinated liabilities	—	—	—	—	—	22,672	—	—	22,67
Total financial liabilities	326,398	70,211	—	13,165	—	1,302,883	315	1,373	1,714,34

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Notes on the Financial Statements (continued)

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HSBC Holdings

	At 31 December 2007					
	Held for trading US$m	**Designated at fair value US$m**	**Loans and receivables US$m**	**Available-for-sale securities US$m**	**Financial assets and liabilities at amortised cost US$m**	**Total US$m**
Financial assets						
Cash at bank and in hand	–	–	–	–	**360**	**360**
Derivatives	**2,660**	–	–	–	–	**2,660**
Loans and advances to HSBC undertakings	–	–	**17,242**	–	–	**17,242**
Financial investments	–	–	–	**3,022**	–	**3,022**
Other assets	–	–	–	–	**21**	**21**
Total financial assets	**2,660**	–	**17,242**	**3,022**	**381**	**23,305**
Financial liabilities						
Amounts owed to HSBC undertakings	–	–	–	–	**2,969**	**2,969**
Financial liabilities designated at fair value	–	**18,683**	–	–	–	**18,683**
Derivatives	**44**	–	–	–	–	**44**
Subordinated liabilities	–	–	–	–	**8,544**	**8,544**
Other liabilities	–	–	–	–	**5**	**5**
Accruals	–	–	–	–	**150**	**150**
Total financial liabilities	**44**	**18,683**	–	–	**11,668**	**30,395**

	At 31 December 2006					
	Held for trading US$m	Designated at fair value US$m	Loans and receivables US$m	Available-for-sale securities US$m	Financial assets and liabilities at amortised cost US$m	Total US$m
Financial assets						
Cash at bank and in hand	–	–	–	–	729	729
Derivatives	1,599	–	–	–	–	1,599
Loans and advances to HSBC undertakings	–	–	14,456	–	–	14,456
Financial investments	–	–	–	3,614	–	3,614
Other assets	–	–	–	–	25	25

Total financial assets	1,599	—	14,456	3,614	754	20,423
Financial liabilities						
Amounts owed to HSBC undertakings	—	—	—	—	3,100	3,100
Financial liabilities designated at fair value	—	14,070	—	—	—	14,070
Derivatives	177	—	—	—	—	177
Subordinated liabilities	—	—	—	—	8,423	8,423
Other liabilities	—	—	—	—	1	1
Accruals	—	—	—	—	111	111
Total financial liabilities	177	14,070	—	—	11,635	25,882

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16 Trading assets

	2007 US$m	2006 US$m
Trading assets:		
not subject to repledge or resale by counterparties	**308,286**	273,507
which may be repledged or resold by counterparties	**137,682**	54,640
	445,968	328,147
Treasury and other eligible bills	**16,439**	21,759
Debt securities	**178,834**	155,447
Equity securities	**51,476**	27,149
	246,749	204,355
Loans and advances to banks	**100,440**	52,006
Loans and advances to customers	**98,779**	71,786
	445,968	328,147

The following table provides an analysis of trading securities which are valued at fair value:

	Fair value	
	2007 US$m	2006 US$m
US Treasury and US Government agencies	**17,335**	8,348
UK Government	**11,607**	6,176
Hong Kong Government	**5,517**	8,759
Other government	**80,268**	70,747
Asset-backed securities	**20,479**	15,781
Corporate debt and other securities	**60,067**	67,395
Equity securities	**51,476**	27,149
	246,749	204,355

Included within the above figures are debt securities issued by banks and other financial institutions of US$69,818 million (20 06: US$36,153 million).

The following table analyses trading securities between those listed on a recognised exchange and those that are unlisted:

	Treasury and other eligible bills US$m	**Debt securities US$m**	**Equity securities US$m**	**Total US$m**
Fair value at 31 December 2007				
Listed on a recognised exchange[1]	**34**	**115,593**	**50,092**	**165,719**
Unlisted	**16,405**	**63,241**	**1,384**	**81,030**
	16,439	**178,834**	**51,476**	**246,749**

Fair value at 31 December 2006				
Listed on a recognised exchange[1]	1,373	112,403	25,337	139,113
Unlisted	20,386	43,044	1,812	65,242
	21,759	155,447	27,149	204,355

1 *Included within listed investments are US$6,977 million (2006: US$4,309 million) of investments listed in Hong Kong.*

Loans and advances to banks held for trading consist of:

	2007	2006
	US$m	US$m
Reverse repos	**80,476**	41,475
Settlement accounts	**8,227**	4,655
Stock borrowing	**8,259**	4,727
Other	**3,478**	1,149
	100,440	52,006

All of the above loans and advances to banks are graded satisfactorily by reference to the Groups legacy credit risk grading system.

Loans and advances to customers held for trading consist of:

	2007 US$m	2006 US$m
Reverse repos	**51,543**	32,869
Stock borrowing	**24,254**	18,591
Settlement accounts	**6,216**	9,998
Other	**16,766**	10,328
	98,779	71,786

Of the above loans and advances to customers, US$97,492 million (2006: US$71,680 million) are rated satisfactorily, US$343 million (2006: nil) as watch list and special mention, US$269 million (2006: US$62 million) as substandard and US$675 million (2006: US$44 million) as impaired.

17 Financial assets designated at fair value

	2007 US$m	2006 US$m
Treasury and other eligible bills	**181**	133
Debt securities	**21,150**	9,449
Equity securities	**20,047**	10,602
	41,378	20,184
Loans and advances to banks	**178**	236
Loans and advances to customers	**8**	153
	41,564	20,573

Securities designated at fair value

	Market value	
	2007 US$m	2006 US$m
US Treasury and US Government agencies	**252**	92
UK Government	**788**	1,359
Hong Kong Government	**314**	216
Other government	**4,427**	2,131
Asset-backed securities	**8,114**	274
Corporate debt and other securities	**7,436**	5,510

Equities	**20,047**	10,602
	41,378	20,184

Included within the above figures are debt securities issued by banks and other financial institutions of US$14,401 million (2006:US$2,438 million).

	Treasury and other eligible bills US$m	**Debt securities US$m**	**Equity securities US$m**	**Total US$m**
Fair value at 31 December 2007				
Listed on a recognised exchange[1]	**50**	**8,659**	**15,449**	**24,158**
Unlisted	**131**	**12,491**	**4,598**	**17,220**
	181	**21,150**	**20,047**	**41,378**
Fair value at 31 December 2006				
Listed on a recognised exchange[1]	133	4,939	9,212	14,284
Unlisted	–	4,510	1,390	5,900
	133	9,449	10,602	20,184

1 *Included within listed investments are US$1,502 million of investments listed in Hong Kong (2006: US$1,014 million).*

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18 Derivatives

Fair values of derivatives by product contract type held by HSBC

	Assets			Liabilities		
	Trading US$m	**Hedging US$m**	**Total US$m**	**Trading US$m**	**Hedging US$m**	**Total US$m**
At 31 December 2007						
Foreign exchange	**52,018**	**3,490**	**55,508**	**50,608**	**371**	**50,979**
Interest rate	**83,982**	**1,759**	**85,741**	**83,374**	**2,013**	**85,387**
Equities	**20,229**	**1**	**20,230**	**19,458**	—	**19,458**
Credit derivatives	**25,268**	—	**25,268**	**26,247**	—	**26,247**
Commodity and other	**1,107**	—	**1,107**	**1,322**	—	**1,322**
Gross total fair values	**182,604**	**5,250**	**187,854**	**181,009**	**2,384**	**183,393**
Netting			—			—
Total			**187,854**			**183,393**

	Assets			Liabilities		
	Trading US$m	Hedging US$m	Total US$m	Trading US$m	Hedging US$m	Total US$m
At 31 December 2006						
Foreign exchange	30,648	2,399	33,047	28,837	394	29,231
Interest rate	52,664	1,551	54,215	52,927	1,287	54,214
Equities	10,767	—	10,767	11,647	7	11,654
Credit derivatives	8,237	—	8,237	8,611	—	8,611
Commodity and other	1,304	—	1,304	1,636	—	1,636
Gross total fair values	103,620	3,950	107,570	103,658	1,688	105,346
Netting			(3,868)			(3,868)
Total			103,702			101,478

Fair values of derivatives by product contract type held by HSBC Holdings with subsidiaries

	Year ended 31 December			
	2007 Trading		2006 Trading	
	Assets US$m	**Liabilities US$m**	Assets US$m	Liabilities US$m
Foreign exchange	**2,381**	**2**	1,557	—
Interest rate	**279**	**42**	42	177
Gross total fair values	**2,660**	**44**	1,599	177

Derivatives are financial instruments that derive their value from the price of underlying items such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices. Derivatives enable users to increase, reduce or alter exposure to credit or market risks. HSBC makes markets in derivatives for its customers and uses derivatives to manage its exposure to credit and market risks.

Derivatives are carried at fair value and shown in the balance sheet as separate totals of assets and liabilities. Asset values represent the cost to HSBC of replacing all transactions with a fair value in HSBCs favour assuming that all HSBCs relevant counterparties default at the same time, and that transactions can be replaced instantaneously. Liability values represent the cost to HSBCs counterparties of replacing all their transactions with HSBC with a fair value in their favour if HSBC were to default. Derivative assets and liabilities on different transactions are only set off if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis.

Use of derivatives

HSBC transacts derivatives for three primary purposes: to create risk management solutions for clients, for proprietary trading purposes, and to manage and hedge HSBCs own risks. Derivatives (except for derivatives which are designated as effective hedging instruments as defined in IAS 39) are held for trading. The held for trading classification includes two types of derivatives: those used in sales and trading activities, and those used for risk

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management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

HSBCs derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels, with matching deals being utilised to achieve this where necessary. When entering into derivative transactions, HSBC employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

Derivative assets with a carrying amount of US$123,041 million or 65.5 per cent of the total carrying amount (2006: US$67,628 million; 65.2 per cent) are held with banking counterparties, and US$46,789 million or 24.9 per cent of the total carrying amount (2006: US$26,811 million; 25.9 per cent) with other financial institutions. The remainder are held with government and other counterparties.

Trading derivatives

Most of HSBCs derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in exchange rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

As mentioned above, other derivatives classified as held for trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value.

Gains and losses from changes in the fair value of derivatives that do not qualify for hedge accounting are reported in Net trading income, except for derivatives managed in conjunction with financial instruments designated at fair value, where gains and losses are reported in Net income from financial instruments designated at fair value, together with the gains and losses on the hedged items. Changes in the fair values of trading derivatives are inclusive of contractual interest. Changes in the fair value of derivatives managed in conjunction with financial instruments designated at fair value are included in Net income from financial instruments designated at fair value inclusive of contractual interest unless the derivatives are managed with debt securities in issue, in which case the contractual interest is shown in interest payable with the interest payable on the issued debt. Substantially all of HSBC Holdings derivatives entered into with HSBC undertakings are managed in conjunction with financial liabilities designated at fair value.

Notional contract amounts of derivatives held for trading purposes by product type

	HSBC		HSBC Holdings	
	2007	2006	**2007**	2006

	US$m	US$m	**US$m**	US$m
Foreign exchange	**3,243,738**	2,182,005	**12,790**	9,869
Interest rate	**10,672,971**	9,843,601	**7,804**	5,304
Equities	**286,927**	207,016		
Credit derivatives	**1,893,802**	1,109,828		
Commodity and other	**33,188**	30,532		
	16,130,626	13,372,982	**20,594**	15,173

Credit derivatives

HSBC trades credit derivatives through its principal dealing operations and acts as a principal counterparty to a broad range of users, structuring deals to produce risk management products for its customers, or making markets in certain

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products. Risk is typically controlled through entering into offsetting credit derivative contracts with other counterparties.

HSBC manages the credit risk arising on buying and selling credit derivative protection by including the related credit exposures within its overall credit limit structure for the relevant counterparty. Trading of credit derivatives is restricted to a small number of offices within the major centres which have the control infrastructure and market skills to manage effectively the credit risk inherent in the products.

Credit derivatives are also deployed to a limited extent for the risk management of the Group's loan portfolios.

The contract amount of credit derivatives of US$1,893,802 million (2006: US$1,109,828 million) consisted of protection bought of US$926,794 million (2006: US$540,229 million) and protection sold of US$967,008 million (2006: US$569,599 million).

The difference between these notional amounts is attributable to HSBC selling protection on large, diversified, predominantly investment grade portfolios (including the most senior tranches) and then hedging these positions by buying protection on the more subordinated tranches of the same portfolios. In addition, HSBC uses securities to hedge certain derivative positions. Consequently, while there is a mismatch in notional amounts of credit derivatives bought and sold this should not be interpreted as representing the open risk position. The credit derivative business operates within the market risk management framework described from page 248.

Derivatives valued using models with unobservable inputs

The amount that has yet to be recognised in the consolidated income statement relating to the difference between the fair value at initial recognition (the transaction price) and the amount that would have arisen had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows:

	2007 **US$m**	2006 US$m
Unamortised balance at 1 January	**214**	252
Deferral on new transactions	**384**	283
Recognised in the income statement during the period:		
– amortisation	**(85)**	(59)
– subsequent to unobservable inputs becoming observable	**(83)**	(226)
– maturity, termination or offsetting derivative	**(121)**	(53)
Exchange differences	**4**	17
Risk hedged	**(7)**	–
Unamortised balance at 31 December	**306**	214

Hedging instruments

HSBC uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables HSBC to optimise the overall cost to the Group of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

The accounting treatment of hedge transactions varies according to the nature of the instrument hedged and the type of hedge transactions. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges, cash flow hedges, or investment hedges. These are described under the relevant headings below:

Notional contract amounts of derivatives held for hedging purposes by product type

	At 31 December 2007	At 31 December 2006

	Cash flow hedge US$m	**Fair value hedge US$m**	Cash flow hedge US$m	Fair value hedge US$m
Foreign exchange	**21,641**	**3,116**	21,765	2,985
Interest rate	**248,134**	**34,897**	201,635	24,279
Equities	—	**24**	—	30
	269,775	**38,037**	223,400	27,294

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HSBC HOLDINGS PLC

Notes on the Financial Statements (continued)

Notes 18 and 19

With respect to exchange rate and interest rate contracts, the notional contract amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Fair value hedges

HSBCs fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to the income statement as a yield adjustment over the remainder of the hedging period.

Fair value of derivatives designated as fair value hedges

	At 31 December 2007 Fair value		At 31 December 2006 Fair value	
	Assets US$m	**Liabilities US$m**	Assets US$m	Liabilities US$m
Foreign exchange	**163**	**65**	28	113
Interest rate	**171**	**338**	173	195
Equities	**1**	****		7
	335	**403**	201	315

Gains or losses arising from fair value hedges	**2007 US$m**	2006 US$m
Gains/(losses):		
on hedging instruments	**(186)**	8
on the hedged items attributable to the hedged risk	**205**	8
	19	16

The gains and losses on ineffective portions of fair value hedges are recognised immediately in Net trading income.

Cash flow hedges

HSBCs cash flow hedges consist principally of interest rate and cross-currency swaps that are used to protect against exposures to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. Gains and losses are initially recognised directly in equity, in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement.

Fair value of derivatives designated as cash flow hedges

	At 31 December 2007 Fair value		At 31 December 2006 Fair value	
	Assets US$m	**Liabilities US$m**	Assets US$m	Liabilities US$m
Foreign exchange	**3,327**	**306**	2,371	281
Interest rate	**1,588**	**1,675**	1,378	1,083
	4,915	**1,981**	3,749	1,364

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The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December 2007 is as follows:

	3 months or less US$m	More than 3 months but less than 1 year US$m	5 years or less but more than 1 year US$m	More than 5 years US$m
At 31 December 2007				
Assets	**90,575**	**78,215**	**36,952**	**227**
Liabilities	**(89,891)**	**(77,389)**	**(68,189)**	**(5,955)**
Net cash inflows/(outflows) exposure	**684**	**826**	**(31,237)**	**(5,728)**
At 31 December 2006				
Assets	61,649	51,471	22,271	496
Liabilities	(96,852)	(91,868)	(60,712)	(8,093)
Net cash outflows exposure	(35,203)	(40,397)	(38,441)	(7,597)

This table reflects the interest rate repricing profile of the underlying hedged items.

The gains and losses on ineffective portions of such derivatives are recognised immediately in Net trading income. During the year to 31 December 2007, a loss of US$77 million (2006: US$122 million) was recognised due to hedge ineffectiveness.

Hedges of net investments in foreign operations

HSBCs consolidated balance sheet is affected by exchange differences between the US dollar and all the non-US dollar functional currencies of subsidiaries. HSBC hedges structural foreign exchange exposures only in limited circumstances. Hedging is undertaken using forward foreign exchange contracts which are accounted for as hedges of a net investment in a foreign operation, or by financing with borrowings in the same currencies as the functional currencies involved.

At 31 December 2007, the fair values of outstanding financial instruments designated as hedges of net investments in foreign operations were liabilities of US$450 million (2006: US$254 million) and notional contract values of US$1,204 million (2006: US$995 million).

The ineffectiveness recognised in Net trading income in the year ended 31 December 2007 that arose from hedges in foreign operations was nil (2006: nil).

19 Financial investments

	2007 US$m	2006 US$m
Financial investments:		
not subject to repledge or resale by counterparties	**271,126**	197,055
which may be repledged or resold by counterparties	**11,874**	7,751
	283,000	204,806

2007		2006	
Carrying	**Fair**	Carrying	Fair

	amount US$m	**value US$m**	amount US$m	value US$m
Treasury and other eligible bills	**30,104**	**30,104**	25,313	25,313
– available-for-sale	**30,104**	**30,104**	25,268	25,268
– held-to-maturity	–	–	45	45
Debt securities	**240,302**	**240,688**	171,196	171,498
– available-for-sale	**230,534**	**230,534**	161,870	161,870
– held-to-maturity	**9,768**	**10,154**	9,326	9,628
Equity securities	**12,594**	**12,594**	8,297	8,297
– available-for-sale	**12,594**	**12,594**	8,297	8,297
Total financial investments	**283,000**	**283,386**	204,806	205,108

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Notes on the Financial Statements (continued)

Note 19

	Amortised cost US$m	Fair value US$m
At 31 December 2007		
US Treasury	**6,799**	**6,831**
US Government agencies	**5,709**	**5,732**
US Government sponsored entities	**14,732**	**14,533**
UK Government	**757**	**749**
Hong Kong Government	**3,941**	**3,942**
Other government	**60,109**	**60,320**
Asset-backed securities	**66,172**	**65,962**
Corporate debt and other securities	**112,969**	**112,723**
Equities	**8,405**	**12,594**
	279,593	**283,386**
At 31 December 2006		
US Treasury	10,219	10,203
US Government agencies	6,004	5,968
US Government sponsored entities	14,010	13,799
UK Government	7,515	7,502
Hong Kong Government	1,085	1,080
Other government	37,828	38,198
Asset-backed securities	26,752	26,750
Corporate debt and other securities	93,217	93,311
Equities	6,295	8,297
	202,925	205,108
At 31 December 2005		
US Treasury	9,015	8,997
US Government agencies	4,173	4,173
US Government sponsored entities	16,099	15,889
UK Government	7,658	7,740
Hong Kong Government	4,429	4,408
Other government	34,623	34,853
Asset-backed securities	2,893	2,889
Corporate debt and other securities	96,018	96,055
Equities	6,414	7,519
	181,322	182,523

Included within the above figures are debt securities issued by banks and other financial institutions of US$142,863 million (2006: US$86,649 million). The fair value of these was US$143,023 million (2006: US$86,596 million).

	Treasury and other eligible bills available-for-sale US$m	Treasury and other eligible bills held-to-maturity US$m	Debt securities available-for-sale US$m	Debt securities held-to-maturity US$m	Equity securities US$m	Total US$m
Carrying amount at 31 December 2007						
Listed on a recognised exchange	**1,062**	—	**107,059**	**3,399**	**3,301**	**114,821**
Unlisted	**29,042**	—	**123,475**	**6,369**	**9,293**	**168,179**
	30,104	—	**230,534**	**9,768**	**12,594**	**283,000**
Carrying amount at 31 December 2006						
Listed on a recognised exchange	1,861	45	58,216	3,590	2,937	66,649
Unlisted	23,407	—	103,654	5,736	5,360	138,157
	25,268	45	161,870	9,326	8,297	204,806

The fair value of listed held-to-maturity debt securities as at 31 December 2007 was US$3,469 million (2006: US$3,663 million). Included within listed investments were US$2,066 million (2006: US$1,179 million) of investments listed in Hong Kong.

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The maturities of investment securities at carrying amount are analysed as follows:

	At 31 December	
	2007	2006
	US$m	US$m
Remaining contractual maturity of total debt securities:		
1 year or less	**80,979**	63,932
5 years or less but over 1 year	**76,306**	55,145
10 years or less but over 5 years	**34,175**	12,015
over 10 years	**48,842**	40,104
	240,302	171,196
Remaining contractual maturity of debt securities available for sale:		
1 year or less	**80,498**	63,382
5 years or less but over 1 year	**74,279**	53,497
10 years or less but over 5 years	**30,607**	8,827
over 10 years	**45,150**	36,164
	230,534	161,870
Remaining contractual maturity of debt securities held to maturity:		
1 year or less	**481**	550
5 years or less but over 1 year	**2,027**	1,648
10 years or less but over 5 years	**3,568**	3,188
over 10 years	**3,692**	3,940
	9,768	9,326

The following table provides an analysis of contractual maturities and weighted average yields of investment debt securities as at 31 December 2007:

	Within one year		**After one year but within five years**		**After five years but within ten years**		**After ten years**	
	Amount US$m	**Yield %**	**Amount US$m**	**Yield %**	**Amount US$m**	**Yield %**	**Amount US$m**	**Yield %**
Available-for-sale								
US Treasury	**111**	**3.43**	**164**	**3.86**	**1**	**6.86**	**—**	**—**
US Government agencies	**320**	**3.27**	**76**	**3.56**	**84**	**4.84**	**4,700**	**5.20**
US Government-sponsored agencies	**404**	**3.23**	**550**	**5.53**	**1,254**	**3.43**	**10,663**	**5.35**
UK Government	**48**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Hong Kong Government	**185**	**2.99**	**78**	**3.07**	**186**	**4.90**	**—**	**—**
Other governments	**21,340**	**5.47**	**13,725**	**5.58**	**3,657**	**3.91**	**2,453**	**4.26**
Asset-backed securities	**6,781**	**5.57**	**13,625**	**5.46**	**17,475**	**5.62**	**28,292**	**5.65**

Corporate debt and other securities	**51,187**	**5.00**	**41,092**	**4.31**	**7,025**	**4.92**	**5,836**	**5.14**
Total amortised cost	**80,376**		**69,310**		**29,682**		**51,944**	
Total carrying value	**80,498**		**74,279**		**30,607**		**45,150**	
Held-to-maturity								
US Treasury	**2**	**5.80**	**35**	**5.71**	**33**	**4.48**	**67**	**5.08**
US Government agencies	**1**	**7.80**	**3**	**—**	**7**	**8.16**	**518**	**6.41**
US Government-sponsored agencies	**—**	**—**	**8**	**7.08**	**69**	**6.03**	**1,784**	**5.89**
Hong Kong Government	**—**	**—**	**21**	**4.76**	**—**	**—**	**8**	**4.82**
Other governments	**100**	**4.86**	**147**	**5.44**	**75**	**4.26**	**616**	**7.08**
Corporate debt and other securities	**378**	**3.95**	**1,813**	**4.74**	**3,384**	**4.55**	**699**	**4.95**
Total amortised cost	**481**		**2,027**		**3,568**		**3,692**	
Total carrying value	**481**		**2,027**		**3,568**		**3,692**	

The maturity distributions of asset-backed securities are presented in the above table based upon contractual maturity dates. The weighted average yield for each range of maturities in the above table is calculated by dividing the annualised interest income for the year ended 31 December 2007 by the book amount of available-for-sale debt securities at that date. The yields do not include the effect of related derivatives.

20 Securitisations and other structured transactions

HSBC enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to SPEs. These transfers may give rise to the full or partial derecognition of the financial assets concerned.

- Full derecognition occurs when HSBC transfers its contractual right to receive cash flows from the financial assets, or retains the right but assumes an obligation to pass on the cash flows from the asset, and transfers substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks.

- Partial derecognition occurs when HSBC sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised on the balance sheet to the extent of HSBCs continuing involvement.

The majority of financial assets that do not qualify for derecognition are (i) debt securities held by counterparties as collateral under repurchase agreements or (ii) equity securities lent under securities lending agreements. The following table analyses the carrying amount of financial assets that did not qualify for derecognition and their associated financial liabilities:

	2007		2006	
	Carrying amount of transferred assets US$m	**Carrying amount of associated liabilities US$m**	Carrying amount of transferred assets US$m	Carrying amount of associated liabilities US$m
Nature of transaction				
Repurchase agreements	**126,534**	**126,111**	67,558	66,127
Securities lending agreements	**24,087**	**23,304**	12,908	12,469
	150,621	**149,415**	80,466	78,596

A small proportion of financial assets that do not qualify for derecognition relate to loans, credit cards, debt securities and trade receivables that have been securitised under arrangements by which HSBC retains a continuing involvement in such transferred assets. Continuing involvement may entail retaining the rights to future cash flows arising from the assets after investors have received their contractual terms (for example, interest rate strips); providing subordinated interest; liquidity support; continuing to service the underlying asset; or entering into derivative transactions with the securitisation vehicles. As such, HSBC continues to be exposed to risks associated with these transactions.

The rights and obligations that HSBC retains from its continuing involvement in securitisations are initially recorded as an allocation of the fair value of the financial asset between the part that is derecognised and the part that continues to be recognised on the date of transfer. The following analyses the carrying amount of financial assets to the extent of HSBCs continuing involvement that qualified for partial derecognition during the year, and their associated liabilities:

	Securitisations at 31 December	
	2007	2006
	US$m	US$m
Carrying amount of assets (original)	**17,713**	20,095
Carrying amount of assets (currently recognised)	**598**	599
Carrying amount of associated liabilities (currently recognised)	**299**	306

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21 Interests in associates and joint ventures

Principal associates of HSBC

	At 31 December 2007		At 31 December 2006	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m
Listed				
Bank of Communications Co., Limited	**3,957**	**12,992**	2,710	11,065
Financiera Independencia S.A. de C.V.[2]	**69**	**206**	–	–
Industrial Bank Company Limited[1]	**683**	**4,538**	–	–
Ping An Insurance (Group) Company of China, Limited	**3,790**	**13,232**	2,037	6,825
SABB Takaful Company	**5**	**101**	–	–
The Saudi British Bank Limited	**1,082**	**5,719**	978	4,700
	9,586	**36,788**	5,725	22,590

1 *Listed on the Shanghai Stock Exchange on 5 February 2007.*
2 *Listed on the Mexican Stock Exchange on 31 October 2007.*

	At 31 December 2007		
	Country of incorporation	**HSBC's interest in equity capital**	**Issued equity capital**
Listed			
Bank of Communications Co., Limited	PRC[1]	19.01%	RMB45,804m
Financiera Independencia S.A. de C.V.	Mexico	18.68%	MXP154m
Industrial Bank Company Limited[3]	PRC[1]	12.78%	RMB5,000m
Ping An Insurance (Group) Company of China, Limited	PRC[1]	16.78%	RMB7,345m
SABB Takaful Company	Saudi Arabia	32.50%	SR100m
The Saudi British Bank Limited	Saudi Arabia	40.00%	SR3,750m
Unlisted			
Barrowgate Limited[2,3]	Hong Kong	24.64%	–
British Arab Commercial Bank Limited	England	46.51%	US$81m £32m fully paid £5m nil paid
Vietnam Technological and Commercial Joint Stock Bank	Vietnam	14.44%	VND2,521,308m
VocaLink	England	13.95%	£100m
Wells Fargo HSBC Trade Bank, N.A[4]	United States	20.00%	–

1 *People's Republic of China.*
2 *Issued equity capital is less than HK$1 million.*
3 *Investment held through Hang Seng Bank Limited, a 62.14 per cent owned subsidiary of HSBC.*
4 *Issued equity capital is less than US$1 million.*

All the above investments in associates are owned by subsidiaries of HSBC Holdings.

HSBC had US$7,747 million (2006: US$4,747 million) of investments in associates and joint ventures listed in Hong Kong.

For the year ended 31 December 2007, HSBCs share of associates and joint ventures tax on profit was US$469 million (2006: US$279 million), which is included within share of profit in associates and joint ventures in the income statement.

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HSBC HOLDINGS PLC

Notes on the Financial Statements (continued)

Notes 21 and 22

Summarised aggregate financial information on associates

	2007 **US$m**	2006 US$m
HSBC□s share of:		
□ assets	**100,799**	83,096
□ liabilities	**94,178**	77,446
□ revenues	**5,568**	5,521
□ profit after tax	**1,466**	823

HSBC□s investment in Industrial Bank Company Limited was equity accounted with effect from May 2004, reflecting HSBC□s significant influence over this associate. HSBC□s significant influence was established as a result of representation on the Board of Directors, and in accordance with the Technical Support and Assistance Agreements, HSBC is assisting in the development of financial and operating policies.

HSBC□s investment in Ping An Insurance (Group) Company of China, Limited was equity accounted with effect from 31 August 2005, reflecting HSBC□s significant influence over this associate. HSBC□s significant influence was established as a result of representation on the Board of Directors.

HSBC□s significant influence in Bank of Communications Co., Limited was established as a result of representation on the Board of Directors, and in accordance with the Technical Support and Assistance Agreements, HSBC is assisting in the development of financial and operating policies and a number of staff have been seconded to assist in this process.

The statutory accounting reference date of Bank of Communications Co., Limited, Ping An Insurance (Group) Company of China, Limited and Industrial Bank Company Limited is 31 December. For the year ended 31 December 2007, these companies were included on the basis of financial statements made up for the twelve months to 30 September 2007, taking into account changes in the subsequent period from 1 October 2007 to 31 December 2007 that would have materially affected their results.

HSBC also has a 100 per cent interest in the issued preferred stock (less than US$1 million) of Wells Fargo HSBC Trade Bank, N.A. HSBC has a 40 per cent economic interest in Wells Fargo HSBC Trade Bank, N.A. by virtue of the joint agreement under which HSBC□s equity capital and preferred stock interests are being held.

HSBC□s investment in Financiera Independencia S.A. de C.V. was equity accounted with effect from June 2006, reflecting HSBC□s significant influence over this associate. HSBC□s influence results from representation on the Board of Directors.

HSBC acquired 15 per cent of Vietnam Technological & Commercial Joint Stock Bank in October 2007. This investment was equity accounted from that date due to HSBC□s representation on the Board of Directors and involvement in the Technical Support and Assistance Agreement. In December 2007, as a result of a rights issue in which HSBC did not participate, HSBC□s equity interest was diluted to 14.44 per cent.

HSBC acquired 13.95 per cent of VocaLink in June 2007. This investment was equity accounted from that date, reflecting HSBC□s significant influence over that entity arising from representation on the Board of Directors and transactions with the associate.

During the year, certain HSBC associates issued new shares which HSBC did not subscribe for. As a result, its interests in the associates□ equity decreased. The resulting gains from dilution of the Group□s interest in the associates are described in Note 4.

Principal interests in joint ventures

	At 31 December 2007			
	Country of incorporation	Principal activity	HSBC's interest in equity capital	Issued equity capital
HSBC Saudi Arabia Limited	Saudi Arabia	Investment banking	60%	SR50m
Vaultex (UK) Limited	England	Cash management	50%	£10m

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HSBC Saudi Arabia Limited was established as a joint venture between HSBC and The Saudi British Bank with effect from July 2006. The ownership of HSBC Saudi Arabia Limited is split between HSBC, with 60 per cent, and The Saudi British Bank, with 40 per cent. The strategic financial and operating decisions of HSBC Saudi Arabia Limited require the unanimous consent of HSBC and The Saudi British Bank.

Summarised aggregate financial information on joint ventures

	2007 **US$m**	2006 US$m
HSBC's share of:		
current assets	**448**	125
non-current assets	**76**	107
current liabilities	**397**	98
non-current liabilities	**46**	87
income	**339**	102
expenses	**302**	79

22 Goodwill and intangible assets

Goodwill and intangible assets includes goodwill arising on business combinations, the PVIF long-term insurance business, and other intangible assets.

Goodwill

	Europe US$m	**Hong Kong US$m**	**Rest of Asia-Pacific US$m**	**North America US$m**	**Latin America US$m**	**Total US$m**
Cost						
At 1 January 2007	**15,234**	**124**	**325**	**12,527**	**4,262**	**32,472**
Additions	**42**	****	**6**	****	**143**	**191**
Disposals	**(43)**	****	****	**(12)**	****	**(55)**
Exchange differences	**1,516**	****	**19**	**46**	**120**	**1,701**
Other changes	**(5)**	****	****	****	**(51)**	**(56)**
At 31 December 2007	**16,744**	**124**	**350**	**12,561**	**4,474**	**34,253**
Cost						
At 1 January 2006	13,777	120	270	12,424	2,634	29,225
Additions	29		34	55	1,608	1,726
Exchange differences	1,428	4	25		20	1,477
Other changes			(4)	48		44
At 31 December 2006	15,234	124	325	12,527	4,262	32,472

During 2007 there was no impairment of goodwill (2006: nil; 2005: nil). Impairment testing in respect of goodwill is performed annually by comparing the recoverable amount of cash-generating units (CGUs) determined at 1 July 2007 based on a value in use calculation. That calculation uses cash flow estimates based on management's cash flow projections, extrapolated in perpetuity using a nominal long-term growth rate based on current market assessment of GDP and inflation for the countries within which the CGU operates. Cash flows are extrapolated in perpetuity due to the long-term perspective within the Group of the business units making up the CGUs. The pre-tax discount rate used is based on the cost of capital HSBC allocates to investments in the countries within which the CGU operates.

The cost of capital assigned to an individual CGU and used to discount its future cash flows can have a significant effect on its valuation. The cost of capital percentage is generally derived from an appropriate capital asset pricing model, which itself depends on inputs reflecting a number of financial and economic variables including the risk-free rate in the country concerned and a premium to reflect the inherent risk of the business being evaluated. These variables are established on the basis of management judgement and current market assessments of economic variables.

Management judgement is required in estimating the future cash flows of the CGUs. These values are sensitive to the cash flows projected for the periods for which detailed forecasts are available, and to assumptions regarding the long-term sustainable pattern of cash flows thereafter. While the acceptable range within which underlying assumptions can be applied is governed by the requirement for resulting forecasts to be compared with actual performance and verifiable economic data in future years, the cash flow forecasts necessarily and appropriately reflect management's view of future business prospects.

It is HSBC's policy to retest goodwill when there are indications that conditions have changed since the last goodwill impairment test such that a different outcome may result. During the fourth quarter of 2007, the Personal Financial Services – North America CGU experienced deterioration in economic and credit conditions, and carried out restructuring in certain operations. As a result, goodwill impairment was retested as at 31 December 2007. This testing confirmed that, notwithstanding the effects of the above factors, goodwill for the CGU as a whole remained unimpaired.

The following CGUs include in their carrying value goodwill that is a significant proportion of total goodwill reported by HSBC. These CGUs do not carry on their balance sheets any intangible assets with indefinite useful lives, other than goodwill.

	2007			2006		
Cash-generating unit	**Goodwill at 1 July 2007 US$m**	**Discount rate %**	**Nominal growth rate beyond initial cash flow projections %**	Goodwill at 1 July 2006 US$m	Discount rate %	Nominal growth rate beyond initial cash flow projections %
Personal Financial Services – Europe	**4,197**	**10.3**	**5.2**	4,149	10.6	5.0
Commercial Banking – Europe	**3,045**	**10.1**	**4.6**	2,948	10.2	4.5
Private Banking – Europe	**4,694**	**10.0**	**3.8**	4,417	10.0	4.2
Global Banking and Markets – Europe	**3,894**	**10.1**	**4.4**	3,792	8.2	4.5
Personal Financial Services – North America	**10,160**	**12.3**	**4.0**	10,169	10.0	5.8
Personal Financial	**2,781**	**16.4**	**7.8**	1,753	16.0	8.2

Services Latin America		
Total goodwill in the CGUs listed above	**28,771**	27,228

At 1 July 2007, aggregate goodwill of US$4,254 million had been allocated to CGUs that were not considered individually significant. These CGUs do not carry on their balance sheets any intangible assets with indefinite useful lives, other than goodwill.

The present value of in-force long-term insurance business

Movement on the PVIF

	2007 **US$m**	2006 US$m
At 1 January	**1,549**	1,400
Addition from current year new business	**380**	254
Acquisition of subsidiaries or portfolios	**390**	
Movement from in-force business (including investment return variances and changes in investment assumptions)	**(204)**	(203)
Exchange differences and other movements	**(150)**	98
At 31 December	**1,965**	1,549

PVIF-specific assumptions

The key assumptions used in the computation of PVIF for HSBCs main life insurance operations were:

	2007			2006	
	UK %	**Hong Kong %**	**France**1 **%**	UK %	Hong Kong %
Risk free rate	**4.30**	**3.51**	**4.26**	4.30	3.73
Risk discount rate	**8.00**	**11.00**	**8.00**	8.00	11.00
Expenses inflation	**3.40**	**3.00**	**2.00**	3.40	3.00

1 *HSBC acquired HSBC Assurances in March 2007.*

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The PVIF represents the value of the shareholders interest in the in-force business of the life insurance operations. The calculation of the PVIF is based upon assumptions that take into account risk and uncertainty. To project these cash flows, a variety of assumptions regarding future experience is made by each insurance operation which reflect local market conditions and managements judgement of local future trends. Some of the Groups insurance operations incorporate risk margins separately into the projection assumptions for each product, while others incorporate risk margins into the overall discount rate. This is reflected in the wide range of risk discount rates applied.

Other intangible assets

The analysis of the movement of intangible assets, excluding the PVIF, was as follows:

	Trade names US$m	**Mortgage servicing rights US$m**	**Internally generated software US$m**	**Purchased software US$m**	**Customer/ merchant relation-ships US$m**	**Other US$m**	**Total US$m**
Cost							
At 1 January 2007	**57**	**1,078**	**2,871**	**645**	**1,655**	**179**	**6,485**
Additions1		**124**	**587**	**104**	**140**	**6**	**961**
Acquisition of subsidiaries					**4**		**4**
Disposals			**(7)**	**(21)**	**(6)**	**(2)**	**(36)**
Exchange differences	**6**		**81**	**38**	**83**	**1**	**209**
Other changes			**(59)**	**(6)**	**(10)**	**(19)**	**(94)**
At 31 December 2007	**63**	**1,202**	**3,473**	**760**	**1,866**	**165**	**7,529**
Accumulated amortisation							
At 1 January 2007	**(21)**	**(619)**	**(1,772)**	**(426)**	**(320)**	**(13)**	**(3,171)**
Charge for the year2	**(20)**	**(108)**	**(327)**	**(120)**	**(209)**	**(21)**	**(805)**
Impairment			**(3)**				**(3)**
Disposals				**18**	**6**	**1**	**25**
Exchange differences	**(3)**		**(51)**	**(25)**	**(17)**		**(96)**
Other changes		**3**	**(14)**	**4**	**(1)**		**(8)**
At 31 December 2007	**(44)**	**(724)**	**(2,167)**	**(549)**	**(541)**	**(33)**	**(4,058)**

Net carrying amount at 31 December 2007	**19**	**478**	**1,306**	**211**	**1,325**	**132**	**3,471**
Cost							
At 1 January 2006	43	979	2,094	295	1,034	373	4,818
Additions[1]	—	99	589	70	96	3	857
Acquisition of subsidiaries	15	—	—	6	195	114	330
Disposals	—	—	(3)	(21)	—	(1)	(25)
Amounts written-off	—	—	—	—	(71)	—	(71)
Exchange differences	(1)	—	150	17	28	39	233
Other changes	—	—	41	278	373	(349)	343
At 31 December 2006	57	1,078	2,871	645	1,655	179	6,485
Accumulated amortisation							
At 1 January 2006	(15)	(560)	(1,301)	(170)	(173)	(24)	(2,243)
Charge for the year[2]	(7)	(59)	(345)	(107)	(137)	(36)	(691)
Impairment	—	—	(25)	(3)	(56)	—	(84)
Disposals	—	—	—	20	—	—	20
Amounts written-off	—	—	—	—	71	—	71
Exchange differences	1	—	(97)	(13)	(1)	(4)	(114)
Other changes	—	—	(4)	(153)	(24)	51	(130)
At 31 December 2006	(21)	(619)	(1,772)	(426)	(320)	(13)	(3,171)
Net carrying amount at 31 December 2006	36	459	1,099	219	1,335	166	3,314

1 *At 31 December 2007, HSBC had US$47 million (2006: US$23 million) of contractual commitments to acquire intangible assets.*

2 *The amortisation charge for the year is recognised within the income statement under Amortisation and impairment of intangible assets, with the exception of the amortisation of mortgage servicing rights that is charged to net fee income.*

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23 Property, plant and equipment

HSBC

Property, plant and equipment

	Freehold land and buildings US$m	Long leasehold land and buildings US$m	Short leasehold land and buildings[1] US$m	Equipment, fixtures and fittings[2] US$m	Equipment on operating leases US$m	Total[3] US$m
Cost or fair value						
At 1 January 2007	**5,331**	**1,936**	**2,574**	**9,702**	**5,923**	**25,466**
Additions at cost[4]	**684**	**78**	**397**	**1,429**	**132**	**2,720**
Acquisition of subsidiaries	**93**	–	–	–	–	**93**
Fair value adjustments	**25**	**21**	**106**	–	–	**152**
Disposals	**(256)**	**(37)**	**(117)**	**(542)**	**(129)**	**(1,081)**
Reclassified as held for sale	**(446)**	**(596)**	**(82)**	**(160)**	–	**(1,284)**
Transfers	–	**(5)**	**5**	–	–	–
Exchange differences	**237**	**1**	**49**	**450**	**128**	**865**
Other changes	**(967)**	**40**	**(76)**	**78**	–	**(925)**
At 31 December 2007	**4,701**	**1,438**	**2,856**	**10,957**	**6,054**	**26,006**
Accumulated depreciation and impairment						
	(342)	**(168)**	**(723)**	**(5,974)**	**(1,835)**	**(9,042)**

At 1 January 2007						
Depreciation charge for the year	**(93)**	**(37)**	**(167)**	**(1,192)**	**(205)**	**(1,694)**
Disposals	**41**	**7**	**95**	**469**	**115**	**727**
Reclassified as held for sale	**73**	**23**	**3**	**67**		**166**
Transfers						
Impairment losses recognised	**(26)**		**(5)**	**(3)**		**(34)**
Impairment losses reversed	**14**					**14**
Exchange differences	**(18)**	**(1)**	**(19)**	**(282)**	**(38)**	**(358)**
Other changes	**7**	**1**	**(10)**	**(88)**	**(1)**	**(91)**
At 31 December 2007	**(344)**	**(175)**	**(826)**	**(7,003)**	**(1,964)**	**(10,312)**
Net carrying amount at 31 December 2007	**4,357**	**1,263**	**2,030**	**3,954**	**4,090**	**15,694**
Cost or fair value						
At 1 January 2006	4,828	2,235	2,265	8,639	4,964	22,931
Additions at cost4	376	24	253	1,473	274	2,400
Acquisition of subsidiaries	189		17	55	1	262
Fair value adjustments	64	77	23			164
Disposals	(407)	(421)	(66)	(972)	(28)	(1,894)
Transfers		(38)	38			
Exchange differences	287	102	65	633	474	1,561
Other changes	(6)	(43)	(21)	(126)	238	42
	5,331	1,936	2,574	9,702	5,923	25,466

At 31 December 2006						
Accumulated depreciation and impairment						
At 1 January 2006	(252)	(132)	(604)	(5,418)	(1,319)	(7,725)
Depreciation charge for the year	(85)	(46)	(131)	(1,075)	(177)	(1,514)
Disposals	30	2	59	915	89	1,095
Transfers	—	1	(1)	—	—	—
Exchange differences	(28)	(8)	(40)	(401)	(190)	(667)
Other changes	(7)	15	(6)	5	(238)	(231)
At 31 December 2006	(342)	(168)	(723)	(5,974)	(1,835)	(9,042)
Net carrying amount at 31 December 2006	4,989	1,768	1,851	3,728	4,088	16,424

Leasehold land and buildings are considered to be held under finance lease contracts where the value of the land cannot reliably be separated from the value of the lease, and the respective contracts do not meet the criteria for classification as operating leases.

1 *Including assets held on finance leases with a net book value of US$13 million (2006: US$11 million).*
2 *Including assets held on finance leases with a net book value of US$397 million (2006: US$450 million).*
3 *Including assets with a net book value of US$422 million (2006: US$425 million) pledged as security for liabilities.*
4 *At 31 December 2007, HSBC had US$1,011 million (2006: US$1,380 million) of contractual commitments to acquire property, plant and equipment.*

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Included within Short leasehold land and buildings are the following amounts in respect of assets classed as improvements to buildings, which are carried at depreciated historical cost:

	2007		2006	
	Cost US$m	**Accumulated depreciation US$m**	Cost US$m	Accumulated depreciation US$m
At 1 January	**1,277**	**(351)**	1,026	(315)
Additions	**294**		218	
Disposals	**(117)**	**94**	(67)	47
Depreciation charge for the year		**(123)**		(35)
Impairment loss recognised				(3)
Exchange differences	**43**	**(10)**	63	(37)
Other changes	**(7)**	**(281)**	37	(8)
At 31 December	**1,490**	**(671)**	1,277	(351)
Net carrying amount at 31 December	**819**		926	

Investment properties

The composition of the investment properties at fair value in the year was as follows:

	Freehold land and buildings US$m	**Long leasehold land and buildings US$m**	**Short leasehold land and buildings US$m**	**Total US$m**
Fair value				
At 1 January 2007	**1,533**	**174**	**242**	**1,949**
Acquisition of subsidiaries	**93**			**93**
Additions at cost	**287**			**287**
Fair value adjustments	**25**	**21**	**106**	**152**
Disposals	**(3)**			**(3)**
Reclassified as held for sale	**(61)**	**(5)**	**(48)**	**(114)**
Transfers		**(2)**	**4**	**2**
Exchange differences	**27**	**1**	**(1)**	**27**
Other changes[1]	**(976)**	**16**	**(87)**	**(1,047)**
At 31 December 2007	**925**	**205**	**216**	**1,346**
At 1 January 2006	1,438	477	255	2,170
Additions at cost	179			179
Fair value adjustments	64	77	23	164
Disposals	(178)	(371)	(8)	(557)
Exchange differences	42	12		54
Other changes[1]	(12)	(21)	(28)	(61)
At 31 December 2006	1,533	174	242	1,949

1 *Mainly relating to investment properties of subsidiaries no longer qualifying for consolidation, because HSBC does not have the majority of the risks and rewards of ownership.*

Investment properties are valued on an open market value basis as at 31 December each year by independent professional valuers who have recent experience in the location and type of properties. Investment properties in Hong Kong, the Macau Special Administrative Region and mainland China, which represent 25 per cent by value of HSBCs investment properties subject to revaluation, were valued by DTZ Debenham Tie Leung Limited, which is a member of the Hong Kong Institute of Surveyors.

Included within Other operating income was rental income of US$42 million (2006: US$153 million) earned by HSBC on its investment properties. Direct operating expenses of US$3 million (2006: US$61 million) incurred in respect of the investment properties during the year were recognised in General and administrative expenses. Direct operating expenses arising in respect of investment properties that did not generate rental income during 2007 amounted to nil (2006: nil).

HSBC recognised US$22 million (2006: US$144 million) as contractual obligations to purchase, construct, develop, maintain or enhance investment properties.

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Notes on the Financial Statements (continued)

Note 24

HSBC Holdings had no investment properties at 31 December 2007 or 2006.

HSBC properties leased to customers

HSBC properties leased to customers included US$387 million at 31 December 2007 (2006: US$470 million) let under operating leases, net of accumulated depreciation of US$18 million (2006: US$53 million). None was held by HSBC Holdings.

24 Investments in subsidiaries

Principal subsidiaries of HSBC Holdings

	At 31 December 2007		
	Country of incorporation or registration	**HSBC's interest in equity capital %**	**Issued equity capital**
Europe			
HFC Bank Limited	England	100	£109m
HSBC Investments (UK) Limited	England	100	£37m
HSBC Asset Finance (UK) Limited	England	100	£265m
HSBC Bank A.S.	Turkey	100	TRL652m
HSBC Bank Malta p.l.c.	Malta	70.03	Lm36m
HSBC Bank plc	England	100	£797m
HSBC France	France	99.99	€380m
HSBC Bank International Limited	Jersey	100	£1m
HSBC Life (UK) Limited	England	100	£94m
HSBC Private Banking Holdings (Suisse) S.A.	Switzerland	100	CHF1,363m
HSBC Trinkaus & Burkhardt AG	Germany	78.60	€70m
Marks and Spencer Retail Financial Services Holdings Limited	England	100	£67m
Hong Kong			
Hang Seng Bank Limited	Hong Kong	62.14	HK$9,559m
HSBC Insurance (Asia) Limited	Hong Kong	100	HK$125m
HSBC Life (International) Limited	Bermuda	100	HK$327m
The Hongkong and Shanghai Banking Corporation Limited	Hong Kong	100	HK$22,494m
Rest of Asia-Pacific			
HSBC Bank Australia Limited	Australia	100	A$ 811m
HSBC Bank (China) Company Limited	PRC[1]	100	RMB8,000m
HSBC Bank Egypt S.A.E.	Egypt	94.53	E£1,073m
HSBC Bank Malaysia Berhad	Malaysia	100	RM$114m
HSBC Bank Middle East Limited	Jersey	100	US$431m
North America			

The Bank of Bermuda Limited	Bermuda	100	US$30m
HSBC Bank Canada	Canada	100	C$1,125m
HSBC Bank USA, N.A.	United States	100	US$2m
HSBC Finance Corporation	United States	100	US$3,038m
HSBC Securities (USA) Inc.	United States	100	2
Latin America			
HSBC Bank Argentina S.A.	Argentina	99.99	ARS1,792m
HSBC Bank Brasil S.A. Banco Múltiplo	Brazil	100	BRL2,147m
HSBC Mexico S.A.	Mexico	99.99	MXP4,272m
HSBC Bank Panama S.A.	Panama	100.00	US$315m

1 *Peoples Republic of China.*
2 *Issued equity capital is less than US$1 million.*
3 *Details of the debt, subordinated debt and preference shares issued by the principal subsidiaries to parties external to the Group are included in the Notes 28 Debt securities in issue, 32 Subordinated liabilities and 37 Minority interests, respectively.*

All the above subsidiaries are included in the HSBC consolidated financial statements.

Details of all HSBC companies will be annexed to the next Annual Return of HSBC Holdings filed with the UK Registrar of Companies.

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All the above make their financial statements up to 31 December except for HSBC Bank Argentina S.A., HSBC La Buenos Aires Seguros S.A. and Maxima S.A. AFJP, whose financial statements are made up to 30 June annually.

The principal countries of operation are the same as the countries of incorporation except for HSBC Bank Middle East Limited which operates mainly in the Middle East and HSBC Life (International) Limited which operates mainly in Hong Kong.

Subsidiaries which experience significant restrictions on their ability to transfer funds to HSBC in the form of cash dividends or to repay loans and advances

During 2007 and 2006, none of the Groups subsidiaries have experienced significant restrictions on paying dividends or repaying loans and advances.

Subsidiaries excluding SPEs where HSBC owns less than 50 per cent of the voting rights

Subsidiary	HSBCs interest in equity capital %	Description of relationship that gives HSBC control
2007		
HSBC Private Equity Fund 3	38.8	HSBC has been appointed as investment adviser/manager of the fund and is therefore deemed to have control in the fund.
2006		
HSBC Private Equity Fund 3	38.8	HSBC has been appointed as investment adviser/manager of the fund and is therefore deemed to have control in the fund.

SPEs consolidated by HSBC where HSBC owns less than 50 per cent of the voting rights

	Carrying value of total consolidated assets US$bn	Nature of SPE
2007		
Asscher Finance Limited	7.4	Structured investment vehicle
Bryant Park Funding LLC	5.3	Conduit
Cullinan Funding Ltd	33.3	Structured investment vehicle
Household Consumer Loan Corporation	9.3	Securitisation
HSBC Affinity Corporation I	5.8	Securitisation
HSBC Auto Receivables Corporation	5.2	Securitisation
HSBC Home Equity Loan Corporation I	8.2	Securitisation
HSBC Receivables Funding, Inc I	6.0	Securitisation
Metris Receivables Inc	5.5	Securitisation
Regency Assets Limited	9.1	Conduit
Solitaire Funding Ltd	21.6	Conduit
2006		
Bryant Park Funding LLC	5.3	Conduit
Household Consumer Loan Corporation	6.1	Securitisation
HSBC Affinity Corporation I	5.7	Securitisation
HSBC Auto Receivables Corporation	6.9	Securitisation
HSBC Home Equity Loan Corporation I	8.7	Securitisation
HSBC Receivables Funding, Inc I	6.0	Securitisation

Metris Receivables Inc	6.2	Securitisation
Regency Assets Limited	9.4	Conduit
Solitaire Funding Ltd	20.4	Conduit

In each of the above cases, HSBC has less than 50 per cent of the voting rights, but consolidates because it has the majority of risks and rewards of ownership of the SPE, or the substance of the relationship with the SPE is such that its activities are conducted on behalf of HSBC according to its specific business needs so that HSBC obtains benefit from the SPEs operation. HSBC also consolidates a number of other individually insignificant SPEs where it owns less than 50 per cent of the voting rights.

Acquisitions

HSBC made the following acquisitions of subsidiaries or business operations in 2007, which were accounted for using the purchase method:

On 26 March 2007, the Group, through its subsidiary, HSBC France, acquired the 50.01 per cent of Erisa S.A. and Erisa I.A.R.D. (together now re-named HSBC Assurances) shares not already owned, raising the total holding in each entity to 100 per cent. HSBC Assurances is a group of companies offering life, property and casualty insurance products through HSBC France's networks. HSBC paid a cash consideration of US$304 million in respect of this acquisition. The fair value of the assets acquired exceeded the cash consideration by US$17 million and this excess has been recognised within other operating income in the income statement.

The fair values of the assets, liabilities and contingent liabilities of HSBC Assurances were as follows:

	Fair value US$m	**Carrying value immediately prior to acquisition US$m**
At date of acquisition		
Financial assets designated at fair value	**7,684**	**7,684**
Derivative assets	**50**	**50**
Loans and advances to banks	**94**	**94**
Financial investments	**11,211**	**11,211**
Intangible assets	**390**	**390**
Property, plant and equipment	**93**	**93**
Prepayments and accrued income	**257**	**257**
Other assets	**81**	**81**
Deposits by banks	**(1)**	**(1)**
Financial liabilities designated at fair value	**(72)**	**(72)**
Derivative liabilities	**(15)**	**(15)**
Provisions and deferred tax	**(143)**	**(143)**
Other liabilities	**(1,434)**	**(1,434)**
Liabilities under insurance contracts issued	**(17,478)**	**(17,478)**
Subordinated liabilities	**(74)**	**(74)**
Net assets acquired	**643**	**643**
Less: carrying value of HSBC's existing interest in HSBC Assurances	**(322)**	
Excess fair value of assets acquired	**(17)**	
Total consideration including costs of acquisition	**304**	

In addition to the above, there were other minor acquisitions and increases in investment in subsidiaries which increased goodwill by US$191 million, including US$94 million of goodwill arising on the increase in HSBC's stake in Inversiones Financieras Bancosal.

25 Other assets

	2007 US$m	2006 US$m

Bullion	**9,244**	3,145
Assets held for sale	**2,804**	1,826
Reinsurers share of liabilities under insurance contracts (Note 30)	**1,315**	1,769
Endorsements and acceptances	**12,248**	9,577
Other accounts	**13,882**	13,506
	39,493	29,823

Assets held for sale

	2007	2006
	US$m	US$m
Non-current assets held for sale		
Interests in associates	**2**	25
Property, plant and equipment	**2,502**	1,149
Investment properties	**111**	13
Financial assets	**185**	634
Other	**4**	5
Total assets classified as held for sale	**2,804**	1,826

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Property, plant and equipment

The property, plant and equipment classified as held for sale comprises two principal categories. The first is as a result of the repossession of property that had been pledged as collateral by customers. These assets are expected to be disposed of within 12 months of acquisition. Neither a gain nor loss was recognised on reclassifying these assets as held for sale. The majority arose within the geographical segment, North America.

Secondly, on 31 May 2007, HSBC entered into a contract for the sale and leaseback of the property and long leasehold land comprising 8 Canada Square, London to Metrovacesa, S.A. (Metrovacesa) for £1,090 million (US$2,154 million). Under the terms of this arrangement, HSBC leased the building back from Metrovacesa for a period of 20 years at an annual rent of £43.5 million (US$87 million), with annual upward-only rent reviews linked to the RPI (all items) and subject to an annual maximum and minimum increase of 6 per cent and 2.5 per cent, respectively. In the normal course of business, HSBC provided finance to Metrovacesa in respect of the debt element of this transaction at arms length market rates in the form of a bridging loan of £810 million (US$1,601 million), secured by a charge on the property. The bridging loan had an original maturity date of 30 November 2007 and was extended with a new facility provided by HSBC with a maturity date of 30 November 2008. The equity portion of £280 million (US$553 million) was settled in cash by Metrovacesa on 31 May 2007.

The sale has not been recognised in the financial statements at 31 December 2007 because HSBC has retained a significant interest by virtue of the loan provided to part-finance the purchase of the building. Accordingly, 8 Canada Square is presented within Non-current assets held for sale with a carrying value of US$884 million. The equity portion received from Metrovacesa is presented in the balance sheet as deferred income with a value at 31 December 2007 of US$562 million. It is expected that the sale will be recognised by HSBC when the bridging loan is repaid.

26 Trading liabilities

	2007 **US$m**	2006 US$m
Deposits by banks	**58,940**	32,040
Customer accounts	**102,710**	89,166
Other debt securities in issue	**44,684**	34,115
Other liabilities net short positions	**108,246**	71,287
	314,580	226,608

27 Financial liabilities designated at fair value

HSBC

	2007 **US$m**	2006 US$m
Deposits by banks and customer accounts	**7,724**	577
Liabilities to customers under investment contracts	**16,053**	13,278
Debt securities in issue (Note 28)	**38,587**	33,167
Subordinated liabilities (Note 32)	**22,831**	18,503
Preference shares (Note 32)	**4,744**	4,686
	89,939	70,211

The carrying amount at 31 December 2007 of financial liabilities designated at fair value was US$648 million less (2006: US$1,257 million more) than the contractual amount at maturity. At 31 December 2007, the accumulated amount of the change in fair value attributable to changes in credit risk was a gain of US$1,619 million (2006: loss of US$1,535 million).

HSBC Holdings

	2007	2006
	US$m	US$m
Subordinated liabilities (Note 32):		
owed to third parties	**14,496**	9,839
owed to HSBC undertakings	**4,187**	4,231
	18,683	14,070

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The carrying amount at 31 December 2007 of financial liabilities designated at fair value was US$130 million less than the contractual amount at maturity (2006: US$551 million more). At 31 December 2007, the accumulated amount of the change in fair value attributable to changes in credit risk was a gain of US$548 million (2006: loss of US$335 million).

28 Debt securities in issue

	2007 US$m	2006 US$m
Bonds and medium term notes	**221,767**	203,404
Other debt securities in issue	**108,083**	94,203
	329,850	297,607
Of which debt securities in issue reported as:		
trading liabilities (Note 26)	**(44,684)**	(34,115)
financial liabilities designated at fair value (Note 27)	**(38,587)**	(33,167)
	246,579	230,325

Certain debt securities in issue are managed on a fair value basis as part of HSBCs interest rate risk management policies. The hedged portion of these debt securities is presented within the balance sheet caption Financial liabilities designated at fair value, with the remaining portion included within Trading liabilities. The following table analyses the carrying amount of bonds and medium term notes in issue at 31 December with original maturities greater than one year:

	2007 US$m	2006 US$m
Fixed rate		
Debentures 8.375%: due 2007		100
Secured financing:		
1.14% to 3.99%: due 2008 to 2009	**115**	195
4.00% to 4.99%: due 2008 to 2010	**1,409**	1,730
5.00% to 5.99%: due 2008 to 2012	**13,002**	6,096
6.00% to 6.99%: due 2008	**459**	
7.00% to 8.99%: due 2008 to 2025	**521**	313
Other fixed rate senior debt:		
0.01% to 3.99%: due 2008 to 2066	**28,322**	17,326
4.00% to 4.99%: due 2008 to 2046	**20,909**	17,759
5.00% to 5.99%: due 2008 to 2024	**18,511**	34,191
6.00% to 6.99%: due 2008 to 2033	**15,400**	16,196
7.00% to 7.99%: due 2008 to 2032	**4,037**	6,692
8.00% to 9.99%: due 2008 to 2017	**1,666**	1,665
10.00% or higher: due 2008 to 2017	**867**	399
	105,218	102,662

Variable interest rate		
Secured financings 1.00% to 9.99%: due 2008 to 2017	**47,404**	23,212
FHLB advances 5.00% to 5.99%: due 2008 to 2036	**5,500**	5,000
Other variable interest rate senior debt 2.16% to 9.99%: due 2008 to 2049	**56,244**	63,504
	109,148	91,716
Structured notes		
Interest rate linked	**770**	379
Equity, equity index or credit linked	**6,631**	8,647
	7,401	9,026
Total bonds and medium term notes	**221,767**	203,404

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29 Other liabilities

	HSBC		HSBC Holdings	
	2007	2006	**2007**	2006
	US$m	US$m	**US$m**	US$m
Amounts due to investors in funds consolidated by HSBC	**3,548**	966		
Obligations under finance leases (Note 42)	**703**	707		
Dividend declared and payable by HSBC Holdings	**1,393**	1,507	**1,393**	1,507
Endorsements and acceptances	**12,248**	9,577		
Other liabilities	**17,121**	15,262	**12**	10
	35,013	28,019	**1,405**	1,517

30 Liabilities under insurance contracts

	Gross	Reinsurers share	Net
	US$m	**US$m**	**US$m**
2007			
Non-life insurance liabilities			
Unearned premium provision	**1,279**	**(181)**	**1,098**
Notified claims	**1,063**	**(380)**	**683**
Claims incurred but not reported	**420**	**(49)**	**371**
Other	**92**	**(43)**	**49**
	2,854	**(653)**	**2,201**
Life insurance policyholders liabilities			
Life (non-linked)	**14,370**	**(605)**	**13,765**
Investment contracts with discretionary participation features1	**18,983**		**18,983**
Life (linked)	**6,399**	**(57)**	**6,342**
	39,752	**(662)**	**39,090**
Total liabilities under insurance contracts	**42,606**	**(1,315)**	**41,291**
2006			
Non-life insurance liabilities			
Unearned premium provision	1,262	(176)	1,086
Notified claims	949	(355)	594
Claims incurred but not reported	460	(58)	402
Other	268	(76)	192
	2,939	(665)	2,274
Life insurance policyholders liabilities			
Life (non-linked)	11,026	(1,046)	9,980
Investment contracts with discretionary participation features1	20		20
Life (linked)	3,685	(58)	3,627
	14,731	(1,104)	13,627
Total liabilities under insurance contracts	17,670	(1,769)	15,901

1 *Though investment contracts with discretionary participation features are financial instruments, HSBC continued to treat them as insurance contracts as permitted by IFRS 4.*

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Notes on the Financial Statements (continued)

Note 30

The movement of liabilities under insurance contracts during the year was as follows:

Non-life insurance liabilities

	2007		
	Gross US$m	**Reinsurers share US$m**	**Net US$m**
Unearned premium reserve (UPR)			
At 1 January	**1,262**	**(176)**	**1,086**
Changes in UPR recognised as (income)/expense	**(2)**	**22**	**20**
Gross written premiums	**1,853**	**(385)**	**1,468**
Gross earned premiums	**(1,855)**	**407**	**(1,448)**
Exchange differences and other movements	**19**	**(27)**	**(8)**
At 31 December	**1,279**	**(181)**	**1,098**
Notified and incurred but not reported claims			
At 1 January	**1,409**	**(413)**	**996**
Notified claims	**949**	**(355)**	**594**
Claims incurred but not reported	**460**	**(58)**	**402**
Claims paid in current year	**(1,017)**	**207**	**(810)**
Claims incurred in respect of current year	**1,035**	**(189)**	**846**
Claims incurred in respect of prior years	**64**	**18**	**82**
Exchange differences and other movements	**(8)**	**(52)**	**(60)**
At 31 December	**1,483**	**(429)**	**1,054**
Notified claims	**1,063**	**(380)**	**683**
Claims incurred but not reported	**420**	**(49)**	**371**
Other	**92**	**(43)**	**49**
Total non-life insurance liabilities	**2,854**	**(653)**	**2,201**

	2006		
	Gross US$m	Reinsurers share US$m	Net US$m
UPR			
At 1 January	1,346	(202)	1,144
Changes in UPR recognised as (income)/expense	(122)	48	(74)
Gross written premiums	1,824	(451)	1,373
Gross earned premiums	(1,946)	499	(1,447)
Exchange differences and other movements	38	(22)	16
At 31 December	1,262	(176)	1,086

Notified and incurred but not reported claims			
At 1 January	1,296	(465)	831
Notified claims	872	(335)	537
Claims incurred but not reported	424	(130)	294
Claims paid in current year	(889)	228	(661)
Claims incurred in respect of current year	680	(147)	533
Claims incurred in respect of prior years	219	(24)	195
Exchange differences and other movements	103	(5)	98
At 31 December	1,409	(413)	996
Notified claims	949	(355)	594
Claims incurred but not reported	460	(58)	402
Other	268	(76)	192
Total non-life insurance liabilities	2,939	(665)	2,274

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Life insurance liabilities to policyholders

	2007		
	Gross US$m	Reinsurers’ share US$m	Net US$m
Life (non-linked)			
At 1 January	11,026	(1,046)	9,980
Benefits paid	(940)	169	(771)
Increase in liabilities to policyholders	3,377	349	3,726
Acquisitions of subsidiaries	702	—	702
Exchange differences and other movements	205	(77)	128
At 31 December	14,370	(605)	13,765
Investment contracts with discretionary participation features			
At 1 January	20	—	20
Benefits paid	(1,080)	—	(1,080)
Increase in liabilities to policyholders	2,188	—	2,188
Acquisitions of subsidiaries	16,406	—	16,406
Exchange differences and other movements	1,449	—	1,449
At 31 December	18,983	—	18,983
Life (linked)			
At 1 January	3,685	(58)	3,627
Benefits paid	(790)	(45)	(835)
Increase in liabilities to policyholders	2,886	(1,120)	1,766
Acquisitions of subsidiaries	339	—	339
Exchange differences and other movements1	279	1,166	1,445
At 31 December	6,399	(57)	6,342
Total liabilities to policyholders	39,752	(662)	39,090

1 *Includes amounts arising under modified reinsurance agreements.*

	2006		
	Gross US$m	Reinsurers’ share US$m	Net US$m
Life (non-linked)			
At 1 January	8,369	(807)	7,562
Benefits paid	(814)	154	(660)
Increase in liabilities to policyholders	3,021	(208)	2,813
Exchange differences and other movements	450	(185)	265
At 31 December	11,026	(1,046)	9,980
Investment contracts with discretionary participation features			
At 1 January	9	—	9
Increase in liabilities to policyholders	6	—	6
Exchange differences and other movements	5	—	5
At 31 December	20	—	20

Life (linked)			
At 1 January	2,895	(69)	2,826
Benefits paid	(495)	9	(486)
Increase in liabilities to policyholders	1,146	11	1,157
Exchange differences and other movements	139	(9)	130
At 31 December	3,685	(58)	3,627
Total liabilities to policyholders	14,731	(1,104)	13,627

The increase in liabilities to policyholders represents the aggregate of all events giving rise to additional liabilities to policyholders in the year. These include death claims, surrenders, lapses, the setting up of liability to policyholders at the initial inception of the policy, the declaration of bonuses and other amounts attributable to policyholders.

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Notes on the Financial Statements (continued)

Notes 31 and 32

31 Provisions

	2007 US$m	2006 US$m
At 1 January	**1,763**	1,436
Additional provisions/increase in provisions1	**1,307**	652
Acquisition of subsidiaries	**1**	54
Provisions utilised	**(986)**	(379)
Amounts reversed	**(318)**	(154)
Exchange differences and other movements	**191**	154
At 31 December	**1,958**	1,763

1 *The increase in provisions includes the unwinding of discounts of US$1 million (2006: US$8 million) in relation to vacant space provisions and US$24 million (2006: US$19 million) in relation to Brazilian provisions for civil and fiscal labour claims.*

Included within Provisions are:

(i) Provisions for onerous property contracts of US$56 million (2006: US$106 million), of which US$33 million (2006: US$71 million) relates to discounted future costs associated with leasehold properties that became vacant as a consequence of HSBC's move to Canary Wharf in 2002. The provisions cover rent voids while finding new tenants, shortfalls in expected rent receivable compared with rent payable and the cost of refurbishing the buildings to attract tenants. Uncertainties arise from movements in market rents, delays in finding new tenants and the timing of rental reviews.

(ii) Labour, civil and fiscal litigation provisions in HSBC's Brazil operations of US$391 million (2006:US$282 million). These relate to labour and overtime litigation claims brought by employees after leaving the bank. The provisions are based on the expected number of departing employees, their individual salaries and historical trends. The timing of the settlement of these claims is uncertain.

(iii) Provisions of US$444 million (2006: US$749 million) have been made in respect of costs arising from contingent liabilities and contractual commitments (Note 41), including guarantees of US$29 million (2006: US$64 million) and commitments of US$125 million (2006: US$93 million).

32 Subordinated liabilities

HSBC

	Carrying amount	
	2007 US$m	2006 US$m
Subordinated liabilities		
At amortised cost	**24,819**	22,672
– subordinated liabilities	**19,308**	17,296

– preferred securities	**5,511**	5,376
Designated at fair value (Note 27)	**27,575**	23,189
– subordinated liabilities	**22,831**	18,503
– preferred securities	**4,744**	4,686
	52,394	45,861
Subordinated liabilities		
HSBC Holdings	**18,931**	14,271
Other HSBC	**33,463**	31,590
	52,394	45,861

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HSBCs subordinated liabilities

		2007 US$m	2006 US$m
Amounts owed to third parties by HSBC Holdings (see below)		**18,931**	14,271
Other HSBC subordinated liabilities			
1,400m	5.3687% non-cumulative step-up perpetual preferred securities[1]	**2,018**	1,918
£700m	5.844% non-cumulative step-up perpetual preferred securities[2]	**1,404**	1,374
US$1,350m	9.547% non-cumulative step-up perpetual preferred securities, Series 11	**1,335**	1,336
US$1,200m	Primary capital subordinated undated floating rate notes	**1,207**	1,205
£600m	4.75% subordinated notes 2046	**1,186**	1,160
800m	Callable subordinated floating rate notes 2016[3]	**1,176**	1,052
US$1,250m	4.61% non-cumulative step-up perpetual preferred securities[1]	**1,130**	1,158
750m	5.13% non-cumulative step-up perpetual preferred securities[1]	**1,039**	1,011
US$1,000m	4.625% subordinated notes 2014	**1,001**	998
£500m	8.208% non-cumulative step-up perpetual preferred securities[1]	**996**	982
US$1,000m	5.911% trust preferred securities 2035[4]	**992**	991
US$1,000m	5.875% subordinated notes 2034	**990**	1,048
£500m	5.375% subordinated notes 2033	**931**	1,043
£500m	4.75% callable subordinated notes 2020[5]	**931**	942
US$900m	10.176% non-cumulative step-up perpetual preferred securities, Series 21	**900**	900
600m	4.25% callable subordinated notes 2016[6]	**881**	801
600m	8.03% non-cumulative step-up perpetual preferred securities[1]	**878**	790
US$750m	Undated floating rate primary capital notes	**750**	750
£350m	Callable subordinated variable coupon notes 2017[7]	**712**	675
500m	Callable subordinated floating rate notes 2020[8]	**676**	658
£350m	5% callable subordinated notes 2023[9]	**672**	687
US$750m	5.625% subordinated notes 2035	**653**	685
£350m	5.375% callable subordinated step-up notes 2030[10]	**652**	701
£300m	6.5% subordinated notes 2023	**598**	585
£300m	5.862% non-cumulative step-up perpetual preferred securities[2]	**558**	599
US$500m	Undated floating rate primary capital notes	**500**	501
US$500m	6.00% subordinated notes 2017	**498**	–
US$450m	Callable subordinated floating rate notes 2016[3]	**448**	448
£225m	6.25% subordinated notes 2041	**447**	438
CAD400m	4.80% subordinated notes 2022	**389**	–
US$300m	7.65% subordinated notes 2025	**359**	373
BRL608m	Subordinated debentures 2008	**341**	285
US$300m	6.95% subordinated notes 2011	**325**	326
US$300m	Undated floating rate primary capital notes, Series 3	**301**	300
US$300m	Callable subordinated floating rate notes 2017[11]	**299**	–
BRL500m	Subordinated certificates of deposit 2016	**281**	234
US$250m	5.875% subordinated notes 2008	**248**	243
US$250m	7.20% subordinated debentures 2097	**218**	217
CAD200m	4.94% subordinated debentures 2021	**207**	169
US$200m	7.75% subordinated notes 2009	**202**	205
US$200m	7.808% capital securities 2026	**200**	200
US$200m	8.38% capital securities 2027	**200**	191
US$200m	6.625% subordinated notes 2009	**199**	197
£150m	8.625% step-up undated subordinated notes	**–**	304
US$200m	7.53% capital securities 2026	**–**	209
	Other subordinated liabilities each less than US$200m	**3,535**	2,701
		33,463	31,590

	52,394	45,861

Subordinated loan capital is repayable at par on maturity, but some is repayable prior to maturity at the option of the borrower, generally with the non objection of the Financial Services Authority, and, where relevant, the consent of the local banking regulator, and in certain cases at a premium over par. Interest rates on the floating rate loan capital are related to interbank offered rates. On the remaining subordinated loan capital, interest is payable at fixed rates up to 10.176 per cent.

1 *See Step-up perpetual preferred securities below, note (a) Guaranteed by HSBC Holdings.*
2 *See Step-up perpetual preferred securities below, note (b) Guaranteed by HSBC Bank.*
3 *The interest margin on the 800m and US$450m callable subordinated floating rate notes 2016 increases by 0.5 per cent from March 2011 and July 2011, respectively.*

Notes on the Financial Statements (continued)

Notes 32

4 *The distributions on the trust preferred securities change in November 2015 to three-month dollar LIBOR plus 1.926 per cent.*
5 *The interest rate on the 4.75 per cent callable subordinated notes 2020 changes in September 2015 to three-month sterling LIBOR plus 0.82 per cent.*
6 *The interest rate on the 4.25 per cent callable subordinated notes changes in March 2011 to three-month EURIBOR plus 1.05 per cent.*
7 *The interest rate on the callable subordinated variable coupon notes 2017 is fixed at 5.75 per cent until June 2012. Thereafter, the rate per annum is the sum of the gross redemption yield of the then prevailing five-year UK gilt plus 1.70 per cent.*
8 *The interest margin on the callable subordinated floating rate notes 2020 increases by 0.5 per cent from September 2015.*
9 *The interest rate on the 5 per cent callable subordinated notes 2023 changes in March 2018 to become the rate per annum which is the sum of the gross redemption yield of the prevailing five-year UK gilt plus 1.80 per cent.*
10 *The interest rate on the 5.375 per cent callable subordinated step-up notes 2030 changes in November 2025 to three month sterling LIBOR plus 1.50 per cent.*
11 *The interest margin on the callable subordinated floating rate notes 2017 increases by 0.5 per cent from July 2012.*

Footnotes 3 to 10 all relate to notes that are repayable at the option of the borrower on the date of the change of the interest rate, and at subsequent interest rate reset dates and interest payment dates in some cases, subject to the prior non objection of the Financial Services Authority and, where relevant, the consent of the local banking regulator.

Step-up perpetual preferred securities

(a) Guaranteed by HSBC Holdings

The seven issues of non-cumulative step-up perpetual preferred securities (footnote 1) were made by Jersey limited partnerships and are guaranteed, on a subordinated basis, by HSBC Holdings. The proceeds of the issues were on-lent to HSBC Holdings by the limited partnerships by issue of subordinated notes. The preferred securities qualify as innovative tier 1 capital for HSBC. The preferred securities, together with the guarantee, are intended to provide investors with rights to income and capital distributions and distributions upon liquidation of HSBC Holdings that are equivalent to the rights that they would have had if they had purchased non-cumulative perpetual preference shares of HSBC Holdings.

The preferred securities are perpetual, but redeemable in 2014, 2010, 2013, 2016, 2015, 2030 and 2012, respectively, at the option of the general partner of the limited partnerships. If not redeemed, the distributions payable step-up and become floating rate or, for the sterling issue, for each successive five-year period the sum of the then five-year benchmark UK gilt plus a margin. There are limitations on the payment of distributions if prohibited under UK banking regulations or other requirements, if a payment would cause a breach of HSBC□s capital adequacy requirements, or if HSBC Holdings has insufficient distributable reserves (as defined).

HSBC Holdings has covenanted that if it is prevented under certain circumstances from paying distributions on the preferred securities in full, it will not pay dividends or other distributions in respect of its ordinary shares, or effect repurchase or redemption of its ordinary shares, until after a distribution has been paid in full.

If (i) HSBC's total capital ratio falls below the regulatory minimum ratio required, or (ii) the Directors expect that, in view of the deteriorating financial condition of HSBC Holdings, the former will occur in the near term, then the preferred securities will be substituted by preference shares of HSBC Holdings having economic terms which are in all material respects equivalent to those of the preferred securities and the guarantee taken together.

(b) Guaranteed by HSBC Bank

The two issues of non-cumulative step-up perpetual preferred securities (footnote 2) were made by Jersey limited partnerships and are guaranteed, on a subordinated basis, by HSBC Bank. The proceeds of the issues were on- lent to HSBC Bank by the limited partnerships by issue of subordinated notes. The preferred securities qualify as innovative tier 1 capital for HSBC and for HSBC Bank on a solo and consolidated basis and, together with the guarantee, are intended to provide investors with rights to income and capital distributions and distributions upon liquidation of HSBC Bank that are equivalent to the rights they would have had if they had purchased non- cumulative perpetual preference shares of HSBC Bank.

The two issues of preferred securities are perpetual, but redeemable in 2031 and 2020, respectively, at the option of the general partner of the limited partnerships. If not redeemed, the distributions payable step-up and become floating rate. The same limitations on the payment of distributions apply to HSBC Bank as to HSBC Holdings, as described above. HSBC Bank has provided a similar covenant to that provided by HSBC Holdings, also as described above.

If (i) any of the two issues of preferred securities are outstanding in November 2048 or April 2049, respectively, or (ii) the total capital ratio of HSBC Bank on a solo and consolidated basis falls below the regulatory minimum ratio required, or (iii) in view of the deteriorating financial condition of HSBC Bank, the Directors expect (ii) to

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occur in the near term, then the preferred securities will be substituted by preference shares of HSBC Bank having economic terms which are in all material respects equivalent to those of the preferred securities and the guarantee taken together.

HSBC Holdings

	2007	2006
	US$m	US$m
Subordinated liabilities:		
– At amortised cost	**8,544**	8,423
– Designated at fair value (Note 27)	**18,683**	14,070
	27,227	22,493

HSBC Holdings subordinated borrowings

		2007	2006
		US$m	US$m
Amounts owed to third parties			
€2,000m	Callable subordinated floating rate notes 2014[1]	**2,905**	2,648
US$2,500m	6.5% subordinated notes 2037	**2,495**	–
US$2,000m	6.5% subordinated notes 2036	**2,058**	2,056
£900m	6.375% callable subordinated notes 2022[2]	**1,858**	–
€1,000m	5.375% subordinated notes 2012	**1,488**	1,394
US$1,400m	5.25% subordinated notes 2012	**1,413**	1,401
£650m	5.75% subordinated notes 2027	**1,262**	1,365
US$1,000m	7.5% subordinated notes 2009	**1,077**	1,088
€700m	3.625% callable subordinated notes 2020[3]	**922**	888
US$750m	Callable subordinated floating rate note 2016[1]	**750**	750
US$750m	Callable subordinated floating rate notes 2015[1]	**750**	749
£250m	9.875% subordinated bonds 2018[4]	**619**	637
US$488m	7.625% subordinated notes 2032	**609**	609
€300m	5.5% subordinated notes 2009	**457**	418
US$222m	7.35% subordinated notes 2032	**268**	268
		18,931	14,271
Amounts owed to HSBC undertaking			
€1400m	5.3687% fixed/floating subordinated notes 2043 – HSBC Capital Funding (Euro 2) LP	**2,018**	1,995
US$1,350m	9.547% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Dollar 1) LP	**1,335**	1,332
US$1,250m	4.61% fixed/floating subordinated notes 2043 – HSBC Capital Funding (Dollar 2) LP	**1,130**	1,187
€750m	5.13% fixed/floating subordinated notes 2044 – HSBC Capital Funding (Euro 3) LP.	**1,039**	1,049
£500m	8.208% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Sterling 1) LP	**996**	974
US$900m	10.176% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Dollar 1) LP	**900**	900
€600m	8.03% subordinated step-up cumulative notes 2040 – HSBC Capital Funding (Euro 1) LP	**878**	785
		8,296	8,222
		27,227	22,493

1 *The interest margins on the callable subordinated floating rate notes 2014, 2015 and 2016 increase by 0.5 per cent from September 2009, March 2010 and October 2011 respectively. The notes are repayable from their step up date at the option of the borrower, subject to the prior non-objection of the Financial Services Authority.*

2 *The interest rate on the 6.375 per cent callable subordinated notes 2022 changes in October 2017 to become three-month sterling LIBOR plus 1.3 per cent. The notes may be redeemed at par from October 2017 at the option of the borrower, subject to the prior non-objection of the Financial Services Authority.*

3 *The interest rate on the 3.625 per cent callable subordinated notes 2020 changes in June 2015 to become three-month EURIBOR plus 0.93 per cent. The notes may be redeemed at par from June 2015 at the option of the borrower, subject to the prior non-objection of the Financial Services Authority.*

4 *The interest rate on the 9.875 per cent subordinated bonds 2018 changes in April 2013 to become the higher of (i) 9.875 per cent or (ii) the sum of the yield on the relevant benchmark treasury stock plus 2.5 per cent. The bonds may be redeemed in April 2013 at par and redemption has also been allowed from April 1998, subject to the prior non-objection of the Financial Services Authority, for an amount based on the redemption yields of the relevant benchmark treasury stocks.*

33 Fair values of financial instruments

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 value of financial instruments carried at fair value

Control framework

Fair values are subject to a control framework that aims 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 Group Finance Director. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that these comply with all relevant accounting standards.

For fair values determined using a valuation model, the control framework may include, as applicable, independent development or validation of (i) valuation models; (ii) any inputs to those models; and (iii) any adjustments required outside of the valuation model, and, where possible, independent validation of model outputs.

For fair values determined without a valuation model, independent price determination or validation is utilised. The results of independent validation processes are reported to senior management, and adjustments to the fair values are made as appropriate.

Determination of fair value

Fair values are determined according to the following hierarchy:

(a) Quoted market price

Financial instruments with quoted prices for identical instruments in active markets.

(b) 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.

(c) Valuation technique with significant non-observable inputs

Financial instruments valued using models where one or more significant inputs are not observable.

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 not observable. For these instruments, the fair value derived is more judgemental. ‘Not observable’ in this context means that there is little or no current market data available from which to determine the level at which an arm’s length transaction would likely occur, but it generally does not mean that there is absolutely no market data available upon which to base a determination of fair value (historical data may, for example, be used). Furthermore, the assessment of hierarchy level is based on the lowest level of input that is significant to the fair value of the financial instrument. Consequently, the level of uncertainty in the determination of the unobservable inputs will generally give rise to valuation uncertainty that is less than the fair value itself. To assist in understanding the extent of this uncertainty, additional information is provided in respect of these instruments in the ‘Effect of changes in significant non-observable assumptions to reasonably possible alternatives’ section below.

In certain circumstances, HSBC applies the fair value option to its own debt in issue. Where available, the fair value will be based upon quoted prices in an active market for the specific instrument concerned. Where unavailable, the fair value will either be based upon quoted prices in an inactive market for the specific instrument concerned, or estimated by comparison with quoted prices in an active market for similar instruments. The fair value of these instruments therefore includes the effect of the appropriate credit spread to apply to HSBC’s liabilities. 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 early.

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 significantly smaller than credit spreads observed for plain vanilla debt or in the credit default swap markets.

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 values of large holdings of non-derivative financial instruments are based on a multiple of the value of a single instrument, and do not include block adjustments for the size of the holding.

The valuation models used where quoted market prices are not available incorporate certain assumptions that HSBC anticipates would be used by a market participant to establish fair value. Where HSBC believes that there are additional considerations not included within the valuation model, appropriate adjustments may be made. Examples of such adjustments are:

- **Credit risk adjustment**: an adjustment to reflect the credit worthiness of over-the-counter (OTC) derivative counterparties.

- **Market data/model uncertainty**: an adjustment to reflect uncertainties in fair values based on unobservable market data inputs (for example, as a result of illiquidity) or in areas where the choice of valuation model is particularly subjective.

- **Inception profit (day 1 P&L reserves)**: for financial instruments valued at inception, on the basis of one or more significant unobservable inputs, the difference between transaction price and model value (as adjusted) at inception is not recognised in the consolidated income statement, but is deferred and any unamortised balance is included as part of the fair value.

Transaction costs are not included in the fair value calculation. Trade origination costs such as brokerage fees and post-trade costs are included in operating expenses. The future costs of administering the OTC derivative portfolio are also not included in fair value, but are expensed as incurred.

- Loans

  Loans are valued from broker quotes and/or market data consensus providers where available. Where unavailable, fair value will be determined based on an appropriate credit spread derived from other market instruments issued by the same or comparable entities.

- Debt securities, treasury and other eligible bills, and equities

  These instruments are valued based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, where available. Where unavailable, fair value is determined by reference to quoted market prices for similar instruments or, in the case of certain mortgage-backed securities and unquoted equities, valuation techniques using inputs derived from observable market data, and, where relevant, assumptions in respect of unobservable inputs.

- Derivatives

  Over-the-counter (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 discrepancy in 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 historic data or other sources. Examples of inputs 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.

Notes on the Financial Statements (continued)

Note 33

- Private equity
  HSBC's private equity positions are generally classified as available-for-sale and are not traded in an active market. In the absence of an active market for the investment, fair value is estimated based upon an analysis of the investee's financial position and results, risk profile, prospects and other factors as well as 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.

HSBC

Analysis of fair value determination

The following table provides an analysis of the basis for valuing financial assets and financial liabilities measured at fair value in the consolidated financial statements:

		Valuation techniques:		
	Quoted market price US$m	**using observable inputs US$m**	**with significant non-observable inputs US$m**	**Total US$m**
At 31 December 2007				
Assets				
Trading assets	**209,339**	**222,678**	**13,951**	**445,968**
Financial assets designated at fair value	**28,565**	**12,694**	**305**	**41,564**
Derivatives	**8,132**	**175,493**	**4,229**	**187,854**
Financial investments: available-for-sale	**77,045**	**187,677**	**8,510**	**273,232**
Liabilities				
Trading liabilities	**140,629**	**167,967**	**5,984**	**314,580**
Financial liabilities at fair value	**37,709**	**52,230**	–	**89,939**
Derivatives	**8,879**	**171,444**	**3,070**	**183,393**
At 31 December 2006				
Assets				
Trading assets	166,515	158,379	3,253	328,147
Financial assets designated at fair value	16,277	4,136	160	20,573
Derivatives	4,903	97,490	1,309	103,702
Financial investments: available-for-sale	60,948	128,286	6,201	195,435
Liabilities				
Trading liabilities	102,758	120,866	2,984	226,608
Financial liabilities at fair value	30,846	39,365	–	70,211
Derivatives	7,248	92,865	1,365	101,478

Trading assets valued using a valuation technique with significant non-observable inputs include leveraged loans underwritten by HSBC, corporate and mortgage loans held for securitisation, and various asset-backed securities. The amount of trading assets reported in this category is higher at 31 December 2007 compared with 31 December 2006 reflects an increase in the amount of leveraged loans held by HSBC, and also reduced liquidity in certain markets during 2007, which affected the availability of market observable inputs for the valuation of certain types of loans and asset-backed securities.

Trading liabilities valued using a valuation technique with significant non-observable inputs have increased as a result of an increase in the issuance of structured note transactions, whereby HSBC issues equity-linked notes to investors which provide the counterparty with a return that is linked to the performance of certain unlisted securities, and holds the unlisted securities to match the liabilities.

Derivative products valued using a valuation technique with significant non-observable inputs include certain types of correlation products, particularly equity and foreign exchange basket options and foreign exchange-interest rate hybrid transactions, long-dated option transactions, particularly equity options, interest rate and foreign exchange options and certain credit derivatives, including tranched credit default swap transactions and credit derivatives executed with certain monoline insurers. Credit derivatives with these monoline insurers were included in the category of valuation techniques using observable inputs at 31 December 2006 and in the non-observable inputs category at 31 December 2007.

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Available-for-sale financial investments and financial assets designated at fair value that are valued using non-observable inputs include holdings of private equity and unlisted debt securities.

Effect of changes in significant non-observable assumptions to reasonably possible alternatives

As discussed above, the fair value of financial instruments are, in certain circumstances, 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 fair values to reasonably possible alternative assumptions.

	Reflected in profit/(loss)		Reflected in equity	
	Favourable Changes US$m	**Unfavourable Changes US$m**	**Favourable Changes US$m**	**Unfavourable Changes US$m**
At 31 December 2007				
Derivatives/trading assets/trading liabilities1	**602**	**(415)**		
Financial assets/liabilities designated at fair value	**30**	**(30)**		
Financial investments: available-for-sale			**529**	**(591)**
At 31 December 2006				
Derivatives/trading assets/trading liabilities	69	(72)		
Financial assets/liabilities designated at fair value	16	(16)		
Financial investments: available-for-sale			165	(165)

1 *Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.*

The increase in the effect of changes in significant non-observable inputs in relation to derivatives/trading assets/trading liabilities from 31 December 2006 to 31 December 2007 primarily reflects certain mortgage loans acquired for the purpose of securitisation, and certain US mortgage-backed securities, that were valued using observable inputs at 31 December 2006 that subsequently became non-observable in the second half of 2007 following the deterioration in market conditions. To a lesser degree, the increase also reflects increased uncertainty in determining the fair value of credit derivative transactions executed against certain monoline insurers, and a general increase in structured derivative business.

Changes in fair value recorded in the income statement

The following table details changes in fair values recognised in profit or loss during the period, where the fair value is estimated using valuation techniques that incorporate significant 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 table details the total change in fair value of these instruments; it does not isolate that component of the change that is attributable to the non-observable component;
- instruments valued with significant non-observable inputs are frequently dynamically hedged with instruments valued using observable inputs; the table does not include any changes in fair value of these hedges; and
- there were significant assets and liabilities valued using observable inputs at 31 December 2006 that became valued with significant unobservable inputs during 2007; the table reflects the full change in fair value of those instruments during 2007, not just that element arising following the category change.

	Recorded profit/(loss)

	2007 US$m	2006 US$m
At 31 December 2007		
Derivatives/trading assets/trading liabilities	**491**	(195)
Financial assets/liabilities designated at fair value	**9**	(5)

The increase in fair value in 2007 primarily reflects increases in the fair value of credit derivatives purchased from certain monoline insurers to provide credit protection on portfolios of securities, offset by write-downs in mortgage loans acquired for the purpose of securitisation, and certain US mortgage-backed securities.

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Note 33

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:

		Valuation techniques:		
	Quoted market price US$m	**using observable inputs US$m**	**with significant non-observable inputs US$m**	**Total US$m**
At 31 December 2007				
Assets				
Derivatives	–	**2,660**	–	**2,660**
Financial investments: available-for-sale	**346**	–	**2,676**	**3,022**
Liabilities				
Financial liabilities at fair value	**18,683**	–	–	**18,683**
Derivatives	–	**44**	–	**44**
At 31 December 2006				
Assets				
Derivatives	–	1,599	–	1,599
Financial investments: available-for-sale	299	–	3,315	3,614
Liabilities				
Financial liabilities at fair value	14,070	–	–	14,070
Derivatives	–	177	–	177

Financial investments measured using a valuation technique with significant non-observable inputs comprise fixed-rate trust 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.

Movements in unobservable assumptions in fair value valuation models

As discussed above, the fair value of financial instruments are in certain circumstances 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 2007	**53**	**(52)**
At 31 December 2006	65	(64)

Fair value of financial instruments not carried at fair value

The fair values of financial instruments that are not recognised at fair value on the balance sheet are calculated as described below.

The calculation of fair value incorporates HSBCs estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arms 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.

In recent months, the unstable market conditions in the US mortgage lending industry have resulted in 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 an absence of liquidity for non-prime asset-backed securities, were reflected in a lack of bid prices other than at distressed levels at 31 December 2007. It is not possible to distinguish from these indicative market prices the relative discount that reflects cash flow impairment due to expected losses to maturity, from the discount that the market is demanding for holding an illiquid asset. Under IFRSs, HSBC recognises loan impairment based on losses incurred up to the balance sheet date: no recognition is given to losses which are expected to arise in the future, but where the loss event has not yet occurred. Neither is the asset written down to reflect its illiquidity as the intention is to fund the asset until the earlier of its prepayment, charge-off or repayment on maturity. Market fair values reflect not only incurred loss, but also loss expected through the life of the asset, as well as a discount for illiquidity and a credit spread which reflects the market's current risk preference rather than the credit spread which existed in the market at the time the loan was underwritten.

The estimated fair values at 31 December 2007 of loans and advances to customers in North America reflect the combined effect of these conditions. This results in fair values that are substantially lower than the carrying value 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.

The following types of financial instruments are measured at amortised cost unless they are held for trading or designated at fair value through profit or loss. Where assets or liabilities are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the assets or liabilities so hedged includes a fair value adjustment for the hedged risk only. Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

(i) 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, repricing 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.

(ii) 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 either the prices of, or future earnings streams of, equivalent quoted securities.

(iii) Deposits by banks and customer accounts

For the purposes of estimating fair value, deposits by banks and customer accounts are grouped by residual 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.

(iv) 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.

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Notes on the Financial Statements (continued)

Note 33

The fair values of intangible assets, such as values placed on portfolios of core deposits, credit card and customer relationships, are not included above because they are not financial instruments.

The following table lists 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
Endorsements and acceptances
Short-term payables within Other liabilities
Accruals

HSBC

The following table provides an analysis of the fair value of financial instruments not carried at fair value on the balance sheet:

	2007		2006	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m
Assets				
Loans and advances to banks	**237,366**	**237,374**	185,205	185,151
Loans and advances to customers	**981,548**	**951,850**	868,133	864,320
Financial investments: Treasury and other eligible bills	–	–	45	45
Financial investments: debt securities	**9,768**	**10,154**	9,326	9,628
Liabilities				
Deposits by banks	**132,181**	**132,165**	99,694	99,691
Customer accounts	**1,096,140**	**1,095,727**	896,834	896,429
Debt securities in issue	**246,579**	**243,802**	230,325	231,189
Subordinated liabilities	**24,819**	**23,853**	22,672	22,468

The following table provides an analysis of the fair value of financial investments classified as held for sale which are not carried at fair value on the balance sheet:

	2007		2006	
	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	**14**	**14**	–	–
Loans and advances to customers	–	–	634	630
Financial investments: Debt securities	**27**	**27**	–	–

The following table provides an analysis of loans and advances to customers by geographical segment:

	2007		2006	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m
Loans and advances to customers				
Europe	**452,275**	**450,010**	392,499	392,806
Hong Hong	**89,638**	**89,908**	84,282	84,659
Rest of Asia-Pacific	**101,852**	**101,860**	77,574	77,429
North America1	**289,860**	**262,123**	277,987	273,903
Latin America	**47,923**	**47,949**	35,791	35,523
	981,548	**951,850**	868,133	864,320

1 *The reasons for the significant difference between carrying amount and fair value of loans and advances to customers in North America are discussed on pages 430 to 431.*

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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:

	2007		2006	
	Carrying amount US$m	**Fair value US$m**	Carrying amount US$m	Fair value US$m
Assets				
Loans and advances to HSBC undertakings	**17,242**	**17,356**	14,456	14,537
Liabilities				
Amounts owed to HSBC undertakings	**2,969**	**2,992**	3,100	3,155
Subordinated liabilities	**8,544**	**8,609**	8,423	9,439

34 Maturity analysis of assets and liabilities

The following is an analysis, by remaining contractual maturities at the balance sheet date, of asset and liability line items that represent amounts expected to be recovered or settled within one year, and after more than one year.

Trading assets and liabilities are excluded because they are not held for collection or settlement over the period of contractual maturity.

HSBC

	At 31 December 2007		
	Due within one year US$m	**Due after more than one year US$m**	**Total US$m**
Assets			
Financial assets designated at fair value	**5,752**	**35,812**	**41,564**
Loans and advances to banks1	**222,674**	**14,692**	**237,366**
Loans and advances to customers	**438,246**	**543,302**	**981,548**
Financial investments	**103,492**	**179,508**	**283,000**
Other financial assets	**24,087**	**6,390**	**30,477**
	794,251	**779,704**	**1,573,955**
Liabilities			
Deposits by banks	**124,475**	**7,706**	**132,181**
Customer accounts	**1,066,148**	**29,992**	**1,096,140**
Financial liabilities designated at fair value	**6,217**	**83,722**	**89,939**
Debt securities in issue	**143,651**	**102,928**	**246,579**
Other financial liabilities	**33,056**	**4,352**	**37,408**
Subordinated liabilities	**341**	**24,478**	**24,819**
	1,373,888	**253,178**	**1,627,066**

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Notes on the Financial Statements (continued)

Notes 34 and 35

	At 31 December 2006		
	Due within one year US$m	Due after more than one year US$m	Total US$m
Assets			
Financial assets designated at fair value	3,735	16,838	20,573
Loans and advances to banks[1]	179,240	5,965	185,205
Loans and advances to customers	360,191	507,942	868,133
Financial investments	87,848	116,958	204,806
Other financial assets	20,833	6,422	27,255
	651,847	654,125	1,305,972
Liabilities			
Deposits by banks	89,043	10,651	99,694
Customer accounts	871,881	24,953	896,834
Financial liabilities designated at fair value	1,410	68,801	70,211
Debt securities in issue	111,622	118,703	230,325
Other financial liabilities	25,938	2,197	28,135
Subordinated liabilities	326	22,346	22,672
	1,100,220	247,651	1,347,871

1 *Loans and advances to banks includes US$189,081 million (2006: US$147,512 million) which is repayable on demand or at short notice.*

HSBC Holdings

	At 31 December 2007		
	Due within one year US$m	**Due after more than one year US$m**	**Total US$m**
Assets			
Loans and advances to HSBC undertakings	**7,371**	**9,871**	**17,242**
Financial investments	**346**	**2,676**	**3,022**
Other financial assets	**21**	**–**	**21**
	7,738	**12,547**	**20,285**

Liabilities			
Amounts owed to HSBC undertakings	**1,906**	**1,063**	**2,969**
Financial liabilities designated at fair value	—	**18,683**	**18,683**
Other financial liabilities	**1,397**	**8**	**1,405**
Subordinated liabilities	—	**8,544**	**8,544**
	3,303	**28,298**	**31,601**

	At 31 December 2006		
	Due within one year US$m	Due after more than one year US$m	Total US$m
Assets			
Loans and advances to HSBC undertakings	6,886	7,570	14,456
Financial investments	—	3,614	3,614
Other financial assets	25	—	25
	6,911	11,184	18,095
Liabilities			
Amounts owed to HSBC undertakings	301	2,799	3,100
Financial liabilities designated at fair value	—	14,070	14,070
Other financial liabilities	1,507	10	1,517
Subordinated liabilities	—	8,423	8,423
	1,808	25,302	27,110

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35 Foreign exchange exposures

Structural foreign exchange exposures

HSBCs structural foreign exchange exposures are represented by the net asset value of its foreign exchange equity and subordinated debt investments in subsidiaries, branches, joint ventures and associates. Gains or losses on structural foreign exchange exposures are recognised directly in equity. HSBCs management of its structural foreign exchange exposures is discussed in the Report of the Directors: The Management of Risk on page 256.

In its separate financial statements, HSBC Holdings recognises its foreign exchange gains and losses on structural foreign exchange exposures in the income statement.

Net structural foreign exchange exposures

	2007	2006
	US$m	US$m
Currency of structural exposure		
Pound sterling	24,527	18,562
Euro	23,985	21,202
Chinese renminbi	10,892	5,678
Mexican pesos	5,247	4,536
Hong Kong dollars	4,635	4,461
Canadian dollars	4,136	3,284
Brazilian reais	4,007	2,684
Indian rupees	2,699	1,575
Swiss francs	2,657	2,495
UAE dirhams	2,182	1,647
Turkish lira	1,796	970
Korean won	1,282	769
Malaysian ringgit	1,044	876
Australian dollars	940	692
Philippine pesos	459	213
Singapore dollars	432	411
Saudi riyals1	404	286
Egyptian pounds	392	325
Thai baht	384	305
Taiwanese dollars	382	299
Costa Rican colon	375	162
Argentine pesos	370	211
Vietnamese dong	331	57
Honduran lempira	325	148
Japanese yen	300	338
Maltese lira	270	269
Indonesia rupiah	221	155
Chilean pesos	214	189
Colombian peso	202	86
Qatari rial	197	150
New Zealand dollars	169	158
South African rand	148	106
Omani rial	140	114
Jordanian dinar	116	92
Russian rouble	114	92
Bahraini dinar	106	90
Others, each less than US$100 million	686	514
Total	**96,766**	74,201

1 *After deducting sales of Saudi riyals amounting to US$750 million (2006: US$750 million) in order to manage the foreign exchange risk of the investments.*

All resulting exchange differences on consolidation of foreign operations are recognised in a separate component of equity. Shareholders equity would decrease by US$2,426 million (2006: US$1,988 million) if euro and sterling foreign currency exchange rates weakened by 5 per cent relative to the US dollar.

Notes on the Financial Statements (continued)

Notes 36, 37 and 38

36 Assets charged as security for liabilities and collateral accepted as security for assets

Financial assets pledged to secure liabilities were as follows:

	Assets pledged at 31 December	
	2007	2006
	US$m	US$m
Treasury bills and other eligible securities	**7,200**	6,480
Loans and advances to banks	**7,389**	934
Loans and advances to customers	**78,755**	63,956
Debt securities	**219,956**	106,652
Equity shares	**19,257**	11,634
Other	**3,933**	390
	336,490	190,046

These transactions are conducted under terms that are usual and customary to standard securities lending and repurchase agreements.

Collateral accepted as security for assets

The fair value of assets accepted as collateral that HSBC is permitted to sell or repledge in the absence of default is US$329,893 million (2006: US$188,008 million). The fair value of any such collateral that has been sold or repledged was US$212,956 million (2006: US$135,998 million). HSBC is obliged to return equivalent securities.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse repurchase agreements.

37 Minority interests

	2007	2006
	US$m	US$m
Minority interests attributable to holders of ordinary shares in subsidiaries	**4,775**	4,026
Preference shares issued by subsidiaries	**2,481**	2,550
	7,256	6,576

Preference shares issued by subsidiaries

	2007	2006
	US$m	US$m
US$575m 6.36% non-cumulative preferred stock, Series B1	**559**	559

US$518m	Floating rate non-cumulative preferred stock, Series F2	**518**	518
US$374m	Floating rate non-cumulative preferred stock, Series G3	**374**	374
US$374m	6.50% non-cumulative preferred stock, Series H3	**374**	374
CAD175m	Non-cumulative redeemable class 1 preferred shares, Series C4	**178**	150
CAD175m	Non-cumulative class 1 preferred shares, Series D4	**178**	150
US$150m	Depositary shares each representing 25% interest in a share of adjustable-rate cumulative preferred stock, Series D5	**150**	150
US$150m	Cumulative preferred stock6	**150**	150
US$125m	Dutch auction rate transferable securities preferred stock, Series A and B7	**—**	125
		2,481	2,550

1 *The Series B preferred stock is redeemable at the option of HSBC Finance Corporation, in whole or in part, from 24 June 2010 at par.*
2 *The Series F preferred stock is redeemable at par at the option of HSBC USA Inc., in whole or in part, on any dividend payment date on or after 7 April 2010.*
3 *The Series G and Series H preferred stock are redeemable at par at the option of HSBC USA Inc., in whole or in part, at any time from 1 January 2011 and 1 July 2011, respectively.*
4 *The Series C and Series D preferred stock are redeemable at a declining premium above par at the option of HSBC Bank Canada, in whole or in part, from 30 June 2010 and 31 December 2010, respectively.*
5 *The preferred stock has been redeemable at the option of HSBC USA Inc., in whole or in part, from 1 July 1999 at par.*
6 *The preferred stock has been redeemable at the option of HSBC USA Inc., in whole or in part, from 1 October 2007 at par.*
7 *The preferred stock of each series is redeemable at the option of HSBC USA Inc., in whole or in part, on any dividend payment date at par. This was redeemed in full in 2007.*

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All redemptions are subject to the prior ‘non-objection’ of the Financial Services Authority and, where relevant, the local banking regulator.

38 Called up share capital

Authorised

The authorised ordinary share capital of HSBC Holdings at 31 December 2007 and 2006 was US$7,500 million divided into 15,000 million ordinary shares of US$0.50 each.

At 31 December 2007 and 2006, the authorised preference share capital of HSBC Holdings was 10 million non-cumulative preference shares of £0.01 each, 10 million non-cumulative preference shares of US$0.01 each, and 10 million non-cumulative preference shares of €0.01 each.

At 31 December 2007 and 2006, the authorised non-voting deferred share capital of HSBC Holdings was £301,500 divided into 301,500 non-voting deferred shares of £1 each.

Issued

	2007 **US$m**	2006 US$m
HSBC Holdings ordinary shares	**5,915**	5,786

	Number	**US$m**
HSBC Holdings ordinary shares		
At 1 January 2007	**11,572,207,735**	**5,786**
Shares issued under HSBC Finance share plans	**685,005**	**–**
Shares issued under HSBC employee share plans	**32,620,922**	**17**
Shares issued in lieu of dividends	**223,538,655**	**112**
At 31 December 2007	**11,829,052,317**	**5,915**
At 1 January 2006	11,333,603,942	5,667
Shares issued in connection with the maturity of HSBC Finance 8.875 per cent Adjustable Conversion-Rate Equity Security Units	3,424,742	2
Shares issued under HSBC Finance share plans	643,520	–
Shares issued under HSBC employee share plans	75,956,784	38
Shares issued in lieu of dividends	158,578,747	79
At 31 December 2006	11,572,207,735	5,786

All ordinary shares confer identical rights in respect of capital, dividends, voting and otherwise.

	Number	**US$m**
HSBC Holdings non-cumulative preference shares of US$0.01 each		
At 1 January 2007 and 31 December 2007	**1,450,000**	**–**
At 1 January 2006 and 31 December 2006	1,450,000	–

Dividends on HSBC Holdings non-cumulative dollar preference shares are paid quarterly at the sole and absolute discretion of the Board of Directors. The Board of Directors will not declare a dividend on the preference shares if payment of the dividend would cause HSBC Holdings not to meet the applicable capital adequacy requirements of the FSA or the profit of HSBC Holdings available for distribution as dividends is not sufficient to enable HSBC Holdings to pay in full both dividends on the preference shares and dividends on any other shares that are scheduled to be paid on the same date and that have an equal right to dividends. HSBC Holdings may not declare or pay dividends on any class of its shares ranking lower in the right to dividends than the preference shares nor redeem nor purchase in any manner any of its other shares ranking equal with or lower than the preference shares unless it has paid in full, or set aside an amount to provide for payment in full, the dividends on the preference shares for the then-current dividend period. The preference shares carry no rights to conversion into ordinary shares of HSBC Holdings. Holders of the preference shares will only be entitled to attend and vote at general meetings of shareholders of HSBC Holdings if the dividend payable on the preference shares has not been paid in full for four consecutive dividend payment dates. In such circumstances, holders of preference shares will be entitled to vote on all matters put to general meetings until such time as HSBC Holdings has paid a full dividend on the preference shares. HSBC Holdings may redeem the preference shares in whole at any time on or after 16 December 2010, subject to the prior non-objection of the FSA.

Notes on the Financial Statements (continued)

Note 38

HSBC Holdings non-voting deferred shares

The 301,500 non-voting deferred shares were in issue throughout 2006 and 2007 and are held by a subsidiary of HSBC Holdings. Holders of the non-voting deferred shares are not entitled to receive dividends on these shares. In addition, on winding-up or other return of capital, holders are entitled to receive the amount paid up on their shares after distribution to ordinary shareholders of £10 million in respect of each ordinary share held by them.

Shares under option

Details of the options outstanding to subscribe for HSBC Holdings ordinary shares under the HSBC Holdings Group Share Option Plan, HSBC Holdings Executive Share Option Scheme, the HSBC Share Plan and HSBC Holdings savings-related share option plans are given in Note 10. In aggregate, options outstanding under these plans were as follows:

	Number of HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2007	**240,726,775**	**2008 to 2015**	**£5.3496 – 9.642**
	12,839,412	**2008 to 2013**	**HK$ 103.4401 – 108.4483**
	823,472	**2008 to 2013**	**€10.4217 – 11.0062**
	6,324,920	**2008 to 2013**	**US$13.3290 – 14.7478**
31 December 2006	269,423,027	2007 to 2015	£5.0160 – 9.642
	6,661,998	2007 to 2012	HK$103.4401
	270,473	2007 to 2012	€11.0062
	2,932,100	2007 to 2012	US$13.3290 – 14.1621
31 December 2005	341,281,540	2006 to 2015	£2.1727 – 9.642

HSBC France and subsidiary company plans

Following the acquisition of HSBC France in 2000, outstanding employee share options over HSBC France shares vested. On exercise of the options, the HSBC France shares are exchangeable for HSBC Holdings ordinary shares in the same ratio as for the acquisition of HSBC France (13 HSBC Holdings ordinary shares for each HSBC France share).

During 2007, 280,850 (2006: 445,115) HSBC France shares were issued following the exercise of employee share options and were exchanged for 3,651,050 HSBC Holdings ordinary shares. These shares were delivered from The HSBC Holdings Employee Benefit Trust 2001 (No. 1) (2006: 5,786,495 HSBC Holdings ordinary shares). During 2007, no options over HSBC France shares lapsed (2006: nil). During 2006 and 2007, no HSBC France shares previously issued following the exercise of employee share options were exchanged for HSBC Holdings ordinary shares. At 31 December 2007, The HSBC Holdings Employee Benefit Trust 2001 (No. 1) held 11,665,278 (2006: 15,316,328) HSBC Holdings ordinary shares which may be exchanged for HSBC France shares arising from the exercise of options.

HSBC France options effectively outstanding over HSBC Holdings ordinary shares under this arrangement were as follows:

	Number of HSBC France shares exchangeable for HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2007	**1,007,031**	**2008 to 2010**	**73.50 142.50**
31 December 2006	1,287,881	2007 to 2010	37.05 142.50
31 December 2005	1,732,996	2006 to 2010	35.52 142.50

HSBC Private Bank France plan

There also exist outstanding options over the shares of HSBC Private Bank France, a subsidiary of HSBC France, which are exchangeable for HSBC Holdings ordinary shares, the details of which are set out in the Directors Report on pages 313 and 314 and are summarised below.

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On exercise of options over shares of HSBC Private Bank France, the HSBC Private Bank France shares are exchangeable for HSBC Holdings ordinary shares in the ratio of 1.83 HSBC Holdings shares for each HSBC Private Bank France share. During 2007, 61,880 (2006: 194,804) HSBC Private Bank France shares were issued following the exercise of employee share options and exchanged for 113,234 (2006: 356,472) HSBC Holdings ordinary shares, such shares being delivered from The CCF Employee Benefit Trust 2001 (Private Banking France). During 2007, no options over HSBC Private Bank France shares lapsed (2006: nil). During 2007, 8,819 (2006: 6,000) HSBC Private Bank France shares previously issued following the exercise of employee share options were exchanged for 16,137 (2006: 10,980) HSBC Holdings ordinary shares. At 31 December 2007, no (2006: 8,819) HSBC Private Bank France shares previously issued following the exercise of employees share options were exchanged for HSBC Holdings ordinary shares. There were 340,976 HSBC Private Bank France employee share options exchangeable for HSBC Holdings ordinary shares outstanding at 31 December 2007 (2006: 402,856). At 31 December 2007, The CCF Employee Benefit Trust 2001 (Private Banking France) held 955,952 (2006: 1,085,323) HSBC Holdings ordinary shares which may be exchanged for HSBC Private Bank France shares arising from the exercise of options.

HSBC Private Bank France options (including shares issued but not exchanged) effectively outstanding over HSBC Holdings ordinary shares under this arrangement were as follows:

	Number of HSBC Private Bank France shares exchangeable for HSBC Holdings ordinary shares	**Period of exercise**	**Exercise price**
31 December 2007	**340,976**	**2008 to 2012**	**10.84 22.22**
31 December 2006	411,675	2007 to 2012	10.84 22.22
31 December 2005	612,479	2006 to 2012	10.84 22.22

Banque Hervet plan

On the acquisition of Banque Hervet in 2001, Banque Hervet shares were held in a *Plan dEpargne Entreprise* on behalf of Banque Hervet employees to vest and be released to employees over a 5 year period. It was agreed to exchange these Banque Hervet shares, on vesting, for HSBC Holdings ordinary shares in the ratio of 3.46 HSBC Holdings ordinary shares for each Banque Hervet share. During 2007, no (2006: 163,369) Banque Hervet shares were released in connection with the vesting of interests in the *Plan dEpargne Entreprise* and exchanged for any (2006: 565,151) HSBC Holdings ordinary shares, such shares being delivered from The CCF Employee Benefit Trust 2001 (Banque Hervet). At 31 December 2007, The CCF Employee Benefit Trust 2001 (Banque Hervet) held no (2006: nil) HSBC Holdings ordinary shares.

Banque Hervet shares to be exchanged for HSBC Holdings ordinary shares under this arrangement were as follows:

	Number of Banque Hervet shares exchangeable for HSBC Holdings ordinary shares	**Period of vesting**
31 December 2007		

31 December 2006		
31 December 2005	169,416	2006

HSBC Finance and subsidiary company plans

Following the acquisition of HSBC Finance in 2003, all outstanding options and equity-based awards over HSBC Finance common shares were converted into rights to receive HSBC Holdings ordinary shares in the same ratio as the share exchange offer for HSBC Finance (2.675 HSBC Holdings ordinary shares for each HSBC Finance common share) and the exercise prices per share adjusted accordingly. During 2007, options over 5,370,104 (2006: 10,484,937) HSBC Holdings ordinary shares were exercised and 4,602,172 (2006: 9,781,228) HSBC Holdings ordinary shares delivered from The HSBC (Household) Employee Benefit Trust 2003 to satisfy the exercise of these options. During 2007, options over 399,823 (2006: 300,555) HSBC Holdings ordinary shares lapsed. At 31 December 2007, The HSBC (Household) Employee Benefit Trust 2003 held a total of 1,856,417 (2006: 3,226,216) HSBC Holdings ordinary shares and 196,455 (2006: 198,665) ADSs, each of which represents five HSBC Holdings ordinary shares, which may be used to satisfy the exercise of these options and equity-based awards under the HSBC Finance share plans.

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Notes on the Financial Statements (continued)

Notes 38 and 39

Options and equity-based awards outstanding over HSBC Holdings ordinary shares under the HSBC Finance share plans were as follows:

	Number of HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2007	**21,728,010**	**2008 to 2012**	**nil US$21.37**
31 December 2006	27,497,937	2007 to 2012	nil US$21.37
31 December 2005	38,107,930	2006 to 2012	nil US$21.37

Prior to its acquisition by HSBC Holdings, HSBC Finance issued 8.875 per cent Adjustable Conversion-Rate Equity Security Units (Units) which included a contract under which the holder agreed to purchase, for US$25 each, HSBC Finance common shares on 15 February 2006, with an option for early settlement. The Units which remained outstanding following the acquisition of HSBC Finance were converted into contracts to purchase HSBC Holdings ordinary shares. Units exercised at maturity, 15 February 2006, entitled the holder to receive a number of shares based on the market value of HSBC Holdings ordinary shares at the time, which was 2.6041 HSBC Holdings ordinary shares for each Unit. During 2007, no (2006: 3,424,742) HSBC Holdings ordinary shares were issued in connection with the maturity of any (2006: 1,315,140) Units.

The maximum number of Units outstanding over HSBC Holdings ordinary shares were as follows:

	Number of Units exchangeable for HSBC Holdings ordinary shares	Period of exercise	Exercise price
31 December 2007			
31 December 2006			
31 December 2005	1,315,140	2006	US$8.00 US$9.60

Bank of Bermuda plan

Following the acquisition of Bank of Bermuda in 2004, all outstanding employee share options over Bank of Bermuda shares were converted into rights to receive HSBC Holdings ordinary shares based on the consideration of US$40 for each Bank of Bermuda share and the average closing price of

HSBC Holdings ordinary shares, derived from the London Stock Exchange Daily Official List, for the five business days preceding the closing date of the acquisition. During 2007, options over 377,046 HSBC Holdings ordinary shares were exercised (2006: 529,233) and delivered from the HSBC (Bank of Bermuda) Employee Benefit Trust 2004 to satisfy the exercise of these options. During 2007, options over 11,228 (2006: 126,854) HSBC Holdings ordinary shares lapsed. At 31 December 2007, the HSBC (Bank of Bermuda) Employee Benefit Trust 2004 held 1,889,903 (2006: 2,266,949) HSBC Holdings ordinary shares which may be used to satisfy the exercise of options.

Options outstanding over HSBC Holdings ordinary shares under the Bank of Bermuda share plans were as follows:

	Number of HSBC Holdings ordinary shares	**Period of exercise**	**Exercise price**
31 December 2007	**2,322,094**	**2008 to 2013**	**US$7.04 – 18.35**
31 December 2006	2,710,368	2007 to 2013	US$7.04 – 18.35
31 December 2005	3,366,455	2006 to 2013	US$7.04 – 18.35

The maximum obligation at 31 December 2007 to deliver HSBC Holdings ordinary shares under all of the above option arrangements, together with Performance Share and Restricted Share awards under the HSBC Holdings Restricted Share Plan 2000 and The HSBC Share Plan, was 417,044,591 (2006: 435,602,017). The total number of shares at 31 December 2007 held by employee benefit trusts that may be used to satisfy such obligations to deliver HSBC Holdings ordinary shares was 149,423,898 (2006: 133,346,569).

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39 Equity

	2007									
				Other reserves						
	Called up share capital US$m	Share premium[1] US$m	Retained earnings[2] US$m	Available-for-sale fair value reserve US$m	Cash flow hedging reserve[3] US$m	Foreign exchange reserve US$m	Share-based payment reserve US$m	Merger reserve[4] US$m	Total share-holders’ equity US$m	Mino intere US
At 1 January	5,786	7,789	65,397	2,005	(101)	4,307	2,111	21,058	108,352	6,5
Shares issued under employee share plans	17	460	–	–	–	–	–	–	477	
Shares issued in lieu of dividends and amounts arising thereon[1]	112	(115)	4,354	–	–	–	–	–	4,351	
Profit for the year	–	–	19,133	–	–	–	–	–	19,133	1,3
Dividends to shareholders	–	–	(10,241)	–	–	–	–	–	(10,241)	(7
Own shares adjustment	–	–	(510)	–	–	–	–	–	(510)	
Share of changes recognised directly in equity in the equity of associates or joint ventures	–	–	372	–	–	–	–	–	372	
Actuarial gains/(losses) on defined benefit plans	–	–	2,234	–	–	–	–	–	2,234	
Exchange differences	–	–	5,459	291	(28)	26	–	–	5,748	1
Fair value gains taken to equity	–	–	–	526	616	–	–	–	1,142	2
Amounts transferred to the income statement[3]	–	–	–	(1,713)	(1,899)	–	–	–	(3,612)	
Exercise and lapse of share options and vesting of share awards	–	–	758	–	–	–	(751)	–	7	
Cost of share-based	–	–	–	–	–	–	870	–	870	

payment arrangements										
Other movements	–	–	**320**	**1**	**(6)**	–	**(262)**	–	**53**	
Tax on items taken directly to or transferred from equity	–	–	**(720)**	**31**	**473**	–	–	–	**(216)**	
Transfers	–	–	**(5,459)**	**(291)**	**28**	**5,722**	–	–	–	
Net increase in minority interest arising on acquisitions, disposals and capital issuance	–	–	–	–	–	–	–	–	–	**(**
At 31 December	**5,915**	**8,134**	**81,097**	**850**	**(917)**	**10,055**	**1,968**	**21,058**	**128,160**	**7,**

1 *Share premium includes the deduction of US$3 million in respect of issuance costs incurred during the year.*

2 *Retained earnings include158,706,463 (US$2,649 million) of own shares held within HSBC’s insurance business, retirement funds for the benefit of policyholders or beneficiaries within employee trusts for the settlement of shares expected to be delivered under employee share schemes or bonus plans, and the market-making activities in Global Markets.*

3 *Amounts transferred to the income statement in respect of cash flow hedges include US$57 million taken to ‘Net interest income’ and US$1,829 million taken to ‘Net trading income’.*

4 *Statutory share premium relief under Section 131 of the Companies Act 1985 was taken in respect of the acquisition of HSBC Bank plc in 1992, HSBC France in 2000 and HSBC Finance Corporation in 2003 and the shares issued were recorded at their nominal value only. In HSBC’s consolidated accounts the fair value difference of US$8,290 million in respect of HSBC France and US$12,768 million in respect of HSBC Finance Corporation is a merger reserve.*

Cumulative goodwill amounting to US$5,138 million has been charged against reserves in respect of acquisitions of subsidiaries prior to 1 January 1998, including US$3,469 million charged against the merger reserve arising on the acquisition of HSBC Bank plc. The balance of US$1,669 million has been charged against retained earnings.

Notes on the Financial Statements (continued)

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	2006									
				Other reserves						
	Called up share capital US$m	Share premium [1] US$m	Retained earnings [2] US$m	Available-for-sale fair value reserve US$m	Cash flow hedging reserve[3] US$m	Foreign exchange reserve US$m	Share-based payment reserve US$m	Merger reserve [4] US$m	Total share-holders– equity US$m	Minor intere US
At 1 January	5,667	6,896	56,223	1,104	233	(284)	1,535	21,058	92,432	5,7
Shares issued under employee share plans	40	975	–	–	–	–	–	–	1,015	
Shares issued in lieu of dividends and amounts arising thereon[1]	79	(82)	2,528	–	–	–	–	–	2,525	
Profit for the year	–	–	15,789	–	–	–	–	–	15,789	1,0
Dividends to shareholders	–	–	(8,769)	–	–	–	–	–	(8,769)	(7
Own shares adjustment	–	–	(529)	–	–	–	–	–	(529)	
Share of changes recognised directly in equity in the equity of associates or joint ventures	–	–	20	–	–	–	–	–	20	
Actuarial gains/(losses) on defined benefit plans	–	–	(92)	–	–	–	–	–	(92)	
Exchange differences	–	–	4,446	89	(8)	26	38	–	4,591	
Fair value gains taken to equity	–	–	–	1,514	1,560	–	–	–	3,074	
Amounts transferred to the income statement[3]	–	–	–	(601)	(2,219)	–	–	–	(2,820)	(
Exercise and lapse of share	–	–	684	–	–	–	(623)	–	61	

options and vesting of share awards										
Cost of share-based payment arrangements							854		854	
Other movements			(102)	(9)	2		345		236	(1
Tax on items taken directly to or transferred from equity			(355)	(3)	323				(35)	
Transfers			(4,446)	(89)	8	4,565	(38)			
Net increase in minority interest arising on acquisitions, disposals and capital issuance										4
At 31 December	5,786	7,789	65,397	2,005	(101)	4,307	2,111	21,058	108,352	6,5

1 *Share premium includes the deduction of US$3 million in respect of issuance costs incurred during the year.*

2 *Retained earnings include 148,323,102 (US$2,305 million) of own shares held within HSBCs insurance business, retirement funds for the benefit of policyholders or beneficiaries within employee trusts for the settlement of shares expected to be delivered under employee share schemes or bonus plans, and the market-making activities in Global Markets. 2006 numbers have been restated to conform with the current years presentation.*

3 *Amounts transferred to the income statement in respect of cash flow hedges include US$479 million taken to Net interest income and US$1,719 million taken to Net trading income.*

4 *Statutory share premium relief under Section 131 of the Companies Act 1985 was taken in respect of the acquisition of HSBC Bank plc in 1992, HSBC France in 2000 and HSBC Finance Corporation in 2003 and the shares issued were recorded at their nominal value only. In HSBCs consolidated accounts the fair value difference of US$8,290 million in respect of HSBC France and US$12,768 million in respect of HSBC Finance Corporation is a merger reserve.*

Cumulative goodwill amounting to US$5,138 million has been charged against reserves in respect of acquisitions of subsidiaries prior to 1 January 1998, including US$3,469 million charged against the merger reserve arising on the acquisition of HSBC Bank plc. The balance of US$1,669 million has been charged against retained earnings.

	2005									
				Other reserves						
	Called up share capital US$m	Share premium[2] US$m	Retained earnings [3] US$m	Available-for-sale fair value reserve US$m	Cash flow hedging reserve[4] US$m	Foreign exchange reserve US$m	Share-based payment reserve US$m	Merger reserve[5] US$m	Total share-holders' equity US$m	Minority interests US$m
At 1 January	5,587	4,881	49,432	—	—	3,215	1,349	21,058	85,522	13,675
IFRSs transition adjustment at 1 January 2005[1]	—	—	(1,762)	1,919	410	686	—	—	1,253	(10,07
Shares issued under employee share plans	28	662	—	—	—	—	—	—	690	
Shares issued in lieu of dividends and amounts arising thereon	52	(52)	1,811	—	—	—	—	—	1,811	
New share capital subscribed, net of costs[2]	—	1,405	—	—	—	—	—	—	1,405	
Profit for the year	—	—	15,081	—	—	—	—	—	15,081	79
Dividends to shareholders	—	—	(7,750)	—	—	—	—	—	(7,750)	(689
Own shares adjustment	—	—	(558)	—	—	—	127	—	(431)	
Share of changes recognised directly in equity in the equity of associates or joint ventures	—	—	161	—	—	—	—	—	161	
Actuarial gains/(losses) on defined benefit plans	—	—	(820)	—	—	—	—	—	(820)	8
Exchange differences	—	—	(3,449)	(141)	(41)	(568)	14	—	(4,185)	(72
Fair value losses taken to equity	—	—	—	(351)	(63)	—	—	—	(414)	(78
Amounts transferred to the income statement[4]	—	—	—	(226)	(106)	—	—	—	(332)	(14
	—	—	303	—	—	—	(481)	—	(178)	

Exercise and lapse of share options and vesting of share awards										
Cost of share-based payment arrangements							540		540	
Other movements			58	(400)					(342)	
Tax on items taken directly to or transferred from equity			267	162	(8)				421	16
Transfers			3,449	141	41	(3,617)	(14)			
Net increase in minority interest arising on acquisitions, disposals and capital issuance										2,23
At 31 December	5,667	6,896	56,223	1,104	233	(284)	1,535	21,058	92,432	5,79

1 *For an explanation of the IFRSs transition adjustment at 1 January 2005, see Note 46 on the Financial Statements in the Annual Report and Accounts 2005.*

2 *Share premium includes the deduction of US$40 million in respect of issuance costs incurred during the year.*

3 *Retained earnings include 144,041,122 (US$2,579 million) of own shares held within HSBCs insurance business, retirement funds for the benefit of policyholders or beneficiaries within employee trusts for the settlement of shares expected to be delivered under employee share schemes or bonus plans, and the market-making activities in Global Markets. 2005 numbers have been restated to conform with the current years presentation.*

4 *Amounts transferred to the income statement in respect of cash flow hedges include US$101 million taken to Net interest income and US$5 million taken to Net trading income.*

5 *Statutory share premium relief under Section 131 of the Companies Act 1985 was taken in respect of the acquisition of HSBC Bank plc in 1992, HSBC France in 2000 and HSBC Finance Corporation in 2003 and the shares issued were recorded at their nominal value only. In HSBCs consolidated accounts the fair value difference of US$8,290 million in respect of HSBC France and US$12,768 million in respect of HSBC Finance Corporation is a merger reserve.*

Cumulative goodwill amounting to US$5,138 million has been charged against reserves in respect of acquisitions of subsidiaries prior to 1 January 1998, including US$3,469 million charged against the merger reserve arising on the acquisition of HSBC Bank plc. The balance of US$1,669 million has been charged against retained earnings.

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40 Notes on the cash flow statement

Non-cash items included in profit before tax

	HSBC			HSBC Holdings	
	2007 US$m	2006 US$m	2005 US$m	**2007 US$m**	2006 US$m
Depreciation, amortisation and impairment	**2,522**	2,528	2,213	**(25)**	–
Gains arising from dilution of interests in associates	**(1,092)**	–	–	–	–
Revaluations on investment property	**(152)**	(164)	(201)	–	–
Share-based payment expense	**870**	854	540	**29**	58
Loan impairment losses gross of recoveries	**18,182**	11,331	8,295	–	–
Provisions for liabilities and charges	**989**	498	327	–	–
Impairment of financial investments	**65**	21	–	–	–
Charge for defined benefit plans	**727**	664	676	–	–
Accretion of discounts and amortisation of premiums	**(449)**	(776)	(446)	**6**	–
	21,662	14,956	11,404	**10**	58

Change in operating assets

	HSBC			HSBC Holdings	
	2007 US$m	2006 US$m	2005 US$m	**2007 US$m**	2006 US$m
Change in loans to HSBC undertakings	–	–	–	**(2,786)**	(1,060)
Change in prepayments and accrued income	**(5,069)**	(2,478)	7,121	**(183)**	(22)
Change in net trading securities and net derivatives	**(4,972)**	(13,620)	4,940	**(1,094)**	(740)
Change in loans and advances to banks	**(8,922)**	(11,505)	307	–	–
Change in loans and advances to customers	**(131,886)**	(132,987)	(80,150)	–	–
Change in financial assets designated at fair value	**(13,360)**	(4,883)	(15,048)	–	–
Change in other assets	**(12,329)**	(9,844)	(8,923)	**4**	(5)
	(176,538)	(175,317)	(91,753)	**(4,059)**	(1,827)

Change in operating liabilities

	HSBC			HSBC Holdings	
	2007	2006	2005	**2007**	2006
	US$m	US$m	US$m	**US$m**	US$m
Change in accruals and deferred income	**5,119**	3,549	(3,810)	**39**	16
Change in deposits by banks	**32,594**	28,378	(14,328)	**—**	—
Change in customer accounts	**199,806**	149,849	46,394	**—**	—
Change in debt securities in issue	**(12,489)**	42,253	(19,047)	**—**	—
Change in financial liabilities designated at fair value	**12,304**	8,382	61,837	**148**	700
Change in other liabilities	**12,761**	4,967	1,166	**(8)**	340
	250,095	237,378	72,212	**179**	1,056

Cash and cash equivalents

	HSBC			HSBC Holdings	
	2007	2006	2005	**2007**	2006
	US$m	US$m	US$m	**US$m**	US$m
Cash at bank with HSBC undertakings	**—**	—	—	**360**	729
Cash and balances at central banks	**21,765**	12,732	13,712	**—**	—
Items in the course of collection from other banks	**9,777**	14,144	11,300	**—**	—
Loans and advances to banks of one month or less	**232,320**	162,998	100,527	**—**	—
Treasury bills, other bills and certificates of deposit less than three months	**41,819**	38,237	22,790	**—**	—
Less: items in the course of transmission to other banks	**(8,672)**	(12,625)	(7,022)	**—**	—
Total cash and cash equivalents	**297,009**	215,486	141,307	**360**	729

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Interest and dividends

	HSBC			HSBC Holdings	
	2007 US$m	2006 US$m	2005 US$m	**2007 US$m**	2006 US$m
Interest paid	**(63,626)**	(47,794)	(33,974)	**(2,397)**	(1,870)
Interest received	**103,393**	85,143	65,799	**1,627**	1,287
Dividends received	**1,833**	1,525	808	**9,187**	7,433

41 Contingent liabilities, contractual commitments and guarantees

	HSBC		HSBC Holdings	
	2007 US$m	2006 US$m	**2007 US$m**	2006 US$m
Contingent liabilities and guarantees				
Guarantees and irrevocable letters of credit pledged as collateral security	**77,885**	77,410	**38,457**	17,605
Other contingent liabilities	**334**	330	–	–
	78,219	77,740	**38,457**	17,605
Commitments				
Documentary credits and short-term trade-related transactions	**13,510**	9,659	–	–
Forward asset purchases and forward forward deposits placed	**490**	2,077	–	–
Undrawn note issuing and revolving underwriting facilities	**109**	213	–	–
Undrawn formal standby facilities, credit lines and other commitments to lend:				
– 1 year and under[1]	**616,167**	584,167	**2,913**	2,920
– over 1 year[1]	**134,181**	118,514	**725**	1,047
	764,457	714,630	**3,638**	3,967

1 *Based on original maturity.*

The above table discloses the nominal principal amounts of contingent liabilities, commitments and guarantees. They are mainly credit-related instruments which include both financial and non-financial guarantees and commitments to extend credit. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. The amount of the loan commitments shown above reflects, where relevant, the expected level of take-up of pre-approved loan offers made by mailshots to personal customers. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements.

Guarantees

HSBC provides guarantees and similar undertakings on behalf of both third party customers and other entities within the HSBC Group. These guarantees are generally provided in the normal course of HSBC's banking business. The principal types of guarantees provided, and the maximum potential amount of future payments which HSBC could be required to make at 31 December 2007, were as follows:

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	At 31 December 2007		At 31 December 2006	
	Guarantees in favour of third parties US$m	**Guarantees by HSBC Holdings in favour of other HSBC Group entities US$m**	Guarantees in favour of third parties US$m	Guarantees by HSBC Holdings in favour of other HSBC Group entities US$m
Guarantee type				
Financial guarantee contracts1	**25,086**	**38,457**	22,746	17,605
Standby letters of credit which are financial guarantee contracts2	**8,357**	–	4,535	–
Other direct credit substitutes3	**4,938**	–	5,514	–
Performance bonds4	**12,969**	–	8,070	–
Bid bonds4	**1,119**	–	592	–
Standby letters of credit related to particular transactions4	**8,235**	–	7,301	–
Other transaction-related guarantees4	**16,940**	–	28,627	–
Other items	**241**	–	25	–
	77,885	**38,457**	77,410	17,605

1 *Financial guarantees are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. The amounts in the above table are nominal principal amounts.*
2 *Standby letters of credit which are financial guarantee contracts are irrevocable obligations on the part of HSBC to pay third parties when customers fail to make payments when due.*
3 *Other direct credit substitutes include re-insurance letters of credit and trade-related letters of credit issued without provision for the issuing entity to retain title to the underlying shipment.*
4 *Performance bonds, bid bonds, standby letters of credit and other transaction-related guarantees are undertakings by which the obligation on HSBC to make payment depends on the outcome of a future event.*

The amounts disclosed in the above table reflect HSBC’s maximum exposure under a large number of individual guarantee undertakings. The risks and exposures arising from guarantees are captured and managed in accordance with HSBC’s overall credit risk management policies and procedures. Approximately half of the above guarantees have a term of less than one year. Guarantees with terms of more than one year are subject to HSBC’s annual credit review process.

Commitments

At 31 December 2007, HSBC had US$942 million (2006: US$1,259 million) of capital commitments contracted but not provided for and US$194 million (2006: US$289 million) of capital commitments authorised but not contracted for.

In addition, the following agreements have been entered into to acquire businesses that are expected to be effected after the date these financial statements are authorised for issue, subject to regulatory approval.

Agreement to acquire Korea Exchange Bank

In September 2007, HSBC agreed to acquire 51.02 per cent of the issued share capital of Korea Exchange Bank (KEB) from LSF-KEB Holdings SCA, a holding company owned by Lone Star Fund IV (US) LP and Lone Star Fund IV (Bermuda) LP (collectively Lone Star). The consideration is KRW3,400 billion plus US$2,833 million, amounting in total to the equivalent of approximately US$6,450 million, payable in cash.

Under a shareholders agreement with Lone Star, The Export-Import Bank of Korea (KEXIM) is entitled to require HSBC to purchase, on substantially the same terms, part or all of its shareholding in KEB (KEXIMs entire shareholding represents a further 6.25 per cent of the issued share capital of KEB).

The acquisition is subject to a number of conditions including the receipt of applicable governmental and regulatory approvals, particularly in South Korea from the Financial Supervisory Commission and the Fair Trade Commission.

The acquisition agreement is conditional on completion taking place on or before 30 April 2008.

Following completion, KEB will be accounted for as a subsidiary in HSBCs consolidated financial statements.

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Acquisition of The Chinese Bank Co., Ltd.

In December 2007, HSBC was named the successful bidder in a government auction to acquire the business of The Chinese Bank Co., Ltd. (The Chinese Bank) in Taiwan.

The agreement relating to this acquisition will result in HSBC assuming The Chinese Banks assets, liabilities and operations with a payment by the Taiwan Governments Central Deposit Insurance Corporation to deliver an agreed net asset position. In addition, HSBC will provide certain additional capital of between US$300 million to US$400 million to ensure that its enlarged operations maintain appropriate financial ratios.

The transaction is subject to obtaining the necessary regulatory approvals.

Associates

HSBCs share of associates contingent liabilities amounted to US$18,437 million at 31 December 2007 (2006: US$13,824 million). No matters arose where HSBC was severally liable.

42 Lease commitments

Finance lease commitments

HSBC leases land and buildings (including branches) and equipment from third parties under finance lease arrangements to support its operations.

	2007 US$m	2006 US$m
Total future minimum payments:		
no later than one year	**39**	60
later than one year and no later than five years	**128**	145
later than five years	**835**	707
	1,002	912
Less: future interest charges	**(299)**	(205)
Present value of finance lease commitments	**703**	707

At 31 December 2007, future minimum sublease payments of US$465 million (2006: US$163 million) are expected to be received under non-cancellable subleases at the balance sheet date.

	2007		2006	
	Land and buildings US$m	**Equipment US$m**	Land and buildings US$m	Equipment US$m
Future minimum lease payments under non-cancellable operating leases:				
no later than one year	**788**	**11**	789	10
later than one year and no later than five years	**2,010**	**14**	2,290	21
later than five years	**1,736**	****	1,198	
	4,534	**25**	4,277	31

In 2007, US$849 million (2006: US$781 million; 2005: US$704 million) was charged to General and administrative expenses in respect of lease and sublease agreements, of which US$838 million (2006: US$762 million; 2005: US$683 million) related to minimum lease payments, US$8 million (2006: US$19 million; 2005:

US$21 million) to contingent rents, and US$3 million (2006: nil; 2005: nil) to sublease payments.

The contingent rent represents escalation payments made to landlords for operating, tax and other escalation expenses.

Finance lease receivables

HSBC leases a variety of assets to third parties under finance leases, including transport assets (such as aircraft), property and general plant and machinery. At the end of lease terms, assets may be sold to third parties or leased for further terms. Lessees may participate in any sales proceeds achieved. Lease rentals arising during the lease terms will either be fixed in quantum or be varied to reflect changes in, for example, tax or interest rates. Rentals are calculated to recover the cost of assets less their residual value, and earn finance income.

	2007			2006		
	Total future minimum payments US$m	**Unearned finance income US$m**	**Present value US$m**	Total future minimum payments US$m	Unearned interest income US$m	Present value US$m
Lease receivables:						
no later than one year	**2,958**	**(528)**	**2,430**	2,305	(460)	1,845
later than one year and no later than five years	**8,741**	**(1,500)**	**7,241**	7,207	(1,400)	5,807
later than five years	**9,194**	**(2,789)**	**6,405**	9,206	(2,944)	6,262
	20,893	**(4,817)**	**16,076**	18,718	(4,804)	13,914

At 31 December 2007, unguaranteed residual values of US$224 million (2006: US$212 million) had been accrued, and the accumulated allowance for uncollectible minimum lease payments receivable amounted to US$23 million (2006: US$28 million).

During the year, a total of US$44 million (2006: US$59 million) was received as contingent rents and recognised in the income statement.

Operating lease receivables

HSBC leases a variety of different assets to third parties under operating lease arrangements, including transport assets (such as rolling stock), property and general plant and machinery.

	2007		2006	
	Land and buildings US$m	**Equipment US$m**	Land and buildings US$m	Equipment US$m
Future minimum lease payments under non-cancellable operating leases:				
no later than one year	**50**	**838**	47	808
later than one year and no later than five years	**14**	**1,363**	17	1,561
later than five years	**10**	**400**	12	573
	74	**2,601**	76	2,942

43 Litigation

HSBC is party to legal actions in a number of jurisdictions including the UK, Hong Kong and the US, arising out of its normal business operations. HSBC considers that none of the actions is material, and none is expected to result in a significant adverse effect on the financial position of HSBC, either individually or in the aggregate. Management believes that adequate provisions have been made in respect of such litigation. HSBC has not disclosed any contingent liability associated with these legal actions because it is not practicable to do so, except as set out below.

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 plc, to determine the legal status and enforceability of certain of the charges applied to their personal customers in relation to unauthorised overdrafts (the charges). Certain preliminary issues in these proceedings were heard in a trial in the Commercial Division of the High Court on 17 January 2008. This trial concluded on 8 February 2008 and judgment, on the preliminary issues tested, is awaited.

The proceedings remain at a very early stage and may, if appeals on the preliminary issues (or, subsequently, on substantive issues) are pursued, take a number of years to conclude. A wide range of outcomes is possible, depending, initially, upon whether the Court finds that some, all, or none of the charges should be tested for fairness and/or tested as common law penalties and, if it does find that some or all of the charges should be so tested, upon the Courts subsequent assessment of each charge across the period under review. Since July 2001, there have been a variety of charges applied by HSBC Bank plc across different charging periods under the then current contractual arrangements. HSBC Bank plc considers the charges to be and to have been valid and enforceable, and intends strongly to defend its position.

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If, contrary to HSBC Bank plcs current assessment, the Court should ultimately (after appeals) reach a decision adverse to HSBC Bank plc that results in liability for it, a large number of different outcomes is possible, each of which would have a different financial impact. Based on the facts currently available to it, and a number of assumptions, HSBC Bank plc estimates that the financial impact could be approximately US$600 million. To make an estimate of the potential financial impact at this stage with any precision is extremely difficult, owing to (among other things) the complexity of the issues, the number of permutations of possible outcomes, and the early stage of the proceedings. In addition, the assumptions made by HSBC Bank plc may prove to be incorrect.

44 Related party transactions

The Groups related parties include associates, joint ventures, post-employment benefit plans for the benefit of HSBC employees, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family members.

Transactions with Directors and other Key Management Personnel

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Holdings, being the members of the Board of Directors of HSBC Holdings and Group Managing Directors.

Compensation of Directors and other Key Management Personnel

	HSBC	
	2007 US$m	2006 US$m
Short-term employee benefits	**62**	76
Post-employment benefits	**4**	3
Termination benefits	**9**	
Share-based payments	**40**	61
	115	140

Transactions, arrangements and agreements involving Directors and others

Particulars of transactions, arrangements and agreements entered into by subsidiaries of HSBC Holdings with Directors and connected persons and companies controlled by them and with officers of HSBC Holdings, disclosed pursuant to section 232 of the Companies Act 1985, were as follows:

	2007		2006	
	Number of persons	**Balance at 31 December US$000**	Number of persons	Balance at 31 December US$000
Directors and connected persons and companies controlled by them	**94**		85	
Loans		**534,227**		407,176
Credit cards		**300**		317
Guarantees		**27,044**		21,751
Officers1	**12**		12	
Loans		**19,041**		16,706

Credit cards	**206**	687
Guarantees	**25**	23

1 *Officers comprised 10 Group Managing Directors, the Group Chief Accounting Officer and the Group Company Secretary in 2007 and 2006.*

Further information on related party transactions, disclosed pursuant to the requirements of IAS 24, is shown below. The disclosure of the year-end balance and the highest amounts outstanding during the year in the table below is considered to be the most meaningful information to represent the amount of the transactions and the amount of outstanding balances during the year.

Notes on the Financial Statements (continued)

Note 44

	2007		2006	
	Balance at 31 December US$000	**Highest amounts outstanding during year US$000**	Balance at 31 December US$000	Highest amounts outstanding during year US$000
Key Management Personnel				
Loans	**325,648**	**804,845**	423,594	582,606
Credit cards	**323**	**1,077**	976	1,637
Guarantees	**27,044**	**30,317**	21,774	24,952

Key Management Personnel of HSBC Holdings for the purposes of IAS 24 comprise all of the Directors of HSBC Holdings, Group Managing Directors, and close members of their families and companies they control, jointly control, or significantly influence, or for which significant voting power is held.

Some of the transactions were connected transactions, as defined by the Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited but were exempt from any disclosure requirements under the provisions of those Rules.

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Shareholdings and options of Directors and other Key Management Personnel

	At 31 December	
	2007 (000s)	2006 (000s)
Number of options over HSBC Holdings ordinary shares made under employee share plans held by Directors and other Key Management Personnel	**36**	4,563
Number of HSBC Holdings ordinary shares held beneficially and non-beneficially by Directors and other Key Management Personnel	**12,358**	20,904
Number of HSBC Holdings preference shares held beneficially and non-beneficially by Directors and other Key Management Personnel	**8**	8
	12,402	25,475

Transactions with other related parties of HSBC

Associates and joint ventures

The Group provides certain banking and financial services to associates and joint ventures. Details of the interests in associates and joint ventures are given in Note 21. Transactions and balances during the year with associates and joint ventures were as follows:

	2007		2006	
	Highest balance during the year[1] **US$m**	**Balance at 31 December**[1] **US$m**	Highest balance during the year[1] US$m	Balance at 31 December[1] US$m
Amounts due from joint ventures:				
unsubordinated	**632**	**603**	746	80
Amounts due from associates:				
subordinated	**15**	**15**	52	15
unsubordinated	**7,310**	**823**	586	376
	7,957	**1,441**	1,384	471
Amounts due to joint ventures	**71**	**27**	1,490	58
Amounts due to associates	**5,243**	**327**	892	506
	5,314	**354**	2,382	564

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

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The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Pension funds

At 31 December 2007, US$4.1 billion (2006: US$15.1 billion) of HSBC pension fund assets were under management by HSBC companies. Fees of US$42 million (2006: US$49 million) were earned by HSBC companies for these management services. HSBCs pension funds had placed deposits of US$506 million (2006: US$348 million) with its banking subsidiaries, on which interest payable to the schemes amounted to US$40 million (2006: US$15 million). The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

HSBC Bank (UK) Pension Scheme entered into swap transactions with HSBC to manage the inflation and interest rate sensitivity of the liabilities. At 31 December 2007, the gross notional value of the swaps was US$21.2 billion (2006: US$14.5 billion), the swaps had a positive fair value of US$248 million (2006: negative fair value of US$273 million) to the scheme and HSBC had delivered collateral of US$759 million (2006: US$265 million) to the scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid offer spreads.

In order to satisfy diversification requirements, the Trustee has requested special collateral provisions for the swap transactions between HSBC and the scheme. The collateral agreement stipulates that the scheme never posts collateral to HSBC. Collateral is posted to the scheme by HSBC at an amount that the Trustee is highly confident would be sufficient to replace the swaps in the event of default by HSBC Bank plc. With the exception of the special collateral arrangements detailed above, all other aspects of the swap transactions between HSBC and the scheme are on substantially the same terms as comparable transactions with third party counterparties.

HSBC International Staff Retirements Benefits Scheme entered into swap transactions with HSBC to manage the inflation and interest rate sensitivity of the liabilities and selected assets. At 31 December 2007, the gross notional value of the swaps was US$1.7 billion (2006: US$1.2 billion), and the swaps had a net positive fair value of US$63 million to the scheme (2006: US$14 million).

HSBC Holdings

Details of HSBC Holdings principal subsidiaries are shown in Note 24. Transactions and balances during the year with subsidiaries were as follows:

	2007		2006	
Subsidiaries	**Highest balance during the year[1] US$m**	**Balance at 31 December[1] US$m**	Highest balance during the year[1] US$m	Balance at 31 December[1] US$m
Assets				
Cash at bank	**729**	**360**	784	729
Derivatives	**2,660**	**2,660**	1,599	1,599
Loans and advances	**17,242**	**17,242**	14,935	14,456
Financial investments	**3,389**	**2,676**	3,426	3,316
Investments in subsidiaries[2]	**69,411**	**69,411**	63,265	63,265
Total related party assets	**93,431**	**92,349**	84,009	83,365
Liabilities				
Amounts owed to HSBC undertakings	**3,191**	**2,969**	4,279	3,100
Derivatives	**290**	**44**	385	177
Subordinated liabilities:				

cost	**4,109**	**4,109**	3,991	3,991
fair value	**4,231**	**4,187**	4,231	4,231
Total related party liabilities	**11,821**	**11,309**	12,886	11,499
Guarantees	**38,457**	**38,457**	36,877	17,605

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

2 *On 1 January 2007, HSBC Holdings adopted IFRIC 11. Comparative information has been restated accordingly. See Note 1a.*

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Notes on the Financial Statements (continued)

The above outstanding balances arose in the ordinary course of business and are on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties, with the exception of US$654 million (2006: US$640 million) in respect of loans from HSBC subsidiaries to HSBC Holdings made at an agreed zero per cent interest rate.

Some employees of HSBC Holdings are members of the HSBC Bank (UK) Pension Scheme, which is sponsored by a separate Group company. HSBC Holdings incurs a charge for these employees equal to the contributions paid into the scheme on their behalf. Disclosure in relation to the scheme is made in Note 8 to the accounts.

45 Events after the balance sheet date

On 29 February 2008, HSBC France, a wholly owned subsidiary of HSBC, received a firm cash offer from Banque Fédérale des Banques Populaires of 2.1 billion (US$3.1 billion) for its seven French regional banking subsidiaries. On the basis of this offer, HSBC France has entered into exclusive discussions with Banque Fédérale des Banques Populaires. HSBC France will now commence consultations with representatives of the relevant employee representative bodies before making any final decision. Any transaction will be subject to regulatory approvals in France. At 31 December 2007, the aggregate total assets attributable to the seven French regional banking subsidiaries were 8.4 billion (US$12.3 billion), and they generated net profits after tax of 100 million (US$137 million) for the year ended 31 December 2007.

A fourth interim dividend for 2007 of US$0.39 per ordinary share (US$4,628 million) (2006: US$0.36 per ordinary share, US$4,171 million) was declared by the Directors after 31 December 2007.

These accounts were approved by the Board of Directors on 3 March 2008 and authorised for issue.

46 UK and Hong Kong accounting requirements

The financial statements have been prepared in accordance with IFRSs. There would be no significant differences had they been prepared in accordance with Hong Kong Financial Reporting Standards.

47 Non-statutory information

The information set out in these accounts does not constitute the company's statutory accounts for the years ended 31 December 2007 or 2006. Those accounts have been reported on by the company's auditors: their reports were unqualified and did not contain a statement made under section 237(2) or (3) of the Companies Act 1985. The accounts for 2006 have been delivered to the Registrar of Companies and those for 2007 will be delivered in due course.

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Shareholder Information

Enforceability of judgements / Exchange controls / Dividends

Information about the enforceability of judgements made in the US

HSBC Holdings is a public limited company incorporated in England and Wales. Most of HSBC Holdings Directors and executive officers live outside the US. As a result, it may not be possible to serve process on such persons or HSBC Holdings in the US or to enforce judgements obtained in US courts against them or HSBC Holdings based on civil liability provisions of the securities laws of the US. There is doubt as to whether English courts would enforce:

- certain civil liabilities under US securities laws in original actions; or
- judgements of US courts based upon these civil liability provisions.

In addition, awards of punitive damages in actions brought in the US or elsewhere may be unenforceable in the UK. The enforceability of any judgement in the UK will depend on the particular facts of the case as well as the laws and treaties in effect at the time.

Exchange controls and other limitations affecting equity security holders

There are currently no UK laws, decrees or regulations which would prevent the import or export of capital or remittance of distributable profits by way of dividends and other payments to holders of HSBC Holdings equity securities who are not residents of the UK. There are also no restrictions under the laws of the UK or the terms of the Memorandum and Articles of Association of HSBC Holdings concerning the right of non-resident or foreign owners to hold HSBC Holdings equity securities or, when entitled to vote, to do so.

Fourth interim dividend for 2007

The Directors have declared a fourth interim dividend for 2007 of US$0.39 per ordinary share. Information on the scrip dividend scheme and currencies in which shareholders may elect to have the cash dividend paid will be sent to shareholders on or about 3 April 2008. The timetable for the dividend is:

	2008
Shares quoted ex-dividend in London, Hong Kong and Bermuda	19 March
ADSs quoted ex-dividend in New York	20 March
Record date and closure of Hong Kong and Bermuda Overseas Branch Registers of shareholders for one day	25 March
Shares quoted ex-dividend in Paris	26 March
Mailing of *Annual Report and Accounts 2007* and/or *Annual Review 2007*, Notice of Annual General Meeting and dividend documentation	3 April
Final date for receipt by registrars of forms of election, Investor Centre electronic instructions and revocations of standing instructions for scrip dividends	24 April
Exchange rate determined for payment of dividends in sterling and Hong Kong dollars	28 April
Payment date: dividend warrants, new share certificates or transaction advices and notional tax vouchers mailed and shares credited to stock accounts in CREST	7 May

Shareholder Information (continued)

Dividends / Nature of trading market

Interim dividends for 2008

The Board has adopted a policy of paying quarterly interim dividends on the ordinary shares. Under this policy it is intended to have a pattern of three equal interim dividends with a variable fourth interim dividend. It is envisaged that the first interim dividend in respect of 2008 will be US$0.18 per ordinary share. The proposed timetables for the dividends in respect of 2008 are:

	Interim dividends for 2008			
	First	**Second**	**Third**	**Fourth**
Announcement	6 May 2008	4 August 2008	3 November 2008	2 March 2009
ADSs quoted ex-dividend in New York	21 May 2008	20 August 2008	19 November 2008	18 March 2009
Shares quoted ex-dividend in London, Hong Kong and Bermuda	21 May 2008	20 August 2008	19 November 2008	18 March 2009
Record date and closure of Hong Kong Overseas Branch Register of shareholders for one day	23 May 2008	22 August 2008	21 November 2008	20 March 2009
Shares quoted ex-dividend in Paris	26 May 2008	25 August 2008	24 November 2008	23 March 2009
Payment date	9 July 2008	8 October 2008	14 January 2009	6 May 2009

Dividends on the ordinary shares of HSBC Holdings

HSBC Holdings has paid dividends on its ordinary shares every year without interruption since it became the HSBC Group holding company by a scheme of arrangement in 1991. The dividends declared, per ordinary share, for each of the last five years were:

		First interim	Second interim	Third interim	Fourth interim[1]	Total [2]
2007	**US$**	**0.170**	**0.170**	**0.170**	**0.390**	**0.900**
	£	**0.085**	**0.084**	**0.086**	**0.194**	**0.449**
	HK$	**1.328**	**1.322**	**1.325**	**3.041**	**7.016**
2006	US$	0.150	0.150	0.150	0.360	0.810
	£	0.082	0.079	0.078	0.183	0.422
	HK$	1.164	1.167	1.168	2.799	6.298
2005	US$	0.140	0.140	0.140	0.310	0.730
	£	0.077	0.079	0.079	0.169	0.404
	HK$	1.088	1.086	1.085	2.403	5.662

2004	US$	0.130	0.130	0.130	0.270	0.660
	£	0.071	0.072	0.069	0.141	0.353
	HK$	1.013	1.014	1.013	2.104	5.144
2003	US$	0.240	0.120	0.240		0.600
	£	0.146	0.065	0.135		0.346
	HK$	1.860	0.931	1.871		4.662

1 *The fourth interim dividend for 2007 of US$0.39 per share has been translated into pounds sterling and Hong Kong dollars at the closing rate on 31 December 2007. The dividend will be paid on 7 May 2008.*

2 *The above dividends declared are accounted for as disclosed in Note 12 on the Financial Statements.*

Dividends are declared in US dollars and, at the election of the shareholder, paid in cash in one of, or in a combination of, US dollars, sterling and Hong Kong dollars, or, subject to the Board's determination, may be satisfied in whole or in part by the issue of new shares in lieu of a cash dividend.

Nature of trading market

HSBC Holdings ordinary shares are listed or admitted to trading on the London Stock Exchange, the Hong Kong Stock Exchange ('HKSE'), Euronext Paris, the New York Stock Exchange ('NYSE') and the Bermuda Stock Exchange. HSBC Holdings maintains its principal share register in England and overseas branch share registers in Hong Kong and Bermuda (collectively, the 'share register').

As at 31 December 2007, there were a total of 210,931 holders of record of HSBC Holdings ordinary shares.

As at 31 December 2007, a total of 13,145,585 of the HSBC Holdings ordinary shares were registered in the HSBC Holdings share register in the name of 12,018 holders of record with addresses in the US. These shares represented 0.1111 per cent of the total HSBC Holdings ordinary shares in issue.

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As at 31 December 2007, there were 10,490 holders of record of ADSs holding approximately 123 million ADSs, representing approximately 614 million HSBC Holdings ordinary shares. 10,284 of these holders had addresses in the US, holding approximately 122.7 million ADSs, representing 613.6 million HSBC Holdings ordinary shares. As at 31 December 2007, approximately 5.2 per cent of the HSBC Holdings ordinary shares were represented by ADSs held by holders of record with addresses in the US.

The following table shows, for the years, calendar quarters and months indicated, the highest and lowest prices for the HSBC Holdings ordinary shares and ADSs. These are based on mid-market prices at close of business on the London Stock Exchange, HKSE, Euronext Paris, NYSE and the Bermuda Stock Exchange.

Past share price performance should not be regarded as a guide to future performance.

High and low mid-market closing prices

	London US$0.50 shares		Hong Kong US$0.50 shares		New York ADSs[1]		Paris US$0.50 shares		Bermuda[2] US$0.50 shares	
	High pence	Low pence	High HK$	Low HK$	High US$	Low US$	High euro	Low euro	High US$	Low US$
2007	**964**	**803**	**152.8**	**129.6**	**99.5**	**82.5**	**14.4**	**11.2**	**19.6**	**16.5**
2006	1028	914	151.2	124.5	98.4	80.5	15.4	13.3	19.6	16.4
2005	950	825	133.5	120.1	85.8	77.5	13.9	12.0	17.1	15.7
2004	954	784	136.5	109.5	87.8	70.0	13.6	11.8	17.3	14.5
2003	914	631	122.5	80.3	78.8	51.1	13.4	9.3	–	–
2007										
4th Quarter	**964**	**803**	**152.8**	**129.6**	**99.5**	**82.5**	**13.9**	**11.2**	**19.6**	**16.5**
3rd Quarter	**917**	**861**	**145.8**	**135.8**	**93.8**	**87.2**	**13.7**	**12.8**	**18.8**	**17.1**
2nd Quarter	**955**	**886**	**147.1**	**136.3**	**95.2**	**88.0**	**14.0**	**13.2**	**18.7**	**17.7**
1st Quarter	**953**	**880**	**145.4**	**133.0**	**93.1**	**85.8**	**14.4**	**12.8**	**18.8**	**17.2**
2006										
4th Quarter	1028	916	151.2	140.3	98.4	90.2	15.4	13.6	19.6	18.1
3rd Quarter	975	942	142.2	134.8	91.8	86.6	14.5	13.7	18.4	17.3
2nd Quarter	985	914	142.2	130.6	92.1	84.2	14.4	13.3	18.1	16.7
1st Quarter	995	924	134.0	124.5	86.6	80.5	14.6	13.4	17.4	16.4
2008										
January	**850**	**676**	**131.9**	**104.0**	**83.8**	**70.4**	**11.5**	**9.1**	**17.0**	**14.1**
2007										
December	**858**	**806**	**136.7**	**130.8**	**87.5**	**82.7**	**11.9**	**11.2**	**17.3**	**16.5**
November	**925**	**803**	**152.0**	**129.6**	**95.5**	**82.5**	**13.3**	**11.2**	**19.3**	**16.5**
October	**964**	**905**	**152.8**	**142.2**	**99.5**	**92.6**	**13.9**	**13.0**	**19.6**	**18.3**
September	**914**	**870**	**143.4**	**137.7**	**93.0**	**88.8**	**13.4**	**12.8**	**18.4**	**17.6**
August	**917**	**861**	**144.7**	**135.8**	**93.3**	**87.2**	**13.6**	**12.9**	**18.4**	**17.1**
July	**916**	**870**	**145.8**	**141.1**	**93.8**	**89.0**	**13.7**	**13.1**	**18.8**	**18.2**

1 *In New York each ADS represents 5 underlying ordinary shares.*
2 *HSBC shares were not listed on the Bermuda Stock Exchange prior to 18 February 2004.*

Stock symbols

HSBC Holdings ordinary shares trade under the following stock symbols:

London Stock Exchange	HSBA
Hong Kong Stock Exchange	5
New York Stock Exchange (ADS)	HBC

Euronext Paris	HSB
Bermuda Stock Exchange	HSBC

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Shareholder Information (continued)

Shareholder profile

At 31 December 2007 the register of members recorded the following details:

Ordinary shares held	Number of shareholders	Total shares held
1-100	**32,395**	**1,034,423**
101-400	**35,392**	**9,004,801**
401-500	**9,839**	**4,456,230**
501-1,000	**32,830**	**24,675,887**
1,001-5,000	**67,037**	**154,854,553**
5,001-10,000	**15,520**	**109,692,980**
10,001-20,000	**8,591**	**119,360,643**
20,001-50,000	**5,185**	**159,148,214**
50,001-200,000	**2,578**	**239,796,284**
200,001-500,000	**654**	**206,507,616**
500,001 and above	**910**	**10,800,520,686**
Total	**210,931**	**11,829,052,317**

Memorandum and Articles of Association

The discussion under the caption Memorandum and Articles of Association contained in HSBC Holdings Annual Reports on Form 20-F for the years ended 31 December 2000 and 2001 is incorporated by reference herein.

Interim results

The interim results for the six months to 30 June 2008 will be announced on 4 August 2008.

Annual General Meeting

The 2008 Annual General Meeting will be held at the Barbican Hall, Barbican Centre, London EC2 on 30 May 2008 at 11 am.

All resolutions considered at the 2007 Annual General Meeting were passed on a poll as follows:

Resolution		Total votes		
		For[1]	Against	Vote withheld[2]
1	To receive the Report and Accounts for 2006	3,864,479,235	8,919,383	9,697,178
2	To approve the Directors Remuneration Report for	3,689,326,342	97,555,034	96,172,523

	2006			
3	To re-elect the following as Directors:			
	(a) The Lord Butler	3,821,854,383	54,773,594	6,390,274
	(b) The Baroness Dunn	3,811,429,682	65,186,829	6,411,316
	(c) R A Fairhead	3,868,782,235	9,708,695	4,535,972
	(d) W K L Fung	3,816,457,837	59,990,498	6,580,256
	(e) Sir Brian Moffat	3,816,081,722	60,292,153	6,650,750
	(f) G Morgan	3,834,697,821	42,204,988	6,079,276
4	To reappoint the Auditor at remuneration to be determined by the Group Audit Committee	3,839,835,491	10,313,830	32,872,395
5	To authorise the Directors to allot shares	3,849,690,002	26,121,717	7,134,352
6	To disapply pre-emption rights (Special Resolution)	3,846,012,397	26,934,800	10,064,563
7	To authorise the Company to purchase its own Ordinary Shares	3,870,162,901	10,921,090	1,871,381
8	To authorise the Directors to offer a scrip dividend alternative	3,870,471,683	6,786,564	5,753,519
9	To authorise the Company to make political donations and incur political expenditure	3,753,329,722	88,666,544	41,001,817
10	To authorise HSBC Bank plc to make political donations and incur political expenditure	3,752,489,533	89,386,605	41,095,387
11	To authorise electronic communications with shareholders in accordance with the Companies Act 2006	3,872,910,676	5,680,069	4,378,887
12	To alter the Articles of Association (Special Resolution)	3,868,543,551	7,036,072	7,398,915

1 *Includes discretionary votes.*

2 *A Vote withheld is not a vote in law and is not counted in the calculation of the votes For and Against the resolution.*

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Shareholder enquiries and communications

Enquiries

Any enquiries relating to your shareholding, for example transfers of shares, change of name or address, lost share certificates or dividend cheques, should be sent to the Registrars:

Principal Register	*Hong Kong Overseas Branch Register:*	*Bermuda Overseas Branch Register:*
Computershare Investor Services PLC PO Box 1064, The Pavilions Bridgwater Road Bristol BS99 3FA UK Telephone: 44 (0) 870 702 0137 Email: web.queries@computershare.co.uk	Computershare Hong Kong Investor Services Limited Hopewell Centre Rooms 1806-1807 18th Floor 183 Queen's Road East Hong Kong Telephone: 852 2862 8555 Email: hkinfo@computershare.com.hk	Corporate Shareholder Services The Bank of Bermuda Limited 6 Front Street Hamilton HM 11 Bermuda Telephone: 1 441 299 6737 Email : david.b.davies@bob.hsbc.com

Any enquiries relating to ADSs should be sent to the depositary:

The Bank of New York Mellon
Investor Services
PO Box 11258
Church Street Station
New York, NY 10286-1258
USA
Telephone (US): 1 888 269 2377
Telephone (International): 001 201 680 6825
Email: shareowners@bankofny.com

Any enquiries relating to shares held through Euroclear France, the settlement and central depositary system for Euronext Paris, should be sent to the paying agent:

HSBC France
103, avenue des Champs Elysées
75419 Paris Cedex 08
France
Telephone: 33 1 40 70 22 56

If you have been nominated to receive general shareholder communications directly from HSBC Holdings it is important to remember that your main contact in terms of your investment remains as it was (so the registered shareholder, or perhaps custodian or broker, who administers the investment on your behalf). Therefore any changes or queries relating to your personal details and holding (including any administration thereof) must continue to be directed to your existing contact at your investment manager or custodian. HSBC Holdings cannot guarantee dealing with matters that are directed to us in error.

Further copies of this *Annual Report and Accounts 2007* may be obtained by writing to the following departments:

For those in Europe, the Middle East and Africa:	*For those in Asia-Pacific:*	*For those in the Americas:*
Group Communications HSBC Holdings plc	Group Communications (Asia)	Internal Communications HSBC-North America

8 Canada Square
London E14 5HQ
UK

The Hongkong and Shanghai Banking
Corporation Limited
1 Queen’s Road Central
Hong Kong

26525 N Riverwoods Boulevard
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Electronic communications

Shareholders may at any time choose to receive corporate communications in printed form or to receive a notification of its availability on HSBC’s website. To receive future notifications of the availability of a corporate communication on HSBC’s website by email, or revoke or amend an instruction to receive such notifications by email, go to www.hsbc.com/ecomms. If you received a notification of the availability of this document on HSBC’s website and would like to receive a printed copy, or would like to receive future corporate communications in printed form, please write to the appropriate Registrars at the address given above. Printed copies will be provided without charge.

Shareholder Information (continued)

Investor relations / Where information is available / Taxation of shares and dividends

Chinese translation

A Chinese translation of this *Annual Report and Accounts 2007* is available upon request after 3 April 2008 from the Registrars:

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Please also contact the Registrars if you wish to receive Chinese translations of future documents or if you have received a Chinese translation of this document and do not wish to receive such translations in future.

Investor relations

Enquiries relating to HSBC's strategy or operations may be directed to:

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Where more information about HSBC is available

This *Annual Report and Accounts 2007*, and other information on HSBC, may be viewed on HSBC's web site: www.hsbc.com.

US Investors may read and copy the reports, statements or information that HSBC Holdings files with the Securities and Exchange Commission at its public reference room in Washington, DC, which is located at 100 F Street, Room 1580, Washington, DC 20549. These documents will also be available at the Commission's regional offices located at the Woolworth Building, 233 Broadway, New York, NY 10279 and at Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, IL 60661. Investors should call the Commission at 1-800-SEC-0330 for further information on the operation of the public reference rooms. Investors can request copies of these documents upon payment of a duplicating fee, by writing to the Commission at 100 F Street, Mail Stop 5100, Washington, DC 50549. The Commission maintains an internet site (www.sec.gov) at which investors may view reports, proxy and information statements, and other information regarding issuers that file electronically with the Commission,

including HSBC Holdings. Investors may also obtain the reports and other information HSBC Holdings files at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, NY 10005.

Taxation of shares and dividends

Taxation – UK residents
The following is a summary, under current law, of the principal UK tax considerations that are likely to be material to the ownership and disposition of shares. The summary does not purport to be a comprehensive description of all the tax considerations that may be relevant to a holder of shares. In particular, the summary deals principally with shareholders who are resident in the UK for UK tax purposes and only with holders who hold the shares as investments and who are the beneficial owners of the shares, and does not address the tax treatment of certain classes of holders such as dealers in securities. Holders and prospective purchasers should consult their own advisers regarding the tax consequences of an investment in shares in light of their particular circumstances, including the effect of any national, state or local laws.

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Taxation of dividends

Currently no tax is withheld from dividends paid by HSBC Holdings. However, dividends are paid with an associated tax credit which is available for set-off by certain shareholders against any liability they may have to UK income tax. Currently, the associated tax credit is equivalent to 10 per cent of the combined cash dividend and tax credit, i.e. one-ninth of the cash dividend.

For individual shareholders who are resident in the UK for taxation purposes and liable to UK income tax at the basic rate, no further UK income tax liability arises on the receipt of a dividend from HSBC Holdings. Individual shareholders who are liable to UK income tax at the higher rate on UK dividend income (currently 32.5 per cent) are taxed on the combined amount of the dividend and the tax credit. The tax credit is available for set-off against the higher rate liability, leaving net higher rate tax to pay equal to 25 per cent of the cash dividend. Individual UK resident shareholders are not entitled to any tax credit repayment.

Although non-UK resident shareholders are generally not entitled to any repayment of the tax credit in respect of any UK dividend received, some such shareholders may be so entitled under the provisions of a double taxation agreement between their country of residence and the UK. However, in most cases no amount of the tax credit is, in practice, repayable.

Information on the taxation consequences of the HSBC Holdings scrip dividends offered in lieu of the 2006 fourth interim dividend and the first, second and third interim dividends for 2007 was set out in the Secretary's letters to shareholders of 3 April, 30 May, 29 August and 5 December 2007. In each case, the difference between the cash dividend foregone and the market value of the scrip dividend did not equal or exceed 15 per cent of the market value and accordingly, the price of HSBC Holdings US$0.50 ordinary shares (the "shares") for UK tax purposes for the dividends was the cash dividend foregone.

Taxation of capital gains

The computation of the capital gains tax liability arising on disposals of shares in HSBC Holdings by shareholders subject to UK capital gains tax can be complex, partly depending on whether, for example, the shares were purchased since April 1991, acquired in 1991 in exchange for shares in The Hongkong and Shanghai Banking Corporation Limited, or acquired subsequent to 1991 in exchange for shares in other companies.

For capital gains tax purposes, the acquisition cost for ordinary shares is adjusted to take account of subsequent rights and capitalisation issues. Further adjustments apply where an individual shareholder has chosen to receive shares instead of cash dividends, subject to scrip issues made since 6 April 1998 being treated for tax as separate holdings. Any capital gain arising on a disposal may also be adjusted to take account of indexation allowance and, in the case of individuals, taper relief. Except for gains made by a company chargeable to UK corporation tax, any such indexation allowance is calculated up to 5 April 1998 only.

Changes to capital gains tax have been announced that will apply to disposals of shares with effect from 6 April 2008. The proposals are expected to be confirmed by the Chancellor of the Exchequer in his budget due on 12 March 2008. The proposals include:

- Shares will no longer be treated as separate holdings but pooled, the consequence of which is the tax basis of disposals will be calculated on the average cost of the shares held;
- Indexation allowance is withdrawn;
- Taper Relief is withdrawn;
- A single tax rate of 18 per cent will apply to all gains.

If in doubt, shareholders are recommended to consult their professional advisers.

Inheritance tax

Shares or ADSs held by an individual whose domicile is determined to be the US for the purposes of the United States-United Kingdom Double Taxation Convention relating to estate and gift taxes (the Estate Tax Treaty) and who is not for such purposes a national of the UK will not, provided any US Federal estate or gift tax chargeable has been paid, be subject to UK inheritance tax on the individuals death or on a lifetime transfer of shares or ADSs except in certain cases where the shares or ADSs (i) are comprised in a settlement (unless, at the time of the settlement, the settlor was domiciled in the US and was not a national of the UK), (ii) is part of the business property of a UK permanent establishment of an enterprise, or (iii) pertains to a UK fixed base of an individual used for the performance of independent personal services. In such cases, the Estate Tax Treaty generally provides a credit against US Federal tax liability for the amount of any tax paid in the UK in a case where the shares or ADSs are subject to both UK inheritance tax and to US Federal estate or gift tax.

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Shareholder Information (continued)

Taxation of shares and dividends / History and development

Stamp duty and stamp duty reserve tax

Transfers of shares by a written instrument of transfer generally will be subject to UK stamp duty at the rate of 0.5 per cent of the consideration paid for the transfer, and such stamp duty is generally payable by the transferee.

An agreement to transfer shares, or any interest therein, normally will give rise to a charge to stamp duty reserve tax at the rate of 0.5 per cent of the consideration. However, provided an instrument of transfer of the shares is executed pursuant to the agreement and duly stamped before the date on which the stamp duty reserve tax becomes payable, under the current practice of UK HM Revenue and Customs it will not be necessary to pay the stamp duty reserve tax, nor to apply for such tax to be cancelled. Stamp duty reserve tax is generally payable by the transferee.

Paperless transfers of shares within CREST, the UK's paperless share transfer system, are liable to stamp duty reserve tax at the rate of 0.5 per cent of the consideration. In CREST transactions, the tax is calculated and payment made automatically. Deposits of shares into CREST generally will not be subject to stamp duty reserve tax, unless the transfer into CREST is itself for consideration.

Taxation – US residents

The following is a summary, under current law, of the principal UK tax and US federal income tax considerations that are likely to be material to the ownership and disposition of shares or ADSs by a holder that is a resident of the US for the purposes of the income tax convention between the US and the UK (the 'Treaty'), and is fully eligible for benefits under the Treaty (an 'eligible US holder'). The summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a holder of shares or ADSs. In particular, the summary deals only with eligible US holders that hold shares or ADSs as capital assets, and does not address the tax treatment of holders that are subject to special tax rules, such as banks, tax- exempt entities, insurance companies, dealers in securities or currencies, persons that hold shares or ADSs as part of an integrated investment (including a 'straddle') comprised of a share or ADS and one or more other positions, and persons that own, directly or indirectly, 10 per cent or more of the voting stock of HSBC Holdings. This discussion is based on laws, treaties, judicial decisions and regulatory interpretations in effect on the date hereof, all of which are subject to change. Under the current income tax treaty between the UK and the US,

eligible US holders are no longer entitled to claim a special foreign tax credit in respect of dividends.

Holders and prospective purchasers should consult their own advisers regarding the tax consequences of an investment in shares or ADSs in light of their particular circumstances, including the effect of any national, state or local laws.

In general, the beneficial owner of a share or ADS will be entitled to benefits under the Treaty (and, therefore, will be an eligible US holder) if it is (i) an individual resident of the US, a US corporation meeting ownership criteria specified in the Treaty or other entity meeting criteria specified in the Treaty; and (ii) not also resident in the UK for UK tax purposes. Special rules, including a limitation of benefits provision, may apply. The Treaty benefits discussed below generally are not available to US holders that hold shares or ADSs in connection with the conduct of a business through a permanent establishment, or the performance of personal services through a fixed base, in the UK.

Taxation of dividends

An eligible US holder must include cash dividends paid on the shares or ADSs in ordinary income on the date that such holder or the ADS depositary receives them, translating dividends paid in UK pounds sterling into US dollars using the exchange rate in effect on the date of receipt. Subject to certain exceptions for positions that are held for less than 61 days or are hedged, and subject to a foreign corporation being considered a “qualified foreign corporation” (which includes not being classified for US federal income tax purposes as a passive foreign investment company), certain dividends (“qualified dividends”) received by an individual eligible US holder before 2009 generally will be subject to US taxation at a maximum rate of 15 per cent. Based on the company’s audited financial statements and relevant market and shareholder data, HSBC Holdings believes that it was not treated as a passive foreign investment company for US federal income tax purposes with respect to its 2005 or 2006 taxable year. In addition, based on the company’s audited financial statements and current expectations regarding the value and nature of its assets, and the sources and nature of its income, HSBC Holdings does not anticipate being classified as a passive foreign investment company for its 2007 taxable year. Accordingly, dividends paid on the shares or ADSs generally should be treated as qualified dividends.

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Taxation of capital gains

Gains realised by an eligible US holder on the sale or other disposition of shares or ADSs normally will not be subject to UK taxation unless at the time of the sale or other disposition the holder carries on a trade, profession or vocation in the UK through a branch or agency or permanent establishment and the shares or ADSs are or have been used, held or acquired for the purposes of such trade, profession, vocation, branch or agency or permanent establishment. Such gains will be included in income for US tax purposes, and will be long-term capital gains if the shares or ADSs were held for more than one year. A long-term capital gain realised by an individual holder generally is subject to US tax at a maximum rate of 15 per cent.

Stamp duty and stamp duty reserve tax ADSs

If shares are transferred into a clearance service or depository receipt (ADR) arrangement (which will include a transfer of shares to the Depository) UK stamp duty and/or stamp duty reserve tax will be payable. The stamp duty or stamp duty reserve tax is generally payable on the consideration for the transfer and is payable at the aggregate rate of 1.5 per cent.

The amount of stamp duty reserve tax payable on such a transfer will be reduced by any stamp duty paid in connection with the same transfer.

No stamp duty will be payable on the transfer of, or agreement to transfer, an ADS, provided that the ADR and any separate instrument of transfer or written agreement to transfer remain at all times outside the UK, and provided further that any such transfer or written agreement to transfer is not executed in the UK. No stamp duty reserve tax will be payable on a transfer of, or agreement to transfer, an ADS effected by the transfer of an ADR.

On a transfer of shares from the Depository to a registered holder of an ADS upon cancellation of the ADS, a fixed stamp duty of £5 per instrument of transfer will be payable by the registered holder of the ADR cancelled.

US backup withholding tax and information reporting

Distributions made on shares and proceeds from the sale of shares or ADSs that are paid within the US, or through certain financial intermediaries to US holders, are subject to information reporting and may be subject to a US backup withholding tax unless, in general, the US holder complies with certain certification procedures or is a corporation or other person exempt from such withholding. Holders that are not US persons generally are not subject to information reporting or backup withholding tax, but may be required to comply with applicable certification procedures to establish that they are not US persons in order to avoid the application of such information reporting requirements or backup withholding tax to payments received within the US or through certain financial intermediaries.

History and development of HSBC

1865 The founding member of the HSBC Group, The Hongkong and Shanghai Banking Corporation, is established in both Hong Kong and Shanghai.

1959 The Mercantile Bank of India Limited and The British Bank of the Middle East, now HSBC Bank Middle East Limited, are purchased.

1965 A 51 per cent interest (subsequently increased to 62.14 per cent) is acquired in Hang Seng Bank Limited. Hang Seng Bank is the fourth-largest listed bank in Hong Kong by market capitalisation.

1980 A 51 per cent interest in Marine Midland Banks, Inc., now HSBC USA, Inc, is acquired (with the remaining interest acquired in 1987).

1981 The Hongkong and Shanghai Banking Corporation incorporates its then existing Canadian operations. HSBC Bank Canada subsequently makes numerous acquisitions, expanding rapidly to become the largest foreign-owned bank in Canada and the seventh-largest overall at 31 December 2007.

1987 A 14.9 per cent interest in Midland Bank plc, now HSBC Bank plc, one of the UK□s principal clearing banks, is purchased.

1991 HSBC Holdings plc is established as the parent company of the HSBC Group.

1992 HSBC purchases the remaining interest in Midland Bank plc.

1993 As a consequence of the Midland acquisition, HSBC□s Head Office is transferred from Hong Kong to London in January.

1997 HSBC assumes selected assets, liabilities and subsidiaries of Banco Bamerindus do Brasil S.A., now HSBC Bank Brazil, following the intervention of the Central Bank of Brazil, and in Argentina completes the acquisition of Grupo Roberts, now part of HSBC Bank Argentina S.A.

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Shareholder Information (continued)

History and development / Organisational Structure

1999 HSBC acquires Republic New York Corporation, subsequently merged with HSBC USA, Inc., and Safra Republic Holdings S.A.

2000 HSBC completes its acquisition of 99.99 per cent of the issued share capital of Crédit Commercial de France S.A., now HSBC France.

2002 HSBC acquires 99.59 per cent of Grupo Financiero Bital, S.A. de C.V., the holding company of what is now HSBC Mexico.

2003 HSBC acquires Household International, Inc., now HSBC Finance Corporation. HSBC Finance brings to the Group national coverage in the US for consumer lending, credit cards and credit insurance through multiple distribution channels.

2003 HSBC acquires Banco Lloyds TSB S.A.- Banco Múltiplo in Brazil and the country’s leading consumer finance company, Losango Promotora de Vendas Limitada.

2004 HSBC Bank USA, Inc. merges with HSBC Bank & Trust (Delaware) N.A. to form HSBC Bank USA, N.A.

2004 The acquisition of The Bank of Bermuda Limited is completed.

2004 HSBC acquires Marks and Spencer Retail Financial Services Holdings Limited, which trades as Marks and Spencer Money (“M&S Money”) in the UK.

2004 HSBC acquires 19.9 per cent of Bank of Communications, mainland China’s fifth-largest bank by total assets, and Hang Seng Bank acquires 15.98 per cent of Industrial Bank.

2005 HSBC increases its holding in Ping An Insurance to 19.9 per cent, having made its initial investment in 2002. Ping An Insurance is the second-largest life insurer and the third-largest property and casualty insurer in mainland China.

2005 HSBC Finance completes the acquisition of Metris Companies Inc., making HSBC the fifth-largest issuer of MasterCard and Visa cards in the USA.

2006 HSBC acquires Grupo Banistmo S.A. (“Banistmo”), the leading banking group in Central America, through a tender offer to acquire 99.98 per cent of the outstanding shares of Banistmo.

2007 During the first half of the year, HSBC’s three associates in mainland China, Industrial Bank, Ping An Insurance and Bank of Comunications, issue new shares. HSBC does not subscribe and, as a result, its interests in the associates’ equity decrease from 15.98 per cent to 12.78 per cent, from 19.90 per cent to 16.78 per cent and from 19.90 per cent to 18.60 per cent, respectively. A gain of US$.1 billion accrues to HSBC from the increase in the associates’ underlying net assets. Subsequently, in September and October, HSBC increases its holding in Bank of Communications from 18.60 per cent to 19.01 per cent for US$308 million.

2007 In September, HSBC agrees to acquire 51.02 per cent of the issued share capital of Korea Exchange Bank for US$6.5 billion, payable in cash, subject to a number of conditions including regulatory approvals.

2007 In December, HSBC is named the successful bidder in a government auction to acquire the assets, liabilities and operations of Chinese Bank Co., Ltd in Taiwan, with a subsidy equivalent to US$1.5 billion from Taiwan Government□s Central Deposit Insurance Corporation. HSBC agrees to provide additional capital of between US$300 million and US$400 million to ensure appropriate financial ratios are maintained.

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Organisational Structure

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Glossary

Accounting terms used	**US equivalent or brief description**
Accounts	Financial Statements
Articles of Association	Bylaws
Associates	Long-term equity investments accounted for using the equity method
Attributable profit	Net income
Balance sheet	Statement of financial position
Bills	Notes
Called up share capital	Ordinary shares, issued and fully paid
Capital allowances	Tax depreciation allowances
Creditors	Payables
Debtors	Receivables
Deferred tax	Deferred income tax
Depreciation	Amortisation
Finance lease	Capital lease
Freehold	Ownership with absolute rights in perpetuity
Interests in associates and joint ventures	Long-term equity investments accounted for using the equity method
Loans and advances	Lendings
Loan capital	Long-term debt
Nominal value	Par value
One-off	Non-recurring
Ordinary shares	Common stock
Overdraft	A line of credit, contractually repayable on demand unless a fixed-term has been agreed, established through a customer’s current account
Preference shares	Preferred stock
Premises	Real estate
Provisions	Allowances
Share capital	Ordinary shares or common stock issued and fully paid
Shareholders’ equity	Stockholders’ equity
Share premium account	Additional paid-in capital
Shares in issue	Shares outstanding
Write-offs	Charge-offs

Abbreviations used	**Brief description**
ABCP	Asset-backed commercial paper
ADR	American Depositary Receipt
ADS	American depositary share
AIEA	Average interest-earning assets
ALCO	Asset and Liability Management Committee
ARM	Adjustable-rate mortgage
ASF	Asset and Structured Finance
Asscher	Asscher Finance Ltd, a structured investment vehicle managed by HSBC
ATM	Automated teller machines
AUM	Assets under management
Banca Nazionale	Banca Nazionale del Lavoro SpA
Bank of Bermuda	The Bank of Bermuda Limited, which was acquired in February 2004
Bank of Communications	Bank of Communications Co., Limited, mainland China’s fifth largest bank in which HSBC currently has 19.01 per cent interest

Basel Committee	The Basel Committee on Banking Supervision
Basel I	The 1988 Basel Capital Accord
Basel II	The Final Accord of the Basel Committee on proposals for a new capital adequacy framework
BHCA	US Bank Holding Company Act of 1956
BIB	Business Internet Banking

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Abbreviations used	Brief description
Bps	Basis points. One basis point is equal to one hundredth of a percentage point
Brazilian operations	HSBC Bank Brasil S.A.-Banco Múltiplo and subsidiaries, plus HSBC Serviços e Participações Limitada
Cash flow hedge	Hedge of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction
CC	The Competition Commission
CCF	CCF S.A., the former name of HSBC France
CD	Certificate of deposit
CDO	Collateralised debt obligation
CGU	Cash-generating unit
Chailease	Chailease Credit Services Company Ltd, a receivables finance company acquired in Taiwan by HSBC
CIS	Core Investment Solutions
CNAV	Constant Net Asset Value
Combined Code	Combined Code on Corporate Governance issued by the Financial Reporting Council
CP	Commercial paper
CPI	Consumer price index
Cullinan	Cullinan Finance Ltd, a structured investment vehicle managed by HSBC
Cyprus Popular Bank	The Cyprus Popular Bank Limited
Decision One	Decision One Mortgage Company, HSBC Finances subsidiary which originates loans referred by mortgage brokers
DPF	Discretionary participation feature of insurance and investment contracts
Enhanced VNAV	Enhanced Variable Net Asset Value
EPS	Earnings per share
EU	European Union
Fair value hedge	Hedge of the change in fair value of recognised assets or liabilities or firm commitments
FDIC	Federal Deposit Insurance Corporation (US)
FFIEC	Federal Financial Institution Examination Council
FHC	Financial holding company, as defined under the Gramm-Leach-Bliley Act amendments to the BHCA
FSA	Financial Services Authority (UK)
FSMA	Financial Services and Markets Act 2000 (UK)
FTSE	Financial Times Stock Exchange index
GAAP	Generally Accepted Accounting Principles
GCRO	Group Chief Risk Officer
GDP	Gross domestic product
Global Banking and Mrakets	The global business of the Group (previously known as Corporate, Investment Banking and Markets) comprising Global Markets, Global Banking and Global Asset Management
Global Markets	HSBCs treasury and capital markets services in Global Banking and Markets
GMB	Group Management Board
Group	HSBC Holdings together with its subsidiary undertakings
GSC	Group Service Centre
Hang Seng Bank	Hang Seng Bank Limited, the fourth largest bank in Hong Kong by market capitalisation
HFC	HFC Bank Limited, the UK-based consumer finance business acquired through the acquisition by HSBC of HSBC Finance
HKMA	Hong Kong Monetary Authority
HKSE	The Stock Exchange of Hong Kong Limited
Hong Kong	Hong Kong Special Administrative Region of the Peoples Republic of China
HNAH	

	HSBC North America Holdings Inc, the bank holding company formed on 1 January 2004 to hold all of HSBC's North America operations
HSBC	HSBC Holdings together with its subsidiary undertakings
HSBC Assurances	HSBC Assurances, comprising Erisa S.A., the French life insurer, and Erisa I.A.R.D., the property and casualty insurer (together, formerly Erisa)

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Glossary (continued)

Abbreviations used	Brief description
HSBC Bank	HSBC Bank plc, formerly Midland Bank plc
HSBC Bank Argentina	HSBC Bank Argentina S.A.
HSBC Bank Brazil	HSBC Bank Brasil S.A.-Banco Múltiplo, HSBCs retail banking operation in Brazil, formerly Banco Bamerindus do Brasil S.A.
HSBC Bank China	HSBC Bank (China) Company Limited, HSBCs banking subsidiary in mainland China which was incorporated in March 2007
HSBC Bank Delaware	HSBC Trust Company (Delaware), N.A., a US nationally chartered bank restricted to trust activities
HSBC Bank Malaysia	HSBC Bank Malaysia Berhad
HSBC Bank Maryland	HSBC National Bank USA
HSBC Bank Middle East	HSBC Bank Middle East Limited, formerly The British Bank of the Middle East
HSBC Bank Nevada	HSBC Bank Nevada, NA, (formerly Household Bank (SB), N.A.) a nationally chartered ‘credit card bank’ in the US which is a subsidiary of HSBC Finance
HSBC Bank Panama	HSBC Bank (Panama) S.A., formerly Grupo Banistmo S.A., the leading banking group in Central America
HSBC Bank USA	HSBCs retail bank in the US. From 1 July 2004, HSBC Bank USA, N.A. (formerly HSBC Bank USA, Inc.)
HSBC Direct	HSBCs online banking and savings proposition
HSBC Finance	HSBC Finance Corporation, the US consumer finance company acquired in March 2003 (formerly Household International, Inc.)
HSBC France	HSBCs French banking subsidiary, formerly CCF S.A.
HSBC Holdings	HSBC Holdings plc, the parent company of HSBC
HSBC Mexico	HSBC México S.A., the commercial banking subsidiary of Grupo Financiero HSBC, S.A. de C.V. and the fifth-largest bank in Mexico by deposits and assets
HSBC Premier	HSBCs premium global banking service
HSBC Private Bank (Suisse)	HSBC Private Bank (Suisse) S.A., HSBCs private bank in Switzerland (formerly HSBC Republic Bank (Suisse) S.A.)
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IFRSs	International Financial Reporting Standards
IFRIC	International Financial Reporting Interpretations Committee
Industrial Bank	Industrial Bank Co. Limited, a national joint-stock bank in mainland China of which Hang Seng currently has a 12.78 per cent interest
IPO	Initial public offering
IRB	Internal ratings-based approach to implementing Basel II
IVA	Individual voluntary arrangement (UK)
KEB	Korea Exchange Bank
Key Management Personnel	Directors and Group Managing Directors of HSBC Holdings
KPI	Key performance indicator
KPMG	KPMG Audit Plc and its affiliates
LIBOR	London Interbank Offer Rate
Losango	Losango Promoções e Vendas Ltda, the Brazilian consumer finance company acquired in December 2003
Mainland China	Peoples Republic of China excluding Hong Kong
MBSs	US mortgage-backed securities

Metris	Metris Companies Inc., US credit card issuer acquired in December 2005
M&S Money	Marks and Spencer Retail Financial Services Holdings Limited, acquired by HSBC in November 2004
MSCI	Morgan Stanley Capital International index
MSRs	Mortgage servicing rights
NA	Nationally Chartered, a designation for certain categories of banks in the US
Net investment hedges	Hedge of a net investment in a foreign operation
NYSE	New York Stock Exchange

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Abbreviations used	**Brief description**
OCC	Office of the Comptroller of the Currency (US)
OFT	Office of Fair Trading (UK)
Patriot Act	The US Patriot Act of October 2001
Performance Shares	Awards of HSBC Holdings ordinary shares under employee share plans that are subject to corporate performance conditions
Ping An Insurance	Ping An Insurance (Group) Company of China, Limited, the second-largest life insurer in the PRC, in which HSBC currently has 16.78 per cent interest
PPI	Payment protection insurance
Premier	HSBC Premier, a global banking and wealth management service for affluent customers
PVIF	Present value of in-force long-term insurance business
QDII	The Chinese government's Qualified Domestic Institutional Investors scheme
Repos	Sale and repurchase transactions
Restricted shares	Awards of HSBC Holdings ordinary shares to which the employee will become entitled, normally after three years, subject to remaining an employee
Reverse repos	Securities purchased under commitments to sell
RMB	renminbi, the currency of mainland China
RMM	Risk Management Meeting
RPI	Retail price index (UK)
Seasoning	The emergence of credit loss patterns in portfolios over time
S&P	Standard and Poor's rating agency
SEC	Securities and Exchange Commission (US)
SIP	Statement of investment principles produced by trustees of defined pension plans
SIS	Structured Investment Solutions
SIV	Structured investment vehicles
SME	Small and medium-sized enterprise
Solitaire	Solitaire Funding Limited, a special purpose entity managed by HSBC
SPE	Special purpose entity
Sub-prime	A US description for customers who have limited credit histories, modest incomes, high debt-to-income ratios, high loan-to-value ratios (for real estate secured products) or have experienced credit problems caused by occasional delinquencies, prior charge-offs, bankruptcy or other credit-related actions
The Chinese Bank	The Chinese Bank. Co., Ltd., which HSBC signed an agreement to acquire in December 2007
The Hongkong and Shanghai Banking Corporation	The Hongkong and Shanghai Banking Corporation Limited, the founding member of the HSBC Group
TSR	Total shareholder return
TSR award	TSR measure applied to half of the award of Performance Shares under The HSBC Share Plan
UAE	United Arab Emirates
UK	United Kingdom
UK GAAP	UK Generally Accepted Accounting Principles
US	United States of America
VAR	Value at risk
VNAV	Variable Net Asset Value
WHIRL	Worldwide Household International Revolving Lending system
WTAS	Wealth and Tax Advisory Services, Inc.

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Group Chairman		Niall McDiarmid

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Item 19. Exhibits

Documents filed as exhibits to this Form 20-F:

Exhibit Number	Description
1.1	Memorandum and Articles of Association of HSBC Holdings plc ***
2.1	The total amount of long-term debt securities of HSBC Holdings plc authorized under any instrument does not exceed 10 percent of the total assets of the Group on a consolidated basis. HSBC Holdings plc hereby agrees to furnish to the Commission, upon its request, a copy of any instrument defining the rights of holders of long-term debt of HSBC Holdings plc or of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.
4.1	Service Agreement dated September 29, 1995 between HSBC Holdings plc and Douglas Jardine Flint.*
4.2	Service Agreement dated May 24, 2007 between HSBC Holdings plc and Stephen Keith Green, as amended February 28, 2008.
4.3	Service Agreement dated May 24, 2007 between HSBC Asia Holdings BV and Michael F Geoghegan, as amended February 29, 2008.
7.1	Computation of ratios of earnings to combined fixed charges (and preference share dividends)
8.1	Subsidiaries of HSBC Holdings plc (set forth in Note 24 to the consolidated financial statements included in this Form 20-F).
12.1	Certificate of HSBC Holdings plc's Group Chief Executive pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12.2	Certificate of HSBC Holdings plc's Group Finance Director pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13.1	Annual Certification of HSBC Holdings plc's Group Chief Executive and Group Finance Director pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
14.1	Consent of KPMG Audit plc
14.2	Pages of HSBC Holdings plc's 2000 Form 20-F/A dated February 26, 2001 relating to the Memorandum and Articles of Association of HSBC Holdings plc that are incorporated by reference into this Form 20-F.**
14.3	Pages of HSBC Holdings plc's 2001 Form 20-F dated March 13, 2002 relating to the Memorandum and Articles of Association of HSBC Holdings plc that are incorporated by reference into this Form 20-F.**

* As previously filed with the Securities and Exchange Commission as an exhibit to HSBC Holdings plc's Form 20-F dated March 5, 2004.

** As previously filed with the Securities and Exchange Commission as an exhibit to HSBC Holdings plc's Form 20-F dated March 20, 2006.

*** As previously filed with the Securities and Exchange Commission as Exhibit 4.3 to HSBC Holdings plc's Registration Statement on Form S-8 (333-145859) dated September 4, 2007

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf

HSBC Holdings plc

By: /s/ DOUGLAS J FLINT

Name: Douglas J Flint
Title: Group Finance Director

Dated: 10 March 2008