HSBC HOLDINGS PLC
Form 20-F
March 10, 2009

As filed with the Securities and Exchange Commission on March 10, 2009.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

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

or

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2008

or

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

or

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report . . . .

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

Commission file number: 1-14930

HSBC Holdings plc

(Exact name of Registrant as specified in its charter)

N/A	**United Kingdom**
(Translation of Registrant's name into English)	(Jurisdiction of incorporation or organisation)

8 Canada Square
London E14 5HQ
United Kingdom
(Address of principal executive offices)

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8 Canada Square
London E14 5HQ
United Kingdom
Tel +44 (0) 20 7991 8888
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Securities registered or to be registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of each class	Name of each exchange on which registered

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

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

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

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

Ordinary Shares, nominal value US$0.50 each 12,105,265,082

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

Yes No

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

Yes No.

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

Yes No

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

Large accelerated filter Accelerated filter Non-accelerated filter

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

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

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

Item 17 Item 18

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

Yes	No

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

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HSBC HOLDINGS PLC

Annual Report and Accounts 2008

Headquartered in London, HSBC is one of the largest banking and financial services organisations in the world. Its international network comprises some 10,000 properties in 86 countries and territories in Europe; Hong Kong; Rest of Asia-Pacific, including the Middle East and Africa; North America and Latin America.

With listings on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares in HSBC Holdings plc are held by over 210,000 shareholders in 120 countries and territories. The shares are traded on the New York Stock Exchange in the form of American Depositary Shares.

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

Certain defined terms

Unless the context requires otherwise, ‘HSBC Holdings’ means HSBC Holdings plc and ‘HSBC’ or the ‘Group’ means HSBC Holdings together with its subsidiaries. Within this document the Hong Kong Special Administrative Region of the People’s Republic of China is referred to as ‘Hong Kong’. When used in the terms ‘shareholders’ equity’ and ‘total shareholders’ equity’, ‘shareholders’ means holders of HSBC Holdings ordinary shares and those preference shares classified as equity.

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

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HSBC HOLDINGS PLC

Financial Highlights

Highlights / Ratios

For the year

- Total operating income up by 1 per cent to US$88,571 million (2007: US$87,601 million).
- Net operating income before loan impairment charges up by 3 per cent to US$81,682 million (2007: US$78,993 million).
- Group pre-tax profit down by 62 per cent to US$9,307 million (2007: US$24,212 million).
- Profit attributable to shareholders of the parent company down by 70 per cent to US$5,728 million (2007: US$19,133 million).
- Return on average shareholders’ equity of 4.7 per cent (2007: 15.9 per cent).
- Earnings per ordinary share down by 72 per cent to US$0.47 (2007: US$1.65).

At the year-end[1]

- Total equity down by 26 per cent to US$100,229 million (2007: US$135,416 million).
- Customer accounts and deposits by banks up by 1 per cent to US$1,245,411 million (2007: US$1,228,321 million).
- Risk-weighted assets up by 2 per cent to US$1,147,974 million (2007: US$1,123,782 million).

Dividends and capital position[1]

- Total dividends declared in respect of 2008 of US$0.64 per share, a decrease of 28.9 per cent over dividends for 2007; fourth interim dividend for 2008 of US$0.10 per share, a decrease of 74.4 per cent.
- Tier 1 ratio of 8.3 per cent and total capital ratio of 11.4 per cent.

Dividends per share[2]
(US dollars)

Return on average invested capital
(per cent)

Earnings per share
(US dollars)

Cost efficiency ratio
(per cent)

For footnotes, see page 5.

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Capital and performance ratios

	2008	2007
	%	%
Capital ratios[1]		
Tier 1 ratio	**8.3**	9.3
Total capital ratio	**11.4**	13.6
Performance ratios		
Return on average invested capital[3]	**4.0**	15.3
Return on average total shareholders equity[4]	**4.7**	15.9
Post-tax return on average total assets	**0.26**	0.97
Post-tax return on average risk-weighted assets	**0.55**	1.95
Credit coverage ratios		
Loan impairment charges as a percentage of total operating income	**27.24**	19.61
Loan impairment charges as a percentage of average gross customer advances	**2.46**	1.97
Total impairment allowances outstanding as a percentage of impaired loans at the year-end	**94.3**	98.1
Efficiency and revenue mix ratios		
Cost efficiency ratio[5]	**60.1**	49.4
As a percentage of total operating income:		
net interest income	**48.1**	43.1
net fee income	**22.6**	25.1
net trading income	**7.4**	11.2
Financial ratios		
Loans and advances to customers as a percentage of customer accounts	**83.6**	89.5
Average total shareholders equity to average total assets	**4.87**	5.69

Share information at the year-end

	2008	2007
US$0.50 ordinary shares in issue (million)	**12,105**	11,829
Market capitalisation (billion)	**US$114**	US$198
Closing market price per ordinary share:		
London	**£6.62**	£8.42
Hong Kong	**HK$73.70**	HK$131.70
Closing market price per American Depositary Share[7]	**US$48.67**	US$83.71

	Over 1 year	Over 3 years	Over 5 years
HSBC total shareholder return to 31 December 2008[8]	**84.5**	**84.5**	**98.5**
Benchmarks:			
FTSE 100[9]	71.7	88.1	118.3
MSCI World[10]	81.8	93.6	123.7
MSCI Banks[11]	63.0	60.8	82.7

For footnotes, see page 5.

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Financial Highlights (continued)

5-year comparison

Five-year comparison	**2008**	2007	2006	2005	2004[12]
	US$m	US$m	US$m	US$m	US$m
For the year					
Net interest income	**42,563**	37,795	34,486	31,334	31,099
Other operating income	**46,008**	49,806	35,584	30,370	24,889
Loan impairment charges and other credit risk provisions	**(24,937)**	(17,242)	(10,573)	(7,801)	(6,191)
Total operating expenses	**(49,099)**	(39,042)	(33,553)	(29,514)	(26,487)
Profit before tax	**9,307**	24,212	22,086	20,966	18,943
Profit attributable to shareholders of the parent company	**5,728**	19,133	15,789	15,081	12,918
Dividends[2]	**11,301**	10,241	8,769	7,750	6,932
At the year-end					
Called up share capital	**6,053**	5,915	5,786	5,667	5,587
Total shareholders equity	**93,591**	128,160	108,352	92,432	85,522
Capital resources[1,13]	**131,460**	152,640	127,074	105,449	90,780
Customer accounts	**1,115,327**	1,096,140	896,834	739,419	693,072
Undated subordinated loan capital	**2,843**	2,922	3,219	3,474	3,686
Preferred securities and dated subordinated loan capital[14]	**50,307**	49,472	42,642	35,856	32,914
Loans and advances to customers[15]	**932,868**	981,548	868,133	740,002	672,891
Total assets	**2,527,465**	2,354,266	1,860,758	1,501,970	1,279,974
	US$	US$	US$	US$	US$
Per ordinary share					
Basic earnings	**0.47**	1.65	1.40	1.36	1.18
Diluted earnings	**0.47**	1.63	1.39	1.35	1.17
Dividends	**0.93**	0.87	0.76	0.69	0.63
Net asset value at year-end[16]	**7.44**	10.72	9.24	8.03	7.66

Share information						
US$0.50 ordinary shares in issue (millions)		**12,105**	11,829	11,572	11,334	11,172
		%	%	%	%	%
Financial ratios						
Dividend payout ratio[17]		**197.9**	52.7	54.3	50.7	53.4
Post-tax return on average total assets		**0.26**	0.97	1.00	1.06	1.14
Return on average total shareholders equity		**4.7**	15.9	15.7	16.8	16.3
Loans and advances to customers as a percentage of customer accounts		**83.6**	89.5	96.8	100.1	97.1
Average total shareholders equity to average total assets		**4.87**	5.69	5.97	5.96	6.35
Capital ratios[1]						
Tier 1 ratio		**8.3**	9.3	9.4	9.0	8.9
Total capital ratio		**11.4**	13.6	13.5	12.8	12.0
Foreign exchange translation rates to US$						
Closing	£:US$1	**0.686**	0.498	0.509	0.581	0.517
	:US$1	**0.717**	0.679	0.759	0.847	0.733
Average	£:US$1	**0.545**	0.500	0.543	0.550	0.546
	:US$1	**0.684**	0.731	0.797	0.805	0.805

For footnotes, see page 5.

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Consolidated Financial Statements

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2008, there were no unendorsed standards effective for the year ended 31 December 2008 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, HSBCs financial statements for the year ended 31 December 2008 are prepared in accordance with IFRSs as issued by the IASB.

HSBC uses the US dollar as its presentation currency because the US dollar and currencies linked to it form the major currency bloc in which HSBC transacts its business. Unless otherwise stated, the information presented in this document has been prepared in accordance with IFRSs.

When reference to underlying or underlying basis is made in tables or commentaries, comparative information has been expressed at constant currency (see page 23) and adjusted for the effects of acquisitions and disposals. A reconciliation of reported and underlying profit before tax is presented on page 22.

Footnotes to Financial Highlights

1 *The calculation of capital resources, capital ratios and risk-weighted assets for 31 December 2008 is on a Basel II basis. Comparatives are on a Basel I basis.*

2 *Dividends recorded in the financial statements are dividends per ordinary share declared in a year and are not dividends in respect of, or for, that year. First, second and third interim dividends for 2008, each of US$0.18 per ordinary share, were paid on 9 July 2008, 8 October 2008 and 14 January 2009, respectively. Note 12 on the Financial Statements provides more information on the dividends declared in 2008. On 2 March 2009 the Directors declared a fourth interim dividend for 2008 of US$0.10 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 6 May 2009 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 27 April 2009, with a scrip dividend alternative. The reserves available for distribution at 31 December 2008 were US$18,838 million.*
Quarterly dividends of US$15.50 per 6.20 per cent non-cumulative Series A US dollar preference share, equivalent to a dividend of US$0.3875 per Series A ADS, each of which represents one-fortieth of a Series A dollar preference share, were paid on 17 March 2008, 16 June 2008, 15 September 2008 and 15 December 2008.
Quarterly coupons per 8.125 per cent capital securities of US$0.541 and US$0.508 were paid on 15 July 2008 and 15 October 2008 respectively.

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

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

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

6 *This footnote is intentionally left blank.*

7 *Each American Depositary Share (ADS) represents five ordinary shares.*

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

9 *The Financial Times Stock Exchange 100 Index.*

10 *The Morgan Stanley Capital International World Index.*

11 *The Morgan Stanley Capital International World Bank Index*

12 *Data for 2004 exclude the provisions of IAS 32, IAS 39 and IFRS 4, which were adopted with effect from 1 January 2005.*

13 *Capital resources are total regulatory capital, the calculation of which is set out on page 278.*

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

15 *Net of impairment allowances.*

16 *The definition of net asset value per share is total shareholders equity, less non-cumulative preference shares and capital securities, divided by the number of ordinary shares in issue.*

17 *Dividends per share expressed as a percentage of earnings per share.*

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Cautionary Statement Regarding Forward-Looking Statements

Cautionary Statement

The *Annual Report and Accounts 2008* contains certain forward-looking statements with respect to the financial condition, results of operations and business of HSBC.

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

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

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement. These factors include, among others:

- changes in general economic conditions in the markets in which HSBC operates, such as:
  - continuing or deepening recessions and fluctuations in employment;
  - changes in foreign exchange rates, in both market exchange rates (for example, between the US dollar and pound sterling) and government-established exchange rates (for example, between the Hong Kong dollar and US dollar);
  - volatility in interest rates;
  - volatility in equity markets, including in the smaller and less liquid trading markets in Asia and Latin America;
  - lack of liquidity in wholesale funding markets;
  - illiquidity and downward price pressure in national real estate markets, particularly consumer-owned real estate markets;
  - the length and severity of current market turmoil;
  - the impact of lower than expected investment returns on the funding of private and public sector defined benefit pensions;
  - the effect of unexpected changes in actuarial assumptions on longevity which would influence the funding of private and public sector defined benefit pensions; and

- consumer perception as to the continuing availability of credit, and price competition in the market segments served by HSBC.

- changes in government policy and regulation, including:

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

  - expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership;

  - initiatives by local, state and national regulatory agencies or legislative bodies to revise the practices, pricing or responsibilities of financial institutions serving their consumer markets;

  - changes in bankruptcy legislation in the principal markets in which HSBC operates and the consequences thereof;

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

  - extraordinary government actions as a result of current market turmoil;

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- other unfavourable political or diplomatic developments producing social instability or legal uncertainty which in turn may affect demand for HSBCs products and services;
- the costs, effects and outcomes of regulatory reviews, actions or litigation, including any additional compliance requirements; and
- the effects of competition in the markets where HSBC operates including increased competition from non-bank financial services companies, including securities firms.

• factors specific to HSBC:

- the success of HSBC in adequately identifying the risks it faces, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, HSBCs ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses.
- the success of HSBC in addressing operational, legal and regulatory and litigation challenges.

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Group Chairman’s Statement

Group Chairman’s Statement

2008 was the most extraordinary year for the global economy and financial services in well over half a century. It marked the first crisis of the era of globalised securitisation. And it also marked the first crisis of the just-in-time global economy as the impact of the financial crisis fed rapidly straight into the performance of the real economy.

Causes of the crisis

The causes of the crisis are complex and interrelated. But we can clearly see that a number of different factors contributed:

- First, the global financial imbalances that arose from the accelerating global economic shift towards emerging markets. The rapid growth of emerging economies created a macro-economic triangle, made up of: the major consumer markets, in particular the US but also a number of other Western economies; major producer nations – notably a number of fast-growing emerging markets which have been manufacturing a vast range of goods for consumption in the West; and resource providers whose wealth of hydrocarbons and other commodities have helped power the producer economies and have thus commanded such high prices until recently. This macro-economic triangle delivered high rates of growth, but also created major financial imbalances as producer nations and resource providers accumulated massive reserves whilst the US and other consumer markets ran significant and growing deficits.

- Second, cheap credit. A large proportion of the accumulated savings of the producers and resource providers was invested in the world’s reserve currency, the US dollar, keeping rates low. This cheap money fuelled a consumer boom and rising house prices. It encouraged increased borrowing by banks and by their customers, fuelling asset price bubbles particularly in housing markets. Loose monetary conditions in the US and in much of the emerging world gave added strength to this already potent cocktail.

- Third, securitisation based on overly complex product structures. The complexity and opacity of certain financial instruments reached a point where even senior and experienced bankers and professional investors had trouble understanding them. This meant that people were selling and buying assets whose risks they had not properly assessed.

- And finally, excessive gearing. Many banks became overgeared and too dependent on wholesale funding, which they assumed, incorrectly, would never dry up. Assets were created on the back of ever higher leverage, both direct and indirect. And when the securitisation market began to collapse, banks found themselves with assets that they could neither sell nor fund, so forcing large losses on the asset side and a funding challenge on the liability side for which they were entirely unprepared.

The result has been unprecedented stress in the financial system, and it has led to a major breakdown in trust. In many countries, huge support from taxpayers has been required in order to stabilise the system.

Failings in the banking industry

The industry has done many things wrong. It is important to remember that many ordinary bankers have always sought to provide good service to their customers; but we must also recognise that there have been too many who have profoundly damaged the industry□s reputation.

Inappropriate products were sold inappropriately by many. Compensation practices ran out of control and perverse incentives led to dangerous outcomes. There is genuine and widespread anger that the contributors to the crisis were in some cases amongst the biggest beneficiaries of the system.

Underlying all these events is a question about the culture and ethics of the industry. It is as if, too often, people had given up asking whether something was the right thing to do, and focused only whether it was legal and complied with the rules. The industry needs to recover a sense of what is right and suitable as a key impulse for doing business.

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HSBC strategy intact

We at HSBC were not immune from the crisis. But we have built our business on very strong foundations and are able to report results which demonstrate our ability to withstand the storm.

Our strategy has been tested and remains intact. We will continue to build our business by focusing on faster-growing markets around the world and on businesses where international connectivity is important – all from a position of financial strength. If anything, the current crisis validates our renewed focus over the last few years on fast-growing economies, since it will accelerate the shift in the world's centre of economic gravity from west to east.

Our robust balance sheet and liquidity means that we have continued to lend. In 2008, we grew our lending to commercial customers by 10 per cent on an underlying basis. Lending to personal customers increased in all regions except North America. And our brand strength continues to underpin our performance. It was noticeable that, at times of stress in many markets, HSBC was a beneficiary of funds flowing in. Recently, the HSBC brand was recognised as the number one brand in banking by Brand Finance.

Profitable from a broad-based earnings platform

Excluding the goodwill impairment on our North America Personal Financial Services business, HSBC reported a pre-tax profit for 2008 of US$19.9 billion, a decline of 18 per cent. On a reported basis, pre-tax profit was US$9.3 billion, down 62 per cent. Within this were some strong regional and business line performances. However, there is one area on which I would like to comment.

For North America, we reported a loss of US$15.5 billion including the goodwill impairment charge of US$10.6 billion in Personal Financial Services. The significant deterioration in US employment and economic outlook in the fourth quarter of 2008 were the primary factors in causing us to write off all the remaining goodwill carried on our balance sheet in respect of our Personal Financial Services business in North America.

The management team has worked tirelessly to address this problem acquisition in the US and we have considered all viable options. We saw the disruption in sub-prime lending as early as 2006 and sharply scaled back in 2007 while others continued to grow. We also devoted considerable resources to helping our customers. Virtually no one then foresaw the subsequent scale of the deterioration in the US economy and financial markets. It is now clear that models of direct personal lending that depend on wholesale markets for funding are no longer viable. In light of this, we have taken the difficult decision that, with the exception of credit cards, we will write no further consumer finance business through the HFC and Beneficial brands in the US and close the majority of the network. Thus, in terms of new business, we are drawing a line and we will run off our existing business, providing all necessary support to HSBC Finance to enable it to do so in a measured way and meet all its commitments.

HSBC has a reputation for telling it as it is. With the benefit of hindsight, this is an acquisition we wish we had not undertaken.

The US remains the world's largest economy and HSBC remains committed to the US, which we see as a core market for HSBC. HSBC Bank in the US is not affected by the restructure. In the immediate future we will focus on those businesses and customers for whom our global connectivity gives us advantage – primarily in corporate and commercial business, and in Private and Premier banking.

Performance overview and strategic activity

In this difficult environment, we missed our profitability targets. We hit our capital target with our tier 1 ratio at 8.3 per cent. We maintained a very conservative advances-to-deposits ratio at 84 per cent. We grew lending in each region outside North America on an underlying basis. And we constrained costs, with the cost efficiency ratio improving to 47.2 per cent, excluding the goodwill impairment mentioned above. We also continued implementation of OneHSBC, our programme to enhance customer experience and improve cost efficiency through standardising products, processes and technology around the world.

We also acquired businesses in strategic areas – we acquired the assets, liabilities and operations of The Chinese Bank in Taiwan in March; IL&FS Investsmart, a retail brokerage in India in May; and, in October, the acquisition of Bank Ekonomi in Indonesia was announced. The first two are complete and being integrated, the last is expected to be completed in the second quarter. The most notable disposal was the sale of our regional bank network in France for a consideration of US$3.2 billion.

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Group Chairman's Statement (continued)

Group Chairman's Statement

Thank you to our people

This was an extraordinary year and made extraordinary demands on many of our people. I want to express my sincere thanks for all their efforts and achievements. Our industry has rightly been under considerable public scrutiny and banks have been indiscriminately bunched together. It is through our staff that HSBC's distinctive character stands out for our customers and it is they who ensure that not all banks are the same.

Dividend declaration and progressive dividend policy

The Directors have declared a fourth interim dividend for 2008 of US$0.10 per ordinary share (in lieu of a final dividend) which, together with the first three interim dividends for 2008 of US$0.18 already paid, will make a total distribution in respect of the year of US$0.64 per ordinary share. The payments in total represent a decrease of 29 per cent in US dollar terms compared with 2007 and of 15 per cent in sterling terms. The dividend will be payable on 6 May 2009 to shareholders on the register at the close of business on 20 March 2009.

After 15 years of double-digit dividend growth, we did not make the decision to lower the dividend lightly. Very careful consideration was given to the current operating environment and the increased uncertainty over both the supply of capital required in an increasingly volatile financial world and a pro-cyclical regulatory capital framework.

For 2009, HSBC has rebased the envisaged dividend per share for the first three interim dividends to US$0.08 to reflect the impact of the enlarged ordinary share capital following the Rights Issue we are announcing today, prevailing business conditions and capital requirements. The dividend payments remain substantial and reflect management's long-term confidence in the business. HSBC will continue to aim to pay progressive dividends in line with the long-term growth of the business.

Maintaining HSBC's financial strength

The logic of maintaining HSBC's distinctive financial strength which we have applied to our dividend also applies to our capital position. We have announced today a Rights Issue to strengthen further our capital ratios. We propose to raise, on a fully underwritten basis, approximately US$17.7 billion of equity which will increase our capital ratios by 150 basis points, strengthening the core equity tier 1 ratio to 8.5 per cent and the tier 1 ratio to 9.8 per cent, both on a pro forma basis as at 31 December 2008. I shall be writing to all shareholders with full details.

Over the past 12 months, many of our competitors have received significant government capital injections – something we said we could not envisage – or have raised capital from shareholders and other investors. Higher regulatory capital requirements, in part from the effect of the economic downturn on capital requirements under the Basel II regime, as well as changing market sentiment on appropriate levels of leverage, have also raised expectations regarding capital levels. We are determined that HSBC should maintain its signature financial strength and we are now raising the top of our target range for the tier 1 ratio so that the range will be from 7.5 per cent to 10 per cent.

Planned internal capital generation remains strong and this capital raising will enhance our ability to deal with the impact of an uncertain economic environment and to respond to unforeseen events. Importantly, it will also give us options with respect to opportunities which we believe will present themselves to those with superior financial strength. These may involve organic investment in the continued taking of market share from more capital constrained competitors. There may also be opportunities to grow through targeted acquisitions by taking advantage of attractive valuations where the opportunities in question align with our strategy and the risks are understood.

Culture and compensation

We believe in the profound importance of culture and ethics in business. HSBCs longstanding traditions of financial strength, long-term customer relationships and conservative management are as important today as ever. They have not always been fashionable and we have not always been perfect. One of the consequences of the crisis and rightly is that we are going to see a fundamental re-evaluation of the rules and regulations that govern our business. But we should remember that no amount of rules and regulations will be sufficient if the culture does not encourage people to do the right thing. It is the responsibility of Boards to supervise and management to embed a sustainable culture into the very fibre of the organisation. For HSBC, there is nothing more important.

We also intend to play our part in rebuilding public trust in our industry. This means we must be willing to take part in and shape the debate on how our industry should evolve in the coming years, based on the lessons which must be learnt from this crisis. In particular, we strongly believe that the

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industry must respond to the requirement for a more sober and reasonable approach to compensation. At HSBC, we are committed to the principle of sensible market-related pay, structured to align executive actions with long-term shareholder interests. A small number of individuals in a market system will inevitably receive compensation that is high in absolute terms, but this must be genuinely linked to long-term shareholder interests. It is clear that the banking industry got it wrong in the go-go years: we will play our part in helping the industry respond appropriately to the new realities.

It is right therefore that in HSBC’s case, I outline our present position. As Chairman I elected in 2007 to no longer receive any cash bonus award; any variable compensation would be delivered through performance share awards – which would only vest if performance hurdles are met. And no performance share awards will be made in the Group in respect of 2008. Mike Geoghegan, Group Chief Executive, and Stuart Gulliver, Chief Executive Global Banking and Markets, and Douglas Flint, Group Finance Director, have asked the Remuneration Committee not to consider them for any bonus award for 2008. No cash bonus award will be made to any Executive Director for 2008. Full details on Directors’ remuneration can be found in the *Annual Report*.

Learning the lessons

We are living through a genuinely global crisis; it cannot be solved by one nation alone. Governments need to work together with our industry to tackle the root causes of the crisis, while maintaining the open, globalised markets that have helped spread prosperity in the last two decades. Protectionism, both in trade and in capital flows, is a threat and in all its forms must be resisted.

We must also urgently improve governance and regulation to create a more stable financial framework. The globalisation of financial markets contrasts sharply with the domestic agenda of the regulatory regimes that underpin it. We support intergovernmental efforts to enhance the coordination of regulatory oversight, since we believe that this is essential to the stable development of the international capital markets for the benefit of the common good.

Continued economic strain

The coming twelve months will be difficult. We expect parts of Asia, the Middle East and Latin America to continue to outperform Western economies, but to be constrained by the global downturn.

We see unemployment rising through 2009 into 2010 in both the US and the UK, together with continuing declines in housing markets. We should remember that the US is the driver of the global economy and global growth depends on the US recovery.

We remain confident that HSBC is well-placed in today’s environment and that our strength leads to opportunity. Our strategy has served HSBC well and positions it for long-term growth with attractive returns. HSBC continues to combine its position as the world’s leading emerging markets bank with an extensive international network across both developed and faster growing markets. At the same time, as the financial system exhibits stress, our competitive position is improving as the capacity and capabilities of financial institutions are constrained by lack of capital and funding; many of them are also focusing more on their domestic markets.

Further strengthening our capital base will enhance our ability to deal with the impact of an uncertain economic environment and to respond to unforeseen events, as well as giving us options regarding opportunities which will undoubtedly present themselves to those with superior financial strength.

S K Green, *Group Chairman*
2 March 2009

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Principal activities

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US$114 billion at 31 December 2008.

Through its subsidiaries and associates, HSBC provides a comprehensive range of banking and related financial services. Headquartered in London, HSBC operates through long-established businesses and has an international network of some 10,000 properties in 86 countries and territories in five geographical regions: Europe; Hong Kong; Rest of Asia-Pacific, including the Middle East and Africa; North America and Latin America. Within these regions, a comprehensive range of financial services is offered to personal, commercial, corporate, institutional, investment and private banking clients. Services are delivered primarily by domestic banks, typically with large retail deposit bases, and consumer finance operations. Taken together, the five largest customers of HSBC do not account for more than one per cent of HSBCs income.

There were no significant acquisitions during the year (for details of acquisitions see page 418). HSBC disposed of its seven French regional banks for US$3.2 billion in July 2008 (see pages 418 and 458).

Strategic direction

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

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

HSBC is, therefore, continuing to invest primarily in the faster growing markets and, in the more developed markets, by focusing on businesses which have international connectivity. Central to these reshaping activities is a policy of maintaining HSBCs capital strength and strong liquidity position.

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

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

- businesses with local customers where efficiency can be enhanced through global scale the small business segment of Commercial Banking and the mass market segment of Personal Financial Services; and
- products where global scale is possible through building efficiency, expertise and brand global product platforms such as global transaction banking.

The means of executing the strategy, and further utilising the linkages within the Group, are clear:

- the HSBC brand and global networks will be leveraged to reach new customers and offer further services to existing clients;
- efficiency will be enhanced by taking full advantage of local, regional and global economies of scale, in particular by adopting a common systems architecture wherever possible; and
- objectives and incentives will be aligned to motivate and reward staff for being fully engaged in delivering the strategy.

Challenges and uncertainties

Current economic and market conditions may adversely affect HSBCs results.

The global economy has entered the most severe downturn for 80 years, with the financial services industry facing extraordinary turbulence. A shortage of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes are putting financial institutions under considerable pressure. This is leading governments and central banks to undertake unprecedented intervention designed to stabilise the global and

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domestic financial systems, to stimulate new lending and to support systemically important institutions at risk of failing. Many developed economies have entered recession and growth has slowed in many emerging countries, with serious adverse consequences for asset values, employment, consumer confidence and levels of economic activity. Commodity prices have significantly retrenched, in many cases from recent historical highs, interest rate yield curves have flattened, interest rates have fallen in absolute terms and trade flows have contracted. Global equity markets have experienced severe declines and various currencies, including sterling, have depreciated significantly against the US dollar. Emerging markets have suffered as portfolio investments have been repatriated and cross-border inter-bank funding has been withdrawn. Numerous governments and central banks have responded by proposing programmes to make substantial funds and guarantees available to boost liquidity and confidence in their financial systems, as well as cutting taxes and lowering interest rates. It is not known whether these responses will be effective in addressing the severe economic and market conditions or whether recently proposed measures will be implemented as initially proposed.

HSBCs earnings are affected by global and local economic and market conditions. Dramatic declines in 2007 and 2008 in the housing markets in the US, the UK and elsewhere have combined with increasing unemployment to affect negatively the credit performance of real estate-related exposures, resulting in significant write-downs of asset values by financial institutions, including HSBC. These write-downs, initially of asset-backed securities but spreading to other securities and loans, have caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger competitors or, in some cases, to fail.

A worsening of these conditions may exacerbate the impact of these difficult market conditions on HSBC and other financial institutions and could have an adverse effect on HSBCs operating results. In particular, the Group may face the following challenges in connection with these events:

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

- The demand for borrowing from creditworthy customers may diminish as economic activity slows.

- Lower interest rates will reduce net interest income earned by HSBC on its excess deposits.

- HSBCs ability to borrow from other financial institutions or to engage in funding transactions on favourable terms, or at all, could be adversely affected by further disruption in the capital markets or deteriorating investor sentiment.

- Market developments may affect consumer confidence and may cause declines in credit card usage and adverse changes in payment patterns, leading to increases in delinquencies and default rates, write-offs and loan impairment charges beyond HSBCs expectations.

- Loan impairment allowances and write-offs are likely to rise as a result of a deterioration in payment patterns and increased delinquencies and default rates caused by weakening consumer confidence and increased business failures. A worsening of these economic factors may exacerbate the adverse effects of these difficult market conditions on HSBC and others in the financial services industry.

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

- Trade and capital flows may further contract as a result of protectionist measures being introduced in certain markets.

- Increased government ownership and control over financial institutions and further consolidation in the financial industry, which could significantly alter the competitive landscape.

As a worldwide financial institution, HSBC is exposed to these developments across all its businesses, both directly and through their impact on its customers and clients. Local variations exist, however, reflecting regional circumstances and

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presenting challenges to HSBC which are specific to those areas.

Europe

In the UK, the economy has entered recession and the currency has fallen in value against the US dollar, the yen and the euro. Changes in the marketplace are emerging following the part-nationalisation of some major financial institutions, and political interaction with the regulatory environment is becoming more frequent as the government seeks to stimulate lending to preserve economic activity. A period of low interest rates will reduce deposit spreads and HSBCs retail business model will be more dependent on transactional fees and lending margin. Pension funding requirements, in particular for UK defined benefit schemes, will place increased financing demands on corporates, which may lead to unfunded commitments being drawn down, adding to pressure on system liquidity. The recent deterioration in credit quality is expected to continue as the economy contracts, with loan impairment charges rising as a result. Market volatility is also expected to continue.

In France, changes in the marketplace are slowly emerging following government measures to stimulate lending and preserve economic activity. A period of low interest rates will not adversely impact spreads in the short-term but will have an adverse effect in later years. HSBCs retail business model is dependent on banking fees to maintain profitability and a recovery in financial markets is necessary in order to enhance brokerage and management fees and stimulate fund management activities. Deterioration in credit quality is expected to continue as the economy contracts, with commercial loan impairment charges rising as a result. Personal loan impairment charges are expected to remain at around current levels unless there is a very deep recession.

Conditions are likely to remain difficult in a number of markets in which HSBC currently trades and volatility is expected to continue.

Hong Kong and Rest of Asia-Pacific

In Asia-Pacific, a prolonged period of low interest rates is expected which will put pressure on HSBCs net interest income from its strong deposit base. With capital market and currency volatility endemic, customers are likely to seek capital protection and become increasingly rate and risk sensitive, seeking out products which offer deposit insurance and government guarantees. Regulatory reforms in the areas of wealth management product complexity,

sales requirements and liquidity and reserve ratios are likely, and these will lead to a higher cost of compliance, greater standardisation and slower product approvals. International trade is expected to continue to contract, affecting import and export volumes and reducing HSBCs earnings from trade financing. The quality of the asset book will deteriorate if economic factors beyond HSBCs control do not improve, reducing customer credit ratings and, as a consequence, increasing risk- weighted asset allocations and capital requirements. This could be exacerbated if capital continues to be repatriated from emerging markets to more developed economies to take advantage of lower asset prices, adversely affecting emerging markets balance of payments and foreign exchange reserves. However, Asia is expected to adapt quickly to secure recovery from the global recession, led by mainland China and India.

The fall in global demand for oil products and related prices, and the contraction in financial surpluses held by key oil-producing countries following the declines in capital markets, will reduce the ability of some countries in the Middle East to maintain spending, borrowing and investment domestically and internationally. This will result in the cancellation or postponement of infrastructure projects which, together with weakening property prices, is expected to reduce both credit cover and revenue streams for financial institutions. The availability of economically priced, long-term funding is likely to contract. Business activity and private investment will also slow as consumer confidence declines. These factors will combine to place pressure on net revenues and on capital requirements.

North America

In the US, the steep decline in the housing market, with falling home prices and increasing foreclosures, and rising unemployment have resulted in significant write-downs of loans and advances and mortgage-backed securities. The effect of these write-downs subsequently spread to other capital market activities, leading many financial institutions to seek additional capital, merge with larger and stronger institutions and, in some cases, fail. Many lenders reduced or stopped providing funding to borrowers, including to other financial institutions. This market turmoil and resultant tightening of credit have led to an increased level of delinquencies, a fall in consumer confidence, increased market volatility and a widespread reduction in business activity in general. To date, various government intervention measures designed to stabilise the markets, including

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the decision of the Federal Reserve to reduce interest rates to unprecedentedly low levels, appear to be having an impact on the trading of both guaranteed and non-guaranteed debt in early 2009. A prolonged period of low Federal funds rates will put pressure on deposit spreads earned on HSBC’s deposit base. It is likely that these conditions will continue to adversely affect the Group’s results into 2010, the degree to which remains uncertain.

Latin America

Markets in Latin America are expected to be affected by recession in the developed world, particularly in the US. Output will fall as a decline in the demand for exports will adversely affect the export sector, and these factors are likely to combine with currency volatility to weaken the balance sheets of financial institutions. This may lead to a further contraction in the availability of credit, increasing the likelihood of bankruptcies and unemployment and reducing economic activity and consumption. Lower commodity prices and reduced remittance inflows are likely to affect economies in the region, particularly in Mexico and Central America. Exchange rates are likely to remain under pressure as growth stalls, and inflation may rise. The possibility of a combined credit crunch and stagflation in Latin America cannot be ruled out. The authorities may react with stricter prudential regulation and price controls. Public finances will come under strain if oil and other commodity prices remain low, restricting the authorities’ room for manoeuvre.

Risks associated with liquidity and funding, which are inherent in HSBC’s business, have been greatly increased by the current global market conditions

HSBC’s business model depends upon its ability to access financial resources whenever required to meet its obligations. To this end, HSBC seeks to maintain a diversified and stable funding base comprising core retail and corporate customer deposits and institutional balances and to augment this with wholesale funding and portfolios of highly liquid assets diversified by currency and maturity which are held to enable HSBC to respond to unforeseen liquidity requirements. HSBC’s earnings are affected by its ability to properly value financial instruments. In certain illiquid markets, determining the value at which financial instruments can be realised is highly subjective, and processes to ascertain value and estimates of value, both of which require substantial elements of judgement, assumptions and estimates (which may change over time), are required. Increased illiquidity adds to

uncertainty over the accessibility of financial resources and may reduce capital resources as valuations decline. Rating agencies, which determine HSBC’s own credit ratings and thereby influence the Group’s cost of funds, take into consideration management effectiveness and the success with which HSBC’s liquidity risk factors are managed. Actions by third parties and independent market participants, such as rating agency downgrades of instruments to which HSBC has exposure, can result in reduced liquidity and valuations of those instruments. HSBC’s liquidity could also be constrained by an inability to access the debt capital markets due to a variety of unforeseen market dislocations or interruptions.

The extreme market conditions facing the financial services industry have been reflected in shortages of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes. Illiquidity of these assets has prevented the realisation of existing asset positions and has constrained risk distribution in ongoing banking activities. The extreme market conditions, which have highlighted the importance of a strong diversified core deposit base, have also lead to increased competition for such deposits and the risk of deposit migration. HSBC’s Global Banking and Markets business operates in the markets affected by illiquidity and extreme price volatility, either directly or indirectly, through exposures to securities, loans, derivatives and other commitments, and HSBC has made substantial write-downs and impairments on illiquid legacy credit and structured credit positions. While it is difficult to predict how long the conditions described above will exist and which of HSBC’s markets, products and other businesses will be affected, continuation of these factors could have an adverse effect on the Group’s results.

HSBC has significant exposure to counterparty risk

HSBC’s ability to engage in routine transactions to fund its operations and manage its risks could be adversely affected by the actions and commercial soundness of other financial services institutions. Financial institutions are extremely interdependent because of trading, clearing, counterparty or other relationships. As a consequence, a default by, or decline in market confidence in, individual institutions, or anxiety about the financial services industry generally, can lead to further individual and/or systemic difficulties, defaults and losses. HSBC has exposure to virtually all major industries and counterparties, and it routinely executes transactions with counterparties in financial services, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose HSBC to credit risk in the event of default by its counterparty or client. Where counterparty risk has been mitigated by taking collateral, HSBCs credit risk may be exacerbated if the collateral it holds cannot be realised or has to be liquidated at prices which are insufficient to recover the full amount of its loan or derivative exposure. The failure of one of HSBCs counterparties could have an adverse effect on its results.

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

Consolidation in the financial services industry is increasingly concentrating activity in companies that are capable of offering a wide array of financial products at competitive prices, with globalisation exposing HSBC to competition in capital markets and financial services at global and local levels alike. In addition, technological advances, the growth of e-commerce, regulatory developments and public sector participation or guarantees have made it possible for non-depository institutions to offer products and services that traditionally were the preserve of banks. The prominence in recent years of sovereign wealth funds, private equity and hedge funds as alternative sources of funding which has increased competition for traditional financial institutions may ease as investors seek safer, more traditional alternatives. Competition may further intensify or the competitive landscape may change as the consolidation of financial services companies continues and others are brought into part or full public ownership in response to the current market conditions. HSBCs ability to grow its businesses, and therefore its earnings, is affected by these competitive pressures and is dependent on HSBCs ability to attract and retain talented and dedicated employees.

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

HSBC operates through an international network of subsidiaries and affiliates in 86 countries and territories around the world. Its results are therefore subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and change in government policies on such matters as expropriation, authorisations, international ownership, interest-rate caps, limits

on dividend flows and tax in the jurisdictions in which it operates. These factors may also negatively affect revenues from the trading of securities and investment in securities, the effect being accentuated through certain international trading markets, particularly those in emerging market countries, being typically smaller, less liquid and more volatile than developed trading markets. HSBCs subsidiaries and affiliates ability to pay dividends could be restricted by changes to official banking measures, exchange controls and other requirements. Because HSBC prepares its accounts in US dollars, while a substantial part of its assets, liabilities, assets under management, revenues and expenses are denominated in other currencies, changes in foreign exchange rates have an effect on its reported income and shareholders equity. For a detailed discussion of global and regional factors that impact the results of HSBCs operations, see page 12.

Operational risks are inherent in HSBCs business

HSBC is exposed to many types of operational risk, including fraudulent and other criminal activities (both internal and external), breakdowns in processes or procedures and systems failure or non-availability. HSBC is also subject to the risk of disruption of its business arising from events that are wholly or partially beyond its control (for example natural disasters, acts of terrorism, epidemics and transport or utility failures) which may give rise to losses in service to customers and/or economic loss to HSBC. All of these risks are also applicable where HSBC relies on outside suppliers or vendors to provide services to it and its customers.

HSBC is subject to legal risks, which have an adverse effect on the Group's reputation

The risks to HSBC's reputation arise from a variety of sources with the potential to cause harm to the Group and its ability to operate. These issues require the Group to deal appropriately with potential conflicts of interest; legal and regulatory requirements; ethical issues; anti-money laundering laws or regulations; privacy laws; information security policies; sales and trading practices; and the conduct of companies with which it is associated. Failure to address these issues appropriately may give rise to additional legal and compliance risk to HSBC, with an increase in the number of litigation claims and the amount of damages asserted against HSBC, or subject HSBC to regulatory enforcement actions, fines or penalties.

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Increased regulation of the financial services industry could have an adverse effect on HSBCs operations

HSBC, its subsidiaries and its affiliates are subject to extensive and increasing regulation, accounting standards and interpretations thereof and legislation in the various countries in which the Group operates. From time to time, new laws are introduced, including tax, consumer protection, privacy and other legislation, which affect the operating environment in which the Group operates. As a result of the recent interventions by governments in response to global economic conditions, it is widely expected that there will be a substantial increase in government regulation and supervision of the financial services industry, including the imposition of higher capital requirements and restrictions on certain types of transaction structure. If enacted, such new regulations could require additional capital to be injected into HSBCs subsidiaries and affiliates, require HSBC to enter into business transactions that are not otherwise part of its current Group strategy, prevent HSBC from continuing current lines of operations, restrict the type or volume of transactions HSBC may enter into, limit HSBCs subsidiaries and affiliates ability to declare dividends to HSBC, or set limits on or require the modification of rates or fees that HSBC charges on certain loan or other products. HSBC may also face increased compliance costs and limitations on its ability to pursue business opportunities. Separately, the Basel II Accords requirement for financial institutions to increase their capital in response to deteriorating market conditions may have secondary effects on lending, which could exacerbate the current market downturn. These measures, alone or in combination, could have an adverse effect on HSBCs operations.

In the UK for example, the Banking Act 2009 includes a Special Resolutions Regime which gives wide powers in respect of UK banks and their parent companies to the UK Treasury, the FSA and the Bank of England in circumstances where any such UK bank has encountered, or is likely to encounter, financial difficulties.

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

HSBC is subject to the substance and interpretation of tax laws in all countries in which it operates.

A number of double taxation agreements entered into between countries also affect the taxation of the Group. Tax risk is the risk associated with changes in tax law or in the interpretation of tax law. It also includes the risk of changes in tax rates and the risk of consequences arising from failure to comply with procedures required by tax authorities. Failure to manage tax risks could lead to increased tax charges, including financial or operating penalties, for not complying as required with tax laws.

Key performance indicators

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

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

Financial KPIs

To support the Groups strategy and ensure that HSBCs performance can be monitored, management utilises a number of financial KPIs. The table below presents these KPIs for the period from 2004 to 2008. At a business level, the KPIs are complemented by a range of benchmarks which are relevant to the planning process and to reviewing business performance.

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

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

KPIs

Financial KPIs trend analysis

	2008	2007	2006	2005	2004
	%	%	%	%	%
Revenue growth[1]	**3.4**	20.8	13.4	12.2	
Revenue mix[2]					
Net interest income	**52.1**	47.8	52.8	54.4	60.6
Net fee income	**24.5**	27.9	26.3	25.1	25.2
Other income[3]	**23.4**	24.3	20.9	20.5	14.2
Cost efficiency[4]	**60.1**	49.4	51.3	51.2	51.6
Credit performance as measured by risk adjusted margin[5]	**4.8**	6.0	6.3	6.3	6.8
Return on average invested capital[6]	**4.0**	15.3	14.9	15.9	15.0
Dividends per share growth[7]	**(28.9)**	11.1	11.0	10.6	10.0
Basic earnings per ordinary share[8] (US$)	**0.47**	1.65	1.40	1.36	1.18
Return on average total shareholders equity[9]	**4.7**	15.9	15.7	16.8	16.3

	Over 1 year	**Over 3 years**	**Over 5 years**
Total shareholder return			
HSBC TSR	**84.5**	**84.5**	**98.5**
Benchmarks:			
FTSE 100	71.7	88.1	118.3
MSCI World	81.8	93.6	123.7
MSCI Banks	63.0	60.8	82.7

1 *The percentage increase in net operating income before loan impairment and other credit risk charges since the previous year.*
2 *As a percentage of net operating income before loan impairment charges and other credit risk provisions.*
3 *Other income comprises net operating income before loan impairment charges and other credit risk provisions less net interest income and net fee income.*
4 *Total operating expenses divided by net operating income before loan impairment and other credit risk charges.*
5 *Net operating income divided by average risk-weighted assets.*
6 *Profit attributable to ordinary shareholders divided by average invested capital.*
7 *The percentage increase in dividends per share since the previous year, based on the dividends paid in respect of the year to which the dividend relates.*
8 *Basic earnings per ordinary share is defined in Note 13 on the Financial Statements.*
9 *The return on average total shareholders equity is defined as profit attributable to shareholders of the parent company divided by the average total shareholders equity.*

Revenue growth provides an important guide to the Group's success in generating business. In 2008, total revenue grew by 3.4 per cent to US$81.7 billion, 2.1 per cent on an underlying basis, reflecting the resilience of HSBC's income generating capabilities in these exceptionally difficult economic circumstances.

Revenue mix represents the relative distribution of revenue streams between net interest income, net fee income and other revenue. It is used to understand how changing economic factors affect the Group, to highlight dependence on balance sheet utilisation for income generation and to indicate success in cross-selling fee-based services to customers with loan facilities. This understanding assists management in making business investment decisions. Comparison of the revenue mix between 2005 and 2007 shows a trend of net fee income increasing at a faster rate than net interest income. This trend has been reversed in 2008 as net fee income's contribution fell by 3.4 percentage points mainly due to lower fees on cards and equity-related products.

Cost efficiency is a relative measure that indicates the consumption of resources in generating revenue. Management uses this to assess the success of technology utilisation and, more generally, the productivity of the Group's distribution platforms and sales forces. The cost efficiency ratio for 2008 deteriorated by 10.7 percentage points to 60.1 per cent. This included writing off goodwill in the US.

Credit performance as measured by risk-adjusted margin is an important gauge for assessing whether credit is correctly priced so that the returns available after recognising impairment charges meet the Group's required return parameters. The ratio for 2008 was 4.8 per cent, showing a decline of 1.2 percentage points over 2007, as loan impairment charges rose at a faster rate than income on higher average risk-weighted assets.

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Return on average invested capital measures the return on the capital investment made in the business, enabling management to benchmark HSBC against competitors. In 2008, the ratio of 4.0 per cent was 11.3 percentage points lower than that reported in 2007. This decrease reflected the decline in profit driven by goodwill impairment, the significant increase in loan impairment charges, write-downs in credit trading, leveraged and acquisition finance, and monoline exposures. The comparative period included dilution gains which were not repeated.

HSBC aims to deliver sustained **dividend per share growth** for its shareholders. The total dividend for 2008, based on the year to which the dividends relate (rather than when they were paid), amounts to US$0.64, a reduction of 28.9 per cent on 2007, reflecting the decline in profitability, prevailing business conditions and capital requirements. This basis differs from the disclosure in the five-year comparison on page 4.

Basic earnings per share (“EPS”) is a ratio that shows the level of earnings generated per ordinary share. EPS is one of two KPIs used in rewarding employees and is discussed in more detail in the Director’s Remuneration Report on page 315. EPS for 2008 was US$0.47, a decline of 71.5 per cent on 2007. This, in part, reflected the effect of recognising goodwill impairment in North America as well as the broad based impact of the global economic crisis. In 2007, EPS grew by 17.9 per cent over that reported in 2006.

Return on average total shareholders’ equity measures the return on average shareholders’ investment in the business. This enables management to benchmark Group performance against competitors and its own targets. In 2008, the ratio was 4.7 per cent or 11.2 percentage points lower than in 2007 of which 8.6 percentage points related to the goodwill impairment recognised. This absolute performance is not regarded as satisfactory, being lower than management’s target range of between 15 and 19 per cent.

Total shareholder return (“TSR”) is used as a method of assessing the overall return to shareholders on their investment in HSBC, and is defined as the growth in share value and declared dividend income during the relevant period. TSR is a key performance measure in rewarding employees. In calculating TSR, dividend income is assumed to be invested in the underlying shares. The TSR benchmark is an index set at 100 and measured over one, three and five years for the purpose of comparison with the performance of a group of competitor banks which reflect HSBC’s range and

breadth of activities. As the comparator group includes companies listed on overseas markets, a common currency is used to ensure that TSR is measured on a consistent basis. The TSR levels at the end of 2008 were 84.5, 84.5, and 98.5 over one, three and five years respectively. HSBC’s TSR over all periods, while disappointing in absolute terms, has significantly outperformed the peer group as the current financial crisis has had a significantly more adverse impact on their performance and rating.

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

Non-financial KPIs

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

Employee engagement

Employee engagement is a measure of employees’ emotional and rational attachment to HSBC. It is critical to the long-term success of the Group and, as such, an employee engagement target was included in the 2008 objectives for Group Executives (see Directors’ Remuneration Report, page 315).

In 2008, HSBC conducted its second Global People Survey of HSBC’s permanent workforce worldwide. The 2008 participation rate of 93 per cent improved on the 2007 figure of 88 per cent, which was already around the highest in the industry.

The Groups employee engagement score rose from 60 per cent in 2007 to 67 per cent in 2008. In achieving 67 per cent, HSBC exceeded its target for 2008 of 62 per cent, the external global norm and the sector norm. Its 2009 target is 69 per cent.

The 2008 survey covered 13 dimensions which included assessing for the first time whether action had been perceived to have been taken on the results of the 2007 survey. Employees rated HSBC above the external global norm across all dimensions. HSBC exceeded the external best-in-class norm for Corporate Sustainability, and the dimensions covering Strategy and Vision, Reputation, Direct Manager and Leadership were close to this norm.

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Report of the Directors: Business Review
(continued)

Reconciliation of reported and underlying profit before tax

Brand perception

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

In 2008, Personal Financial Services customers judged HSBCs brand to be 9 points stronger than its competitors (+9), up from 6 points in 2007 and above the 8 point target. Commercial Banking customers judged the brand to be 6 points higher than HSBCs competitors (+6), the same as in 2007.

For 2009, HSBC will track brand health in more countries. During 2008, competitors were acquired or withdrew from certain markets, so HSBC re-benchmarked its 2008 performance in respect of both brand and customer satisfaction for Personal Financial Services and Commercial Banking. For 2009, the benchmark is +4 with a target of +5 for the former and, for the latter, the equivalent numbers are +6 and +7, respectively.

Customer satisfaction

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

The 2008 customer recommendation target for Personal Financial Services increased from +1 to +2, failing to meet the target of +3 by a small margin. Commercial Banking met the target of +7 over competitors, up from +6 in 2007.

In 2009, HSBC has adopted a new benchmark of +1 and a 2009 target of +3 for Personal Financial Services and a benchmark of +4 and a target of +4 for Commercial Banking.

IT performance and systems reliability

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

Number of customer transactions processed

The number of customer transactions processed reflects the dependency on IT in the delivery channels that customers use to interact with HSBC. Monitoring the volumes by channel enables the Group to allocate resources appropriately. Overall, the results show the desired decrease in staff-assisted transactions. Self-service transactions increased as a result of the redesign of the Groups distribution network and the continuing rollout of One HSBC Technologies, HSBCs project to standardise its primary systems, products and processes. Internet transactions unexpectedly decreased as a direct result of lower online trading volumes in retail securities in

2008. To improve efficiency HSBC aims to manage the rate of increase in IT transaction processing costs to below the volume increase. The following chart shows the 2005 to 2008 volumes per delivery channel:

Number of customer transactions (millions)

Percentage of IT services meeting or exceeding targets

HSBCs IT function establishes with its end-users service levels for systems performance, such as systems running 99.9 per cent of the time or credit card authorisations within two seconds, and monitors the achievement of each of these commitments. The following chart shows the percentage of IT services meeting or exceeding the agreed service targets by region. Overall, the results show a trend of improving service performance.

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Percentage of IT services meeting or exceeding targets

Reconciliation of reported and underlying profit before tax

HSBC measures its performance internally on a like-for-like basis by eliminating the effects of foreign currency translation differences, acquisitions, disposals and gains from the dilution of the Group's interests in associates in 2007, which distort a year-on-year comparison. HSBC refers to this as its underlying performance.

The tables below compare HSBC's underlying performance in 2008 with 2007, and 2007 with 2006. Equivalent tables are provided for each of HSBC's customer groups and geographical segments in their respective sections below.

The foreign currency translation differences were mainly due to the strengthening of the US dollar against sterling in the second half of 2008 and its relative weakness against the euro and the Chinese renminbi in 2008 compared with 2007. The Group's reported profit before tax in 2008 was 62 per cent lower than in 2007, with the effect of the change in foreign currency translation rates making a negligible difference. Comparing 2007 with 2006, the reported profit before tax growth was 10 per

cent, of which 4 per cent was explained by exchange rate movements.

The following acquisitions and disposals, which are listed in chronological order, affected both comparisons:

- the acquisition of HSBC's partner's shares in life insurer, Erisa S.A., and property and casualty insurer, Erisa I.A.R.D. (together renamed "HSBC Assurances") in France in March 2007;
- the deemed disposals of the stakes in Ping An Insurance (Group) Company of China, Limited ("Ping An Insurance"), Bank of Communications Co., Limited ("Bank of Communications") and Industrial Bank Co. Limited ("Industrial Bank"), as a consequence of their share offerings on the domestic "A" share market in mainland China in the first half of 2007, and of the stakes in Financiera Independencia S.A.B. de C.V. ("Financiera Independencia") in Mexico and Vietnam Technological and Commercial Joint Stock Bank ("Techcombank") following their share issues;
- the disposal of the Hamilton Insurance Company Limited and Hamilton Life Assurance Company Limited in the UK in October 2007;
- the sale of Wealth and Tax Advisory Services to its management in December 2007;
- the acquisition of the assets, liabilities and operations of The Chinese Bank Co., Ltd. ("The Chinese Bank") in Taiwan in March 2008;

- the sale of HSBC's UK merchant acquiring business to a joint venture 49 per cent owned by the Group in June 2008; and
- the disposal of seven French regional banking subsidiaries in July 2008.

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

Reconciliation of reported and underlying profit before tax / Financial summary

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007							
HSBC	**2007 as reported US$m**	**2007 acquisitions, disposals & dilution gains[1] US$m**	**Currency translation[2] US$m**	**2007 at 2008 exchange rates[3] US$m**	**2008 acquisitions and disposals[1] US$m**	**Underlying change US$m**	**2008 as reported US$m**	**Reporte chang**
Net interest income	**37,795**	**(389)**	**(4)**	**37,402**	**250**	**4,911**	**42,563**	**1**
Net fee income	**22,002**	**(239)**	**(152)**	**21,611**	**18**	**(1,605)**	**20,024**	**(**
Other income[4]	**19,196**	**(1,232)**	**(329)**	**17,635**	**3,148**	**(1,688)**	**19,095**	**(**
Net operating income[5]	**78,993**	**(1,860)**	**(485)**	**76,648**	**3,416**	**1,618**	**81,682**	
Loan impairment charges and other credit risk provisions	**(17,242)**	**31**	**113**	**(17,098)**	**(6)**	**(7,833)**	**(24,937)**	**(4**
Net operating income	**61,751**	**(1,829)**	**(372)**	**59,550**	**3,410**	**(6,215)**	**56,745**	**(**
Operating expenses (excluding goodwill impairment)	**(39,042)**	**514**	**301**	**(38,227)**	**(198)**	**(110)**	**(38,535)**	
Goodwill impairment	—	—	—	—	—	**(10,564)**	**(10,564)**	**n/**
Operating profit	**22,709**	**(1,315)**	**(71)**	**21,323**	**3,212**	**(16,889)**	**7,646**	**(6**
Income from associates	**1,503**	**(12)**	**107**	**1,598**	—	**63**	**1,661**	**1**
Profit before tax	**24,212**	**(1,327)**	**36**	**22,921**	**3,212**	**(16,826)**	**9,307**	**(6**

	2007 compared with 2006								
HSBC	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006, at 2007 exchange rates[6] US$m	2007 acquisitions disposals & dilution gains[1] US$m	Under-lying change US$m	2007 as reported US$m	Reported change %	Underlying change %
Net interest income	34,486	(3)	1,086	35,569	794	1,432	37,795	10	4
Net fee income	17,182	53	750	17,985	(47)	4,064	22,002	28	23
Other income[4]	13,698	(53)	733	14,378	1,113	3,705	19,196	40	26
Net operating income[5]	65,366	(3)	2,569	67,932	1,860	9,201	78,993	21	14
Loan impairment charges and other credit risk provisions	(10,573)	–	(243)	(10,816)	(133)	(6,293)	(17,242)	(63)	(58)
Net operating income	54,793	(3)	2,326	57,116	1,727	2,908	61,751	13	5
Operating expenses	(33,553)	2	(1,536)	(35,087)	(397)	(3,558)	(39,042)	(16)	(10)
Operating profit	21,240	(1)	790	22,029	1,330	(650)	22,709	7	(3)
Income from associates	846	–	20	866	(41)	678	1,503	78	78
Profit before tax	22,086	(1)	810	22,895	1,289	28	24,212	10	[illegible]

For footnotes, see page 143.

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Financial summary

Consolidated financial statements

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2008, there were no unendorsed standards effective for the year ended 31 December 2008 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, HSBCs financial statements for the year ended 31 December 2008 are prepared in accordance with IFRSs as issued by the IASB.

HSBC uses the US dollar as its presentation currency because the US dollar and currencies linked to it form the major currency bloc in which HSBC transacts its business. Unless otherwise stated, the accounting information presented in this document has been prepared in accordance with IFRSs.

Constant currency

Constant currency comparatives for 2007 and 2006 used in the 2008 and 2007 commentaries, respectively, are computed by retranslating into US dollars, for non-US dollar branches, subsidiaries, joint ventures and associates:

- the income statements for 2007 and 2006 at the average rates of exchange for 2008 and 2007, respectively; and
- the balance sheets at 31 December 2007 and 2006 at the prevailing rates of exchange on 31 December 2008 and 2007, respectively.

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

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

Income statement

	2008	2007	2006
	US$m	US$m	US$m
Interest income	**91,301**	92,359	75,879
Interest expense	**(48,738)**	(54,564)	(41,393)
Net interest income	**42,563**	37,795	34,486
Fee income	**24,764**	26,337	21,080
Fee expense	**(4,740)**	(4,335)	(3,898)
Net fee income	**20,024**	22,002	17,182
Trading income excluding net interest income	**847**	4,458	5,619
Net interest income on trading activities	**5,713**	5,376	2,603
Net trading income	**6,560**	9,834	8,222
Changes in fair value of long-term debt issued and related derivatives	**6,679**	2,812	(35)
Net income/(expense) from other financial instruments designated at fair value	**(2,827)**	1,271	692
Net income from financial instruments designated at fair value	**3,852**	4,083	657
Gains less losses from financial investments	**197**	1,956	969
Gains arising from dilution of interests in associates	**–**	1,092	–
Dividend income	**272**	324	340
Net earned insurance premiums	**10,850**	9,076	5,668
Gains on disposal of French regional banks	**2,445**	–	–
Other operating income	**1,808**	1,439	2,546
Total operating income	**88,571**	87,601	70,070
Net insurance claims incurred and movement in liabilities to policyholders .	**(6,889)**	(8,608)	(4,704)
Net operating income before loan impairment charges and other credit risk provisions	**81,682**	78,993	65,366
Loan impairment charges and other credit risk provisions	**(24,937)**	(17,242)	(10,573)
Net operating income	**56,745**	61,751	54,793
Employee compensation and benefits	**(20,792)**	(21,334)	(18,500)
General and administrative expenses	**(15,260)**	(15,294)	(12,823)
Depreciation and impairment of property, plant and equipment	**(1,750)**	(1,714)	(1,514)
Amortisation and impairment of intangible assets	**(733)**	(700)	(716)
Goodwill impairment	**(10,564)**	–	–
Total operating expenses	**(49,099)**	(39,042)	(33,553)

Operating profit	**7,646**	22,709	21,240
Share of profit in associates and joint ventures	**1,661**	1,503	846
Profit before tax	**9,307**	24,212	22,086
Tax expense	**(2,809)**	(3,757)	(5,215)
Profit for the year	**6,498**	20,455	16,871
Profit attributable to shareholders of the parent company	**5,728**	19,133	15,789
Profit attributable to minority interests	**770**	1,322	1,082

2008 compared with 2007

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

The fall in profit before tax was exacerbated by recognition of a US$10.6 billion impairment

charge which wrote off in full the goodwill carried on the balance sheet in respect of the Groups investment in its North America Personal Financial Services business. This non-cash charge arose substantially in the second half of 2008 as heightened risk premia in the market increased discount rates and cash flows estimated from ongoing activities fell as the US economy continued to decline and the outlook for the business deteriorated.

Asian performance was strong, generating profit

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before tax of US$11.9 billion, broadly in line with results excluding the dilution gains which arose in 2007 when HSBC did not participate in share offerings by its mainland Chinese associates. Within Asia, Global Banking and Markets results were strongly ahead, driven by foreign exchange, Rates and securities services. Balance Sheet Management revenues rose significantly from positioning ahead of interest rate cuts, and were especially strong in Europe despite losses from the defaults of certain financial sector companies.

With the exception of Personal Financial Services, which incurred significant losses in North America, all customer groups remained profitable. Commercial Banking and Private Banking delivered results broadly in line with 2007, while Global Banking and Markets profits declined.

Performance was overshadowed by a US$7.7 billion rise in loan impairment charges and other credit risk provisions, largely from the US consumer finance business, and a further US$5.4 billion in trading write-downs on illiquid legacy positions in credit trading, leveraged and acquisition finance and monoline credit exposure in Global Banking and Markets. Increases in loan impairment charges and other credit risk provisions in Personal Financial Services and Commercial Banking, the latter rising rapidly in the second half of 2008 from a low base, occurred as the global economy slowed. Global Banking and Markets also experienced a rise in loan impairment charges and other credit risk provisions as refinancing options dried up for a number of companies as the market for long-term asset financing became increasingly illiquid. The market turmoil also led to impairments on equity securities in the available-for-sale portfolio.

The following items were significant:

- the non-recurrence of US$1.1 billion of gains which arose in 2007 on the dilution of the Groups stakes in various associates;
- a US$3.9 billion increase (from US$2.8 billion in 2007 to US$6.7 billion) in fair value gains from wider credit spreads recorded predominantly on HSBCs own long-term debt designated at fair value. These gains are reported in the Other segment, are not allocated to customer groups and are not included within regulatory capital calculations;
- the gain of US$2.4 billion on the sale of the French regional banks; and
- a charge against trading income of US$984 million following the alleged fraud in December 2008 relating to Bernard L Madoff Investment Securities LLC (Madoff Securities).

On an underlying basis, profit before tax declined by 73 per cent compared with 2007. The difference between the reported and underlying results is explained on page 21. Except where stated otherwise, the commentaries in the Financial Summary are on an underlying basis.

2007 compared with 2006

The strength of HSBCs geographically diversified business model was demonstrated by profit growth in a year in which financial markets experienced significant dislocation and the credit environment, particularly in the US, deteriorated markedly. Pre-tax profits in 2007 increased by 10 per cent to US$24.2 billion and earnings per share rose by 18 per cent to US$1.65. Despite difficult market conditions, the return on shareholders equity exceeded 15 per cent, capital ratios remained strong, revenue growth was in double digits and the cost efficiency ratio improved. For the first time in recent years, pre-tax profits from the Groups emerging markets operations exceeded 60 per cent of total profits.

On an underlying basis, profit before tax was broadly in line with 2006.

The Group had a notably strong year in most emerging markets. Vigorous economic activity, strong trade flows and buoyant equity markets helped drive broadly based profit growth, with profits in all customer groups ahead of 2006. A strong performance in Asia in all customer groups compensated for the effect of deteriorating conditions in the US and slower growth in other mature markets. Commercial Banking and Private Banking again delivered record results, as did many of the businesses within Global Banking and Markets, including foreign exchange, payments and cash management, equities, HSBC Global Asset Management and securities services.

The deterioration in credit quality which began in 2006 in a particular portfolio of purchased mortgages in the US consumer finance business widened in the second half of 2007, leading to significantly increased loan impairment charges in the US as economic conditions deteriorated and global market liquidity for asset-backed securities dried up. This lack of liquidity adversely affected credit trading and asset-backed securities businesses within Global Banking and Markets, where de-leveraging of traded markets contributed to volatility and lower valuations. The effect of these factors was partially offset by a gain on HSBC□s own debt designated at fair value.

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

Group performance by income and expense item

Net interest income

	2008	2007	2006
Net interest income[1] (US$m)	**42,563**	37,795	34,486
Average interest-earning assets (US$m)	**1,466,622**	1,296,701	1,113,404
Gross interest yield[2] (per cent)	**6.23**	7.12	6.82
Net interest spread[3] (per cent)	**2.87**	2.86	2.94
Net interest margin[4] (per cent)	**2.90**	2.91	3.10

1 *Net interest income includes the cost of funding trading assets, while the related external revenues are reported in trading income. In HSBC's customer group results, the cost of funding trading assets is included with Global Banking and Markets' net trading income as an interest expense.*

2 *Gross interest yield is the average annualised interest rate earned on average interest-earning assets ('AIEA').*

3 *Net interest spread is the difference between the average annualised interest rate earned on AIEA, net of amortised premiums and loan fees, and the average annualised interest rate paid on average interest-bearing funds.*

4 *Net interest margin is net interest income expressed as an annualised percentage of AIEA.*

2008 compared with 2007

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

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

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

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

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

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

2007 compared with 2006

Reported net interest income increased by 10 per cent to US$37.8 billion, 4 per cent on an underlying basis. The increase was driven by an underlying 10 per cent rise in average interest earning assets to US$1,297 billion, partly offset by a decline in spreads as funding costs rose more than yields.

The growth in average interest earning assets was due to a 6 per cent rise in average loans and advances to customers. HSBC continued to focus on competitive liability products, with average deposits and current account balances rising by 16 per cent, driven by customer acquisition in Rest of Asia-Pacific and deposit balance growth in North America, Europe and Hong Kong.

Balance Sheet Management revenues increased compared with 2006, particularly in Hong Kong and Rest of Asia-Pacific as deposits grew strongly.

Lending spreads in 2007 reflected the continued benign corporate and commercial credit conditions that have existed in the last three or four years. However, some upward re-pricing occurred in personal lending as a result of growing delinquency and restricted credit appetite and, as market liquidity diminished in the last four months of 2007, the value and cost of funds, including the cost of funding HSBC's trading activities, rose markedly.

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Net fee income

	2008	2007	2006
	US$m	US$m	US$m
Cards	**5,844**	6,496	5,367
Account services	**4,353**	4,359	3,633
Funds under management	**2,757**	2,975	2,718
Insurance	**1,771**	1,836	1,358
Broking income	**1,738**	2,012	1,354
Credit facilities	**1,313**	1,138	922
Global custody	**1,311**	1,404	797
Imports/exports	**1,014**	866	780
Remittances	**610**	556	472
Unit trusts	**502**	875	520
Corporate finance	**381**	409	255
Underwriting	**325**	367	286
Trust income	**325**	299	248
Taxpayer financial services	**168**	252	263
Maintenance income on operating leases	**130**	139	122
Mortgage servicing	**120**	109	97
Other	**2,102**	2,245	1,888
Total fee income	**24,764**	26,337	21,080
Less: fee expense	**(4,740)**	(4,335)	(3,898)
Net fee income	**20,024**	22,002	17,182

2008 compared with 2007

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

Lower equity market-related revenues, notably in Hong Kong, were driven by weakened investor sentiment, and reflected in the fall of 17 per cent in the aggregate of broking income, global custody and unit trust income. Similarly, fund management fees declined as equity markets retreated and lower performance fees were earned.

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

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

2007 compared with 2006

Reported net fee income increased by 28 per cent to US$22 billion, 23 per cent on an underlying basis.

The rise in card fee income was mainly in the US and Mexico. Income growth in the US was driven by higher late and over-limit fees in addition to higher balances. Revenue from enhancement services on cards also increased. In Mexico, the credit card business continued to grow, both in balances and in transaction volumes.

Higher income from funds under management products, broking services, unit trusts and global custody was driven by buoyant stock markets in Hong Kong and throughout the Rest of Asia-Pacific region, enhanced by the launch of new investment schemes.

Increased account services income was due to higher levels of customer activity in Europe, North America and Latin America. In the US, growth in credit card balances triggered an increased use of the Intellicheck service. In the UK, growth in the sale of fee-based packaged accounts contributed to a rise in account services fees.

An increase in insurance fees was driven by higher life insurance commission income, boosted by new product offerings in Hong Kong.

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

Financial summary > Group performance > Net trading income / Net income from financial instruments at FV

Net trading income

	2008 US$m	2007 US$m	2006 US$m
Trading activities	**2,988**	4,521	5,465
Net interest income on trading activities	**5,713**	5,376	2,603
Other trading income hedge ineffectiveness:			
on cash flow hedges	**(40)**	(77)	(122)
on fair value hedges	**5**	19	16
Non-qualifying hedges	**(1,122)**	(5)	260
Losses on collapse of Madoff Securities	**(984)**		
Net trading income[1,2]	**6,560**	9,834	8,222

1 *The cost of internal funding of trading assets was US$5,547 million (2007: US$5,433 million; 2006: US$2,658 million) and is excluded from the reported Net trading income line and included in Net interest income. However, this cost is reinstated in Net trading income in HSBCs customer group and global business reporting.*

2 *Net trading income includes US$529 million (2007: US$34 million), associated with changes in the fair value of issued structured notes and other hybrid instrument liabilities derived from movements in HSBC issuance spreads.*

2008 compared with 2007

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

Net income from trading activities declined by 81 per cent, driven by the continuing effect of the market turmoil which led to US$5.4 billion of write-downs on legacy monoline credit exposures, credit trading and leveraged and acquisition finance loans. More information about the losses, the associated assets and residual exposure is provided in Impact of Market Turmoil on pages 144 to 162.

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

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

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

The units had been acquired in connection with various financing transactions HSBC had entered into with institutional clients.

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

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

2007 compared with 2006

Reported net trading income increased by 20 per cent to US$9.8 billion, 13 per cent on an underlying basis.

Net interest income on trading activities more than doubled, mainly due to increased holdings of shorter maturity assets in the UK.

Net trading income was significantly affected by a total of US$2.1 billion of write-downs on credit trading, leveraged and acquisition financing positions, and monoline credit exposures, resulting from deterioration in the credit market in the second half of 2007. The write-downs arose mainly in the US and, to a lesser extent, the UK.

Income from foreign exchange trading increased by 40 per cent to a record result. Revenues were driven by higher customer volumes, against the backdrop of a weakening US dollar and greater market volatility.

Trading income from structured derivatives fell by 26 per cent. The structured credit business incurred losses in the second half of the year in the difficult trading conditions. This was partly offset by higher trading income from other structured derivative products, following investment made in technical expertise and systems in previous years.

Record results were achieved in the equities business, reflecting strong growth across all regions, particularly Europe.

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Net income from financial instruments designated at fair value

	2008	2007	2006
	US$m	US$m	US$m
Net income arising from:			
financial assets held to meet liabilities under insurance and investment contracts	**(5,064)**	2,056	1,552
liabilities to customers under investment contracts	**1,751**	(940)	(1,008)
HSBCs long-term debt issued and related derivatives	**6,679**	2,812	(35)
change in own credit spread on long-term debt	**6,570**	3,055	(388)
other changes in fair value[1]	**109**	(243)	353
other instruments designated at fair value and related derivatives	**486**	155	148
Net income from financial instruments designated at fair value	**3,852**	4,083	657
Financial assets designated at fair value at 31 December	**28,533**	41,564	20,573
Financial liabilities designated at fair value at 31 December	**74,587**	89,939	70,211

1 *Includes gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with HSBCs long-term debt issued.*

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

HSBC principally uses the fair value designation in the following instances:

- for certain fixed-rate long-term debt issues whose rate profile has been changed to floating through interest rate swaps as part of a documented interest rate management strategy.
  Approximately US$59 billion (2007: US$66 billion) of the Groups debt issues have been accounted for using the fair value option.

  The movement in fair value of these debt issues includes the effect of own credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. As credit spreads widen or narrow, accounting profits or losses are booked, respectively. The size and direction of the accounting consequences of changes in own credit spread and ineffectiveness can be volatile from year to year, but do not alter the cash flows envisaged as part of the documented interest rate management strategy; as a consequence of this, gains and losses arising from changes in own credit spread on long-term debt are not regarded internally as part of managerial performance. Similarly, such gains and losses are ignored in the calculation of regulatory capital.
- for approximately US$11 billion (2007: US$17 billion) of financial assets held to meet liabilities under insurance contracts, and certain liabilities under investment contracts with discretionary participation features; and

- for approximately US$7 billion (2007: US$14 billion) of financial assets held to meet liabilities under unit-linked and other investment contracts.

2008 compared with 2007

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

Credit spreads widened significantly during the year, leading to US$6.6 billion of positive fair value movements on certain long-term debt issued by the Group, compared with US$3.1 billion in 2007. These fair value movements will fully reverse over the life of the debt. The cumulative fair value adjustment at 31 December 2008 amounted to US$8.0 billion.

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

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

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

2007 compared with 2006

Credit spreads widened significantly in the second half of 2007, leading to a substantial increase in net income from financial instruments designated at fair value compared with 2006. This was primarily driven by a widening in credit spreads on certain fixed-rate long-term debt issued by HSBC Holdings

and its subsidiaries. These cumulative gains will fully reverse over the life of the debt. The cumulative adjustments to reserves (when the policy is applied for the first time) and the income statement (subsequent applications of the policy), reflecting the change in own credit spread since the fair value option was available, was US$1.6 billion after taking into account the US$3.1 billion credit in 2007.

Income from assets held to meet liabilities under insurance and investment contracts also rose, by 32 per cent, reflecting primarily premium growth and higher investment returns on the portfolios held by the insurance businesses in the UK and Hong Kong. The change in fair value of liabilities under investment contracts declined by 7 per cent.

Gains less losses from financial investments

	2008 US$m	2007 US$m	2006 US$m
Net gain from disposal of:			
– debt securities	**19**	120	252
– equity securities	**1,216**	1,864	702
– other financial investments	**4**	14	15
	1,239	1,998	969
Impairment of available-for-sale equity securities	**(1,042)**	(42)	–
Gains less losses from financial investments	**197**	1,956	969

2008 compared 2007

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

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

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

2007 compared with 2006

Net gains of US$2.0 billion were reported by HSBC as a result of the disposal of financial investments during 2007, a two-fold increase over 2006 and 93 per cent higher on an underlying basis.

The increase was driven by the sale of shares and various equity investments in all regions, including holdings in Euronext (the European stock exchange), MasterCard in North America and a credit bureau in Brazil. In Private Banking, a gain of US$91 million arose from the sale of a further holding in the Hermitage Fund, compared with US$117 million in 2006. The gains in 2007 were marginally offset by the non-recurrence of a US$101 million gain on the sale of part of HSBCs stake in UTI Bank Limited in 2006.

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Gains arising from dilution of interests in associates

In 2007, HSBCs associates, Industrial Bank, Ping An Insurance and Bank of Communications in mainland China, Financiera Independencia in Mexico and Techcombank in Vietnam issued new shares for which HSBC did not subscribe. As a

Net earned insurance premiums

consequence of the new monies raised by the associates, HSBCs share of their underlying assets increased by US$1.1 billion, notwithstanding the reduction in the Groups interests. These gains were presented in the income statement as Gains arising from dilution of interests in associates, and should be regarded as exceptional.

	2008	2007	2006
	US$m	US$m	US$m
Gross insurance premium income	**12,547**	11,001	6,455
Reinsurance premiums	**(1,697)**	(1,925)	(787)
Net earned insurance premiums	**10,850**	9,076	5,668

2008 compared with 2007

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

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

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

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

2007 compared with 2006

Reported net earned insurance premiums of US$9.1 billion were 60 per cent higher than in 2006, boosted by HSBCs acquisition in the first half of 2007 of the remaining shares in HSBC Assurances in France and the purchase of HSBC Bank Panama in Central America in late 2006. Underlying net insurance premiums grew by 21 per cent.

Growth in net earned insurance premiums was achieved in all regions except North America, primarily from new business growth in the life insurance business in Europe, Hong Kong and Latin America. An increase in net earned premiums was recorded in the UK due to higher sales of Guaranteed Income Bonds and the introduction of enhanced death benefits to pension contracts. New product launches also aided growth in Hong Kong. In Latin America, higher premiums in Brazil were driven by increased sales of pension products with linked-life policies.

In non-life insurance, the UK benefited from a decision to reduce the proportion of risk and corresponding premiums ceded to reinsurers compared with 2006. The Latin American business also performed well, led by growth in motor premiums in Argentina. However, results in North America declined, as a reduction in loan volumes led to a fall in credit insurance sales and HSBC stopped reinsuring credit insurance for other lenders.

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Other operating income

	2008	2007	2006
	US$m	US$m	US$m
Rent received	**606**	630	687
Gains/(losses) recognised on assets held for sale	**(130)**	5	28
Valuation gains/(losses) on investment properties	**(92)**	152	164
Gain on disposal of property, plant and equipment, intangible assets and non-financial investments	**465**	213	781
Change in present value of in-force long-term insurance business	**286**	(145)	40
Gain on repurchase of 8 Canada Square	**416**		
Other	**257**	584	846
Other operating income	**1,808**	1,439	2,546

2008 compared with 2007

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

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

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

During 2008, HSBC recognised a gain of US$416 million in respect of the purchase of the subsidiary of Metrovacesa which owned the property and long leasehold comprising 8 Canada Square, London. See Note 23 on the Financial Statements.

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

2007 compared with 2006

Reported other operating income of US$1.4 billion was 43 per cent lower than in 2006, 51 per cent lower on an underlying basis.

Significant decreases in gain on disposal of property and other income were driven by lower proceeds from the sale of real estate in the declining US property market. This was compounded by the non-recurrence of income earned on asset disposals in 2006, including the sale of the former head office building of Hang Seng Bank in Hong Kong and properties in Japan and India, and the transfer of the credit card acquiring business into a joint venture with Global Payments Inc. A gain on the sale and leaseback of a London building in 2007 and the non-recurrence of a loss on sale on asset disposals in 2006 partially offset these factors.

Although HSBC sold its Canary Wharf headquarters building at 8 Canada Square in 2007, the gain remained unrecognised as the Group continued to provide bridge finance for the debt portion of the transaction.

PVIF business declined, primarily due to a change in the calculation methodology employed in the UK as HSBC implemented regulatory changes to the rules governing the calculation of insurance liabilities. This had a marginally positive effect on profit as there was a corresponding reduction in policyholder liabilities. Income rose in Mexico due to a refinement of the income recognition methodology in respect of long-term insurance contracts.

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Net insurance claims incurred and movement in liabilities to policyholders

	2008	2007	2006
	US$m	US$m	US$m
Insurance claims incurred and movement in liabilities to policyholders:			
gross	**9,206**	9,550	5,072
reinsurers share	**(2,317)**	(942)	(368)
net[1]	**6,889**	8,608	4,704

1 *Net insurance claims incurred and movement in liabilities to policyholders arise from both life and non-life insurance business. For non-life business, amounts reported represent the cost of claims paid during the year and the estimated cost of notified claims. For life business, the main element of claims is the liability to policyholders created on the initial underwriting of the policy and any subsequent movement in the liability that arises, primarily from the attribution of investment performance to savings-related policies. Consequently, claims rise in line with increases in sales of savings-related business and with investment market growth.*

2008 compared with 2007

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

The reduction in net insurance claims incurred and movement in liabilities to policyholders primarily reflected the impact of markedly weaker investment markets worldwide. This led to a reduction in liabilities to policyholders on unit-linked and, to a certain extent, participating policies where policyholders participate in the investment performance of the assets supporting the liabilities. As noted above, the losses experienced on the assets held to support insurance contract liabilities are reported in Net income from financial instruments designated at fair value.

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

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

2007 compared with 2006

Reported net insurance claims incurred and movement in liabilities to policyholders of US$8.6 billion were 83 per cent higher than in 2006 following the acquisition of the remaining shares in HSBC Assurances in France in March 2007 and HSBC Bank Panama in late 2006. The increase was 32 per cent on an underlying basis.

Growth in net insurance claims incurred and movement in liabilities to policyholders was largely driven by the life insurance business. This reflected a combination of business growth, and was in line with higher net earned insurance premiums and, where policyholders participate in the investment performance of the assets supporting the liabilities, higher investment returns on unit-linked and participating policies. This was most notable in Hong Kong, the UK and Brazil. There was an offsetting increase in Net income from financial instruments designated at fair value which reflected these investment returns. In addition, FSA rule changes in the UK led to a lower valuation of the liabilities to policyholders on life policies.

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Loan impairment charges and other credit risk provisions

	2008	2007	2006
	US$m	US$m	US$m
Loan impairment charges			
New allowances net of allowance releases	**24,965**	18,182	11,326
Recoveries of amounts previously written off	**(834)**	(1,005)	(779)
	24,131	17,177	10,547
Individually assessed allowances	**2,064**	796	458
Collectively assessed allowances	**22,067**	16,381	10,089
Impairment of available-for-sale debt securities	**737**	44	21
Other credit risk provisions	**69**	21	5
Loan impairment charges and other credit risk provisions	**24,937**	17,242	10,573
	%	%	%
As a percentage of net operating income before loan impairment charges and other credit risk provisions	**30.5**	21.8	16.2
Impairment charges on loans and advances to customers as a percentage of gross average loans and advances to customers	**2.5**	2.0	1.4
	US$m	US$m	US$m
Customer impaired loans	**25,352**	19,582	15,071
Customer loan impairment allowances	**23,909**	19,205	13,578

2008 compared with 2007

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

A deterioration in credit quality was experienced across all customer groups and geographical regions as the global economy slowed. The rise in Group loan impairment charges and other credit risk provisions also reflected an underlying 8 per cent increase in lending to customers (excluding the financial sector and settlement accounts).

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

In the US consumer lending portfolio, loan impairment charges rose as delinquency rates deteriorated sharply and the economy declined markedly in the second half of 2008, most notably in the first lien portfolio. This was particularly apparent in the geographical regions most affected by house price depreciation and rising unemployment rates. In mortgage services, loan impairment charges rose as 2005 and 2006 vintages matured and moved into the later stages of delinquency. This was partly offset by the benefit of lower balances as run-off continued, albeit at a slowing pace as house price depreciation restricted refinancing options for customers. In HSBC USA, loan impairment charges rose as credit quality worsened across the real estate secured portfolio and private label cards. Delinquencies rose

in the prime first lien residential mortgage portfolio, Home Equity Line of Credit and Home Equity Loan second lien portfolios. The higher delinquency rate for prime first lien mortgages was in part due to lower balances following US$7.0 billion of portfolio sales during the year.

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

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

In the UK, a modest decline in loan impairment charges in Personal Financial Services reflected the non-recurrence of a methodology change at HFC in 2007 which resulted in higher impairment charges. Credit quality in the Personal Financial Services portfolio remained broadly stable, reflecting early risk mitigation through the tightening of lending controls and the sale of non-core credit card portfolios during the year. Credit quality in the unsecured portfolios deteriorated slightly in 2008, particularly in the second half of the year, due to the weakening UK economy. Loan impairment charges in the commercial portfolio rose in 2008 as the

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weakening property market led to higher impairment charges against construction companies and businesses dependent upon the real estate sector, particularly in the final quarter of the year. Impairment charges against banks rose due to some exposure to the Icelandic banks in 2008. In addition, rising levels of personal indebtedness resulted in lower releases and recoveries of charges than in 2007.

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

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

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

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

For the Group as a whole, the aggregate outstanding customer loan impairment allowances at 31 December 2008 of US$23.9 billion represented 2.6 per cent of gross customer advances (net of reverse repos and settlement accounts), compared with 2.0 per cent at the end of 2007.

2007 compared with 2006

Reported loan impairment charges and other credit risk provisions were US$17.2 billion, a 63 per cent increase over 2006.

Loan impairment charges increased by 58 per cent, reflecting substantially higher losses in the US consumer finance loan book, primarily in mortgage lending, but also in the credit cards portfolio in the final part of the year. US delinquency rates increased during 2007 as falling house prices constrained customers' ability to refinance their loans.

The rise in Group charges also reflected an underlying 7 per cent increase in lending to customers (excluding lending to the financial sector and settlement accounts).

In North America, loan impairment charges increased by 79 per cent to US$12.2 billion. The main factor driving this deterioration was the impact of the weaker housing market on both economic activity and the ability of borrowers to extend or refinance debt. In addition, seasoning and mix change within the credit cards portfolio, and increases in bankruptcy filings after the exceptionally low levels seen in 2006 following changes in legislation, added to loan impairment charges.

The real estate secured portfolios experienced continuing deterioration in credit quality as a lack of demand for securitised sub-prime mortgages and falls in house prices severely restricted refinancing options for many customers. Loan impairment charges rose by 41 per cent to US$3.1 billion and by 139 per cent to US$4.1 billion in the mortgage services business and in consumer lending, respectively. Delinquency rates exceeded recent historical trends, particularly for those loans originated in 2005 and 2006. Performance was weakest in housing markets which had previously experienced the steepest home price appreciation, as well as in second lien products and stated income products.

US card services experienced an increase in loan impairment charges from a combination of growth in balances, higher losses in the final part of the year as the economy slowed, a rise in bankruptcy rates to near historical levels, and a shift in portfolio mix to higher levels of non-prime loans.

In the UK, loan impairment charges rose, primarily in the consumer finance business. Delinquency rates on mortgages in the UK offered through HSBC Finance remained stable throughout 2007, with delinquency rates for loans offered in 2006 and 2007 lower than in the preceding two

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years. In the rest of the UK business, loan impairment charges in the second half of 2007 were lower than in the first half of the year, as overall credit quality improved following measures taken to tighten underwriting standards and improve the credit quality of new business. Although losses from mortgage lending remained low, maximum loan to value ratios were reduced during the year to mitigate the effects of a possible housing market downturn.

In Mexico, higher loan impairment charges were driven by strong growth in loan balances, a deterioration in credit quality and portfolio seasoning.

For the Group as a whole, the aggregate outstanding customer loan impairment allowances at 31 December 2007 of US$19.2 billion represented 2.0 per cent of gross customer advances (net of reverse repos and settlement accounts), compared with 1.6 per cent at the end of 2006.

Impaired loans to customers were US$18.3 billion at 31 December 2007 compared with US$13.8 billion at 31 December 2006. On a constant currency basis, impaired loans to customers were 28 per cent higher than in 2006 compared with customer lending growth (excluding loans to the financial sector and settlement accounts) of 7 per cent.

Operating expenses

	2008 US$m	2007 US$m	2006 US$m
By expense category			
Employee compensation and benefits[1]	**20,792**	21,334	18,500
Premises and equipment (excluding depreciation and impairment)	**4,305**	3,966	3,389
General and administrative expenses	**10,955**	11,328	9,434
Administrative expenses	**36,052**	36,628	31,323
Depreciation and impairment of property, plant and equipment	**1,750**	1,714	1,514
Amortisation and impairment of intangible assets	**733**	700	716
Goodwill impairment	**10,564**	–	–
Total operating expenses	**49,099**	39,042	33,553

	At 31 December		
	2008	2007	2006
Staff numbers (full-time equivalent)			
Europe	**82,093**	82,166	78,311

Hong Kong	**29,330**	27,655	27,586
Rest of Asia-Pacific	**98,159**	88,573	72,265
North America	**44,725**	52,722	55,642
Latin America	**58,559**	64,404	64,900
Total staff numbers	**312,866**	315,520	298,704

1 *A charge of US$135 million was realised in 2006 arising from the waiver of the TSR-related performance condition in respect of the 2003 awards under the HSBC Holdings Group Share Option Plan.*

2008 compared with 2007

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

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

headcount to support business expansion, mainly in Asia. Restructuring costs were incurred primarily in Latin America and Europe.

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

General and administrative expenses decreased, primarily due to a one-off recovery of US$110 million of previous years transactional taxes in Brazil and the non-recurrence of a number of one-off items in 2007, most notably (i) ex-gratia payments made in the UK in respect of overdraft

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fees, (ii) the provision for reimbursement of certain charges on historic will trusts and other related services in the UK, (iii) the indemnification agreement with Visa ahead of Visas IPO, and (iv) restructuring charges in the US consumer finance business incurred in 2007. These were partly offset by an increase in the Financial Services compensation scheme levy in the UK and an increase in a litigation provision in Asia.

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

2007 compared with 2006

Reported operating expenses increased by US$5.5 billion to US$39.0 billion. On an underlying basis, cost growth was 10 per cent.

Employee compensation and benefits rose due to increased headcount employed to support business expansion in Rest of Asia-Pacific and Europe and higher salaries and bonuses. Salary increases reflected inflationary pressures and performance as bonuses rose in response to revenue growth. A change in actuarial assumptions regarding the staff defined benefit pension scheme in the UK led to increased costs. Staff numbers in North America fell as the consumer finance business was restructured, resulting in the discontinuation of certain business channels in mortgage services and the closing of branch offices in consumer lending.

Premises and equipment costs increased on investments in technology, straight-through

processing and extending and improving the branch and ATM networks. In particular, there was investment in the distribution platform in Latin America, Middle East, India and mainland China. The retail bank branch network in North America was extended both within and beyond the Groups traditional spheres of operation to support the expansion of retail and Commercial Banking businesses, increasing premises and equipment costs as a consequence. Commercial property rental costs rose in Hong Kongs dynamic economy, the effect magnified by a sale and leaseback agreement on a headquarters building in 2006. In France, the IT systems inherited with the acquisition of HSBC France were replaced with HSBCs universal banking platform.

General and administrative expenses rose in support of the business expansion and a number of one-off costs. Higher transaction volumes drove processing costs and transactional taxes while business expansion was supported by marketing expenditure. In the UK, ex-gratia payments of US$227 million were expensed in respect of overdraft fees applied in previous years and a provision of US$169 million was raised for reimbursement of certain charges on historic will trusts and other related services. In the US, the business incurred US$70 million of one-off costs arising from the indemnification agreement with Visa ahead of its planned IPO. The US consumer finance business incurred restructuring charges of US$103 million resulting from the discontinuation of the wholesale and correspondent channels in mortgage services and the closing of branch offices in consumer lending.

Cost efficiency ratios

	2008	2007	2006
	%	%	%
HSBC	**60.1**	49.4	51.3
Personal Financial Services	**76.4**	50.3	49.7
Europe	**62.7**	64.8	59.2
Hong Kong	**32.2**	27.2	32.2

Rest of Asia-Pacific	**73.5**	73.9	71.1
North America	**106.8**	42.3	42.3
Latin America	**59.7**	61.3	65.6
Commercial Banking	**43.0**	44.8	43.7
Europe	**44.2**	49.3	46.7
Hong Kong	**26.2**	24.9	26.1
Rest of Asia-Pacific	**41.0**	42.9	42.5
North America	**46.1**	45.1	44.9
Latin America	**55.0**	54.3	55.9

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Share of profit in associates and joint ventures

	2008	2007	2006
	US$m	US$m	US$m
Bank of Communications	**741**	445	259
Ping An Insurance	**324**	518	245
Industrial Bank	**221**	128	71
The Saudi British Bank	**251**	216	258
Other	**63**	159	(10)
Share of profit in:			
associates	**1,600**	1,466	823
joint ventures	**61**	37	23
Share of profit in associates and joint ventures	**1,661**	1,503	846

2008 compared with 2007

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

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

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

HSBCs share of profits from Ping An Insurance decreased by 43 per cent, primarily due to the impairment of Ping An Insurances investment in Fortis SA/NV and Fortis N.V. (Fortis Investments), following significant declines in its market value.

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

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

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

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

2007 compared with 2006

Share of profit in associates and joint ventures of US$1.5 billion was 78 per cent higher than in 2006, on both reported and underlying bases.

Profit from associates and joint ventures rose due to increased contributions from HSBCs strategic investments in mainland China. Profit from Bank of Communications, Ping An Insurance and Industrial Bank improved significantly, driven largely by the thriving local economy.

HSBCs share of profit from Ping An Insurance rose by 101 per cent to US$518 million as a result of robust growth, notably from life insurance products, and the realisation of synergistic gains across Ping An Insurances other business offerings.

Profit from the Bank of Communications rose by 64 per cent to US$445 million as a result of improved performance across the associates various product offerings. Increased income from credit and treasury products and significant growth in fee income contributed to the increase in profits.

HSBCs share of profits from the Saudi British Bank decreased by 22 per cent to US$216 million, driven by the effects of a significant correction to the local stock market in the second half of 2006.

A US$73 million adjustment to the embedded value of HSBC Assurances, an associate in France, resulted in an increase in profits from associates.

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Economic profit

HSBCs internal performance measures include economic profit, a calculation which compares the return on financial capital invested in HSBC by its shareholders with the cost of that capital. HSBC prices its cost of capital internally and the difference between that cost and the post-tax profit attributable to ordinary shareholders (less goodwill previously amortised in respect of the French regional banks sold in 2008) represents the amount of economic profit generated. Economic profit generated is used by management as a means of deciding where to allocate resources so that they will be most productive.

In order to concentrate on external factors rather than measurement bases, HSBC emphasises the trend in economic profit ahead of absolute amounts within business units. In order to ensure consistency and comparability with the five-year strategic plan completed in 2008, the cost of capital on a consolidated basis remains at 10 per cent.

Economic profit decreased by US$14.8 billion to a loss of US$8.2 billion. Profit attributable fell, while average shareholders equity increased marginally. The decline in profit was predominately driven by the US$10.6 billion goodwill impairment charge relating to the North American Personal Financial Services business, alongside a significant increase in loan impairment charges and write-downs in credit trading, leveraged and acquisition finance, and monoline exposures. The comparative period included dilution gains of US$1.0 billion (excluding minority interests) which were not repeated. These effects were partially offset by fair value gains on own debt, driven by a widening of credit spreads, of US$6.6 billion compared with US$3.1 billion in 2007. The lower return on average invested capital led to a decrease in economic profit and an erosion in economic spread, which fell by 11.3 percentage points compared with 2007. Excluding the goodwill impairment charge, the economic profit spread decreased by 3.6 percentage points compared with 2007.

	2008		2007	
	US$m	**%**[1]	US$m	%[1]
Average total shareholders equity	**122,292**		120,346	
Adjusted by:				
Goodwill previously amortised or written off	**8,152**		8,172	
Property revaluation reserves	**(828)**		(898)	
Reserves representing unrealised losses on effective cash flow hedges	**997**		425	
Reserves representing unrealised (gains)/losses on available-for-sale securities	**9,163**		(1,918)	
Preference shares and other equity instruments	**(2,685)**		(1,405)	
Average invested capital[2]	**137,091**		124,722	
Return on invested capital[3]	**5,497**	**4.0**	19,043	15.3
Benchmark cost of capital	**(13,709)**	**(10.0)**	(12,472)	(10.0)
Economic profit/(loss) and spread	**(8,212)**	**(6.0)**	6,571	5.3

1 *Expressed as a percentage of average invested capital.*
2 *Average invested capital is measured as average total shareholders equity after:*
 adding back the average balance of goodwill amortised pre-transition to IFRSs or subsequently written-off, directly to reserves (less goodwill previously amortised in respect of the French regional banks sold in 2008);

- *deducting the average balance of HSBC's revaluation surplus relating to property held for own use. This reserve was generated when determining the deemed carrying cost of such properties on transition to IFRSs and will run down over time as the properties are sold;*
- *deducting average preference shares and other equity instruments issued by HSBC Holdings, and;*
- *deducting average reserves for unrealised gains/(losses) on effective cash flow hedges and available-for-sale securities.*

3 *Return on invested capital is based on the profit attributable to ordinary shareholders of the parent company less goodwill previously amortised in respect of the French regional banks sold in 2008.*

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Balance sheet

	At 31 December		
	2008 US$m	2007 US$m	2006 US$m
ASSETS			
Cash and balances at central banks	**52,396**	21,765	12,732
Trading assets	**427,329**	445,968	328,147
Financial assets designated at fair value	**28,533**	41,564	20,573
Derivatives	**494,876**	187,854	103,702
Loans and advances to banks	**153,766**	237,366	185,205
Loans and advances to customers	**932,868**	981,548	868,133
Financial investments	**300,235**	283,000	204,806
Other assets	**137,462**	155,201	137,460
Total assets	**2,527,465**	2,354,266	1,860,758
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	**130,084**	132,181	99,694
Customer accounts	**1,115,327**	1,096,140	896,834
Trading liabilities	**247,652**	314,580	226,608
Financial liabilities designated at fair value	**74,587**	89,939	70,211
Derivatives	**487,060**	183,393	101,478
Debt securities in issue	**179,693**	246,579	230,325
Liabilities under insurance contracts	**43,683**	42,606	17,670
Other liabilities	**149,150**	113,432	103,010
Total liabilities	**2,427,236**	2,218,850	1,745,830
Equity			
Total shareholders equity	**93,591**	128,160	108,352
Minority interests	**6,638**	7,256	6,576
Total equity	**100,229**	135,416	114,928
Total equity and liabilities	**2,527,465**	2,354,266	1,860,758

A more detailed consolidated balance sheet is contained in the Financial Statements on page 334.

Movement from 31 December 2007 to 31 December 2008

Total assets amounted to US$2.5 trillion, 7 per cent higher than at 31 December 2007. After excluding currency movements, the disposal of HSBC's French regional subsidiaries and the acquisition of the assets, liabilities and operations of The Chinese Bank in 2008, underlying assets rose by 22 per cent, driven by growth in derivative assets.

The expansion in the Group's balance sheet was largely attributable to increases in derivative assets and liabilities, and was due to growth in the fair value of these positions rather than a rise in their notional contract amounts. Excluding the growth in derivative liabilities, customer accounts formed an increasing share of the Group's liabilities as depositors and savers responded to HSBC's reputation for strength and security. As a result, a proportion of the Group's funding repayable on demand or within one year rose. For information on the Group's management of liquidity, see pages 235 to 240.

The Group's tier 1 capital ratio declined from 9.3 per cent to 8.3 per cent. For detail on regulatory capital and risk weighted assets, see pages 274 to 280.

The following commentary is on an underlying basis.

Assets

The Group's cash and balances at central banks rose substantially, particularly in Hong Kong as additional liquidity was injected into the banking system, and in the US where excess liquidity was required in the short-term as part of a planned transfer of assets between the Group's subsidiaries.

Trading assets increased by 11 per cent. The majority of the rise occurred on 30 September 2008, following the Group's consolidation of five Constant Net Asset Value ('CNAV') funds with assets of around US$40 billion. The decision to consolidate these funds was based on actions taken to support them. For further details of these actions, see page 180. The rise was partly offset by the reclassification of US$18 billion of trading assets

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partly to Loans and Advances and partly to Financial investments following the changes to International Accounting Standard 39   Financial Instruments Recognition and Measurement (IAS39) issued in October 2008 by the IASB.

Excluding these effects, trading assets remained broadly unchanged as rises in Europe and Asia, where the Group increased its holdings of government bonds, were offset by the run-off of the mortgage-backed securities portfolio in the US and a reduction in debt securities held for balance sheet management purposes due to changes in liquidity and risk preference.

An 18 per cent decline in *financial assets designated at fair value* was driven by falling equity markets, which reduced the value of assets held to meet life insurance liabilities, particularly in Hong Kong and France. To the extent that these liabilities related to unit-linked and participating insurance contracts, there was a corresponding decline in *liabilities under insurance contracts*. The underperformance of certain investment products also led clients to withdraw funds.

Derivative assets rose significantly, led by an increase in interest rate derivatives with further growth in credit and foreign exchange derivatives. The global falls in interest rates resulted in significant gaps between the fixed and floating legs of interest rate swaps, leading to substantial mark-to-market increases in the value of interest rate swap positions. Widening credit spreads and increasing market volatility caused mark-to-market increases in the value of credit derivatives held in the UK and the US. Foreign exchange derivative asset growth was driven by a combination of increased volumes and mark-to-market rises in existing positions in the UK. Under IFRS, only limited netting is allowed between derivative assets and liabilities with the same counterparty, and the balance sheet value is therefore significantly higher than the credit exposure. For information on maximum exposure to credit risk, see pages 197 to 200.

A 29 per cent decline in *loans and advances to banks* occurred mainly in Hong Kong and the UK where Balance Sheet Management invested a greater proportion of its assets in government and government-guaranteed debt.

HSBC also reduced counterparty credit risk in the UK by channelling an increasing proportion of lending to banks through the London Clearing House in the form of reverse repos. This is recorded within customer loans even when the end counterparty is a bank, which means the fall in *loans and advances to banks* and the rise in *loans and advances to customers* are magnified. The rise in loans and advances to customers was also inflated by the reclassification of US$15 billion of assets following changes to IAS39 isused in October 2008.

Further increases in *loans and advances to customers* were due to growth in mortgage lending in Europe and Asia, as well as to a rise in overdraft balances to customers whose exposures are managed net but reported gross under IFRS. These rises were offset by a reduction in customer lending in the US due to the run-off of the mortgage services portfolio, the sale of certain loan portfolios at HSBC USA, tighter underwriting criteria which restricted originations in the consumer lending and credit card portfolios, and the cessation of most new originations in the US vehicle finance portfolio.

Financial investments grew by 15 per cent as Balance Sheet Management assets were increasingly classified as available-for-sale financial investments rather than trading assets. As noted above, there was also a rise in financial investments in the UK as the Group placed a greater proportion of surplus funds in government issued or guaranteed debt. The growth in the Groups financial investments was partly offset by a reduction in holdings of asset-backed securities, including those held through special purpose entities, which decreased due to a combination of asset sales, amortisation and write-downs. For details of the Groups asset-backed securities portfolios, see pages 145 to 158.

Liabilities

Deposits by banks rose by 14 per cent, driven, in particular, by increases in France, due to a rise in repo activity to finance increased trading activity, and in Hong Kong, where banks responded to HSBCs reputation for strength and security and deposited their surplus liquidity with the Group.

Customer account balances grew by 16 per cent, driven by strong inflows from customers attracted by HSBCs relative financial strength as they withdrew funds from more volatile investments.

Trading liabilities declined 9 per cent as a fall in third-party funding requirements allowed a reduction in liabilities in Hong Kong, and repo transactions were reduced in Europe to manage liquidity and counterparty credit risk.

A significant widening of credit spreads led to further falls in the fair value of the Groups own debt which reduced *financial liabilities designated at fair value*. This was compounded by a decline in liabilities in the UK due to the underperformance of certain investment products.

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

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

A decline of 22 per cent in *debt securities in issue* was driven by the US as maturing debt securities did not need replacing as the funding requirements of the consumer finance business declined as its balance sheet contracted. There was also a reduction in debt securities in issue in line with the decrease in holdings of asset-backed securities.

Liabilities under insurance contracts increased by 10 per cent, largely due to new business sales in Hong Kong, France and the UK, partly offset by reduced liabilities on unit-linked policies.

Other liabilities rose by 50 per cent due to the consolidation of the CNAV funds described above.

Equity

Total shareholders equity declined by 19 per cent, which mainly arose from a decline in the available-for-sale reserve. The continuing market turmoil led to falls in the market values of assets held in HSBCs available-for-sale portfolio. These declines mainly represented market illiquidity rather than impairment of the assets concerned, but they nonetheless reduced the value of the available-for-sale reserve from a positive reserve of US$0.9 billion to a negative reserve of US$20.6 billion.

Average balance sheet and net interest income

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

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

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

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

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Assets

		2008			2007			2006		
Summary		**Average balance US$m**	**Interest income US$m**	**Yield %**	Average balance US$m	Interest income US$m	Yield %	Average balance US$m	Interest income US$m	Yield %
Total interest-earning assets (itemised below)		**1,466,622**	**91,301**	**6.23**	1,296,701	92,359	7.12	1,113,404	75,879	6.82
Trading assets[7]		**428,539**	**16,742**	**3.91**	374,973	17,562	4.68	288,605	12,445	4.31
Financial assets designated at fair value[8]		**37,303**	**1,108**	**2.97**	14,899	813	5.46	7,681	290	3.78
Impairment provisions		**(20,360)**			(15,309)			(11,864)		
Non-interest-earning assets		**596,885**			440,686			291,741		
Total assets and interest income		**2,508,989**	**109,151**	**4.35**	2,111,950	110,734	5.24	1,689,567	88,614	5.24
Short-term funds and loans and advances to banks										
Europe	HSBC Bank	**46,703**	**2,187**	**4.68**	49,910	2,592	5.19	33,856	1,536	4.54
	HSBC Private Banking Holdings (Suisse)	**8,040**	**333**	**4.14**	5,295	229	4.32	4,956	190	3.83
	HSBC France	**35,801**	**1,495**	**4.18**	31,591	1,294	4.10	20,197	690	3.42
Hong Kong	Hang Seng Bank	**17,402**	**587**	**3.37**	13,054	609	4.67	10,360	483	4.66
	The Hongkong and Shanghai Banking Corporation	**47,244**	**1,344**	**2.84**	50,210	2,352	4.68	38,802	1,645	4.24
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**27,907**	**881**	**3.16**	19,286	810	4.20	13,388	520	3.88
	HSBC Bank Malaysia	**4,659**	**165**	**3.54**	2,861	103	3.60	2,492	87	3.49
	HSBC Bank Middle East	**6,028**	**188**	**3.12**	6,328	324	5.12	4,279	208	4.86
North America	HSBC Bank USA	**9,595**	**328**	**3.42**	9,393	477	5.08	8,422	465	5.52
	HSBC Bank Canada	**3,354**	**107**	**3.19**	3,810	174	4.57	3,167	138	4.36
Latin America	HSBC Mexico	**3,682**	**247**	**6.71**	3,555	239	6.72	3,395	227	6.69
	Brazilian operations[9]	**7,959**	**951**	**11.95**	5,790	645	11.14	4,129	572	13.85

	HSBC Bank Panama	**1,133**	**30**	**2.65**	897	33	3.68	130	9	6.92
	HSBC Bank Argentina	**612**	**43**	**7.03**	304	16	5.26	196	8	4.08
Other operations		**19,992**	**760**	**3.80**	19,087	898	4.70	16,686	618	3.70
		240,111	**9,646**	**4.02**	221,371	10,795	4.88	164,455	7,396	4.50

For footnotes, see page 143.

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Financial summary > Balance sheet > Average balance sheet and NII

Assets (continued)

		2008			2007			2006		
		Average balance US$m	**Interest income US$m**	**Yield %**	Average balance US$m	Interest income US$m	Yield %	Average balance US$m	Interest income US$m	Yield %
Loans and advances to customers										
Europe	HSBC Bank	**288,214**	**18,587**	**6.45**	237,231	18,078	7.62	226,528	14,166	6.25
	HSBC Private Banking Holdings (Suisse)	**12,355**	**494**	**4.00**	9,805	507	5.17	7,134	338	4.74
	HSBC France	**73,455**	**3,604**	**4.91**	68,027	3,219	4.73	52,990	2,463	4.65
	HSBC Finance	**4,808**	**505**	**10.50**	5,492	611	11.13	5,932	671	11.31
Hong Kong	Hang Seng Bank	**42,304**	**1,589**	**3.76**	37,827	2,120	5.60	34,416	1,952	5.67
	The Hongkong and Shanghai Banking Corporation	**54,628**	**2,291**	**4.19**	48,134	2,901	6.03	47,292	2,843	6.01
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**77,741**	**5,163**	**6.64**	59,286	4,321	7.29	52,159	3,449	6.61
	HSBC Bank Malaysia	**8,407**	**553**	**6.58**	7,467	507	6.79	6,292	430	6.83
	HSBC Bank Middle East	**23,697**	**1,549**	**6.54**	15,125	1,200	7.93	12,757	957	7.50
North America	HSBC Bank USA	**93,088**	**5,758**	**6.19**	90,091	6,585	7.31	88,563	6,141	6.93
	HSBC Finance	**140,957**	**15,835**	**11.23**	153,658	18,086	11.77	147,336	17,061	11.58
	HSBC Bank Canada	**48,331**	**2,455**	**5.08**	43,570	2,598	5.96	35,055	2,037	5.81
Latin America	HSBC Mexico	**17,252**	**2,565**	**14.87**	16,469	2,187	13.28	13,193	1,532	11.61
	Brazilian operations[9]	**19,642**	**4,879**	**24.84**	13,569	3,895	28.71	9,461	3,244	34.29
	HSBC Bank Panama	**8,620**	**810**	**9.40**	8,113	778	9.59	1,189	92	7.74
	HSBC Bank Argentina	**2,136**	**378**	**17.70**	1,667	241	14.46	838	107	12.77
Other operations		**28,027**	**1,707**	**6.09**	21,318	1,790	8.40	19,795	1,528	7.72
		943,662	**68,722**	**7.28**	836,849	69,624	8.32	760,930	59,011	7.76
Financial investments										
Europe	HSBC Bank	**83,725**	**3,840**	**4.59**	45,885	2,431	5.30	42,726	1,977	4.63
		12,018	**553**	**4.60**	10,372	511	4.93	8,729	391	4.48

	HSBC Private Banking Holdings (Suisse)									
	HSBC France	**14,862**	**795**	**5.35**	10,357	511	4.93	2,545	95	3.73
Hong Kong	Hang Seng Bank	**24,031**	**1,063**	**4.42**	30,791	1,550	5.03	27,288	1,224	4.49
	The Hongkong and Shanghai Banking Corporation	**15,361**	**563**	**3.67**	20,717	1,017	4.91	20,362	911	4.47
Rest of Asia-Pacific	The Hongkong and Shanghai BankingCorporation	**31,992**	**1,507**	**4.71**	23,739	1,065	4.49	17,179	737	4.29
	HSBC Bank Malaysia	**937**	**36**	**3.84**	1,515	56	3.70	954	36	3.77
	HSBC Bank Middle East	**5,671**	**144**	**2.54**	3,654	174	4.76	1,387	72	5.19
North America	HSBC Bank USA	**25,089**	**1,232**	**4.91**	23,373	1,189	5.09	22,214	1,109	4.99
	HSBC Finance	**2,908**	**143**	**4.92**	4,072	229	5.62	3,724	200	5.37
	HSBC Bank Canada	**7,037**	**197**	**2.80**	6,068	258	4.25	4,351	174	4.00
Latin America	HSBC Mexico	**3,470**	**244**	**7.03**	3,327	319	9.59	4,049	427	10.55
	Brazilian operations[9]	**6,758**	**853**	**12.62**	5,596	672	12.01	3,862	501	12.97
	HSBC Bank Panama	**618**	**47**	**7.61**	709	58	8.18	429	21	4.90
	HSBC Bank Argentina	**287**	**47**	**16.38**	563	68	12.08	311	38	12.22
Other operations		**29,632**	**1,354**	**4.57**	27,252	1,407	5.16	24,742	1,191	4.81
		264,396	**12,618**	**4.77**	217,990	11,515	5.28	184,852	9,104	4.93

For footnotes, see page 143.

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		2008			2007			2006	
		Average balance US$m	**Interest income US$m**	**Yield %**	Average balance US$m	Interest income US$m	Yield %	Average balance US$m	Interest income US$m
Other interest-earning assets									
Europe	HSBC Bank	**25,885**	**630**	**2.43**	11,170	652	5.84	9,938	652
	HSBC Private Banking Holdings (Suisse)	**21,189**	**875**	**4.13**	16,360	882	5.39	14,558	732
	HSBC France	**23,414**	**630**	**2.69**	12,158	419	3.45	6,434	173
Hong Kong	Hang Seng Bank	**1,629**	**48**	**2.95**	832	42	5.05	538	28
	The Hongkong and Shanghai Banking Corporation	**33,571**	**949**	**2.83**	27,057	1,237	4.57	19,246	909
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**24,492**	**352**	**1.44**	11,137	588	5.28	6,938	449
	HSBC Bank Malaysia	**212**	**7**	**3.30**	231	12	5.19	178	10
	HSBC Bank Middle East	**843**	**63**	**7.47**	758	52	6.86	380	32
North America	HSBC Bank USA	**3,091**	**188**	**6.08**	3,731	231	6.19	1,867	82
	HSBC Finance	**2,638**	**63**	**2.39**	1,724	89	5.16	767	43
	HSBC Bank Canada	**1,025**	**25**	**2.44**	960	31	3.23	1,006	32
Latin America	HSBC Mexico	**193**	**2**	**1.04**	–	–	–	–	–
	Brazilian operations[9]	**1,438**	**147**	**10.22**	840	75	8.93	1,004	190
	HSBC Bank Panama	**1,807**	**23**	**1.27**	1,351	40	2.96	–	–
	HSBC Bank Argentina	**58**	**1**	**1.72**	39	1	2.56	23	3
Other operations		**(123,032)**	**(3,688)**		(67,857)	(3,926)		(59,710)	(2,967)
		18,453	**315**	**1.71**	20,491	425	2.07	3,167	368

Total interest-earning assets									
Europe	HSBC Bank	**444,527**	**25,244**	**5.68**	344,196	23,753	6.90	313,048	18,331
	HSBC Private Banking Holdings (Suisse)	**53,602**	**2,255**	**4.21**	41,832	2,129	5.09	35,377	1,651
	HSBC France	**147,532**	**6,524**	**4.42**	122,133	5,443	4.46	82,166	3,421
	HSBC Finance	**4,808**	**505**	**10.50**	5,492	611	11.13	5,932	671
Hong Kong	Hang Seng Bank	**85,366**	**3,287**	**3.85**	82,504	4,321	5.24	72,602	3,687
	The Hongkong and Shanghai Banking Corporation	**150,804**	**5,147**	**3.41**	146,118	7,507	5.14	125,702	6,308
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**162,132**	**7,903**	**4.87**	113,448	6,784	5.98	89,664	5,155
	HSBC Bank Malaysia	**14,215**	**761**	**5.35**	12,074	678	5.62	9,916	563
	HSBC Bank Middle East	**36,239**	**1,944**	**5.36**	25,865	1,750	6.77	18,803	1,269
North America	HSBC Bank USA	**130,863**	**7,506**	**5.74**	126,588	8,482	6.70	121,066	7,797
	HSBC Finance	**146,503**	**16,041**	**10.95**	159,454	18,404	11.54	151,827	17,304
	HSBC Bank Canada	**59,747**	**2,784**	**4.66**	54,408	3,061	5.63	43,579	2,381
Latin America	HSBC Mexico	**24,597**	**3,058**	**12.43**	23,351	2,745	11.76	20,637	2,186
	Brazilian operations[9]	**35,797**	**6,830**	**19.08**	25,795	5,287	20.50	18,456	4,507
	HSBC Bank Panama	**12,178**	**910**	**7.47**	11,070	909	8.21	1,748	122
	HSBC Bank Argentina	**3,093**	**469**	**15.16**	2,573	326	12.67	1,368	156
Other operations		**(45,381)**	**133**		(200)	169		1,513	370
		1,466,622	**91,301**	**6.23**	1,296,701	92,359	7.12	1,113,404	75,879

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Total equity and liabilities

		2008			2007			2006		
		Average balance US$m	**Interest expense US$m**	**Cost %**	Average balance US$m	Interest expense US$m	Cost %	Average balance US$m	Interest expense US$m	Cost %
Summary										
Total interest-bearing liabilities (itemised below)		**1,451,842**	**48,738**	**3.36**	1,279,460	54,564	4.26	1,067,646	41,393	3.88
Trading liabilities		**277,940**	**11,029**	**3.97**	250,572	12,186	4.86	224,050	9,842	4.39
Financial liabilities designated at fair value (excluding own debt issued)		**21,266**	**345**	**1.62**	20,827	224	1.07	12,537	13	0.10
Non-interest-bearing current accounts		**98,193**			83,958			71,744		
Total equity and other non-interest-bearing liabilities		**659,747**			477,133			313,590		
Total equity and liabilities		**2,508,988**	**60,112**	**2.40**	2,111,950	66,974	3.17	1,689,567	51,248	3.03
Deposits by banks[10]										
Europe	HSBC Bank	**48,167**	**1,875**	**3.89**	44,787	2,148	4.80	32,825	1,311	3.99
	HSBC Private Banking Holdings (Suisse)	**4,493**	**105**	**2.34**	690	22	3.19	1,030	33	3.20
	HSBC France	**37,851**	**1,672**	**4.42**	30,816	1,358	4.41	23,171	886	3.82
Hong Kong	Hang Seng Bank	**1,696**	**55**	**3.24**	2,993	123	4.11	2,031	84	4.14
	The Hongkong and Shanghai Banking Corporation	**3,665**	**70**	**1.91**	3,634	150	4.13	2,745	125	4.55
Rest of	The Hongkong and									

Asia-Pacific	Shanghai Banking Corporation	**16,232**	**450**	**2.77**	10,247	445	4.34	6,276	246	3.92
	HSBC Bank Malaysia	**338**	**10**	**2.96**	375	12	3.20	280	9	3.21
	HSBC Bank Middle East	**1,680**	**29**	**1.73**	672	32	4.76	453	23	5.08
North America	HSBC Bank USA	**11,015**	**220**	**2.00**	6,933	414	5.97	3,695	208	5.63
	HSBC Bank Canada	**1,391**	**41**	**2.95**	1,681	93	5.53	1,520	68	4.47
Latin America	HSBC Mexico	**822**	**32**	**3.89**	983	63	6.41	781	50	6.40
	Brazilian operations[9]	**2,790**	**190**	**6.81**	1,549	106	6.84	1,033	101	9.78
	HSBC Bank Panama	**1,016**	**43**	**4.23**	1,137	66	5.80	349	17	4.87
	HSBC Bank Argentina	**27**	**1**	**3.70**	117	9	7.69	72	5	6.94
Other operations		**4,564**	**166**	**3.64**	4,495	291	6.47	5,304	334	6.30
		135,747	**4,959**	**3.65**	111,109	5,332	4.80	81,565	3,500	4.29

Financial liabilities designated at fair value — own debt issued[11]

Europe	HSBC Holdings	**18,675**	**721**	**3.86**	15,142	822	5.43	15,132	745	4.92
	HSBC Bank	**8,805**	**529**	**6.01**	9,907	525	5.30	7,888	373	4.73
	HSBC France	**1,515**	**79**	**5.21**	143	11	7.69			
Hong Kong	Hang Seng Bank	**127**	**6**	**4.72**	126	6	4.76			
North America	HSBC Bank USA	**1,504**	**67**	**4.45**	1,620	125	7.72	1,892	116	6.13
	HSBC Finance	**32,126**	**1,563**	**4.87**	31,889	2,079	6.52	29,917	1,877	6.27
Other operations		**1,083**	**168**	**15.51**	—	—	—	461	49	10.63
		63,835	**3,133**	**4.91**	58,827	3,568	6.07	55,290	3,160	5.72

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		2008			2007			2006		
		Average balance US$m	**Interest expense US$m**	**Cost %**	Average balance US$m	Interest expense US$m	Cost %	Average balance US$m	Interest expense US$m	Cost %
Customer accounts[12]										
Europe	HSBC Bank	**305,702**	**10,092**	**3.30**	270,965	10,576	3.90	221,369	7,031	3.18
	HSBC Private Banking Holdings (Suisse)	**37,778**	**1,349**	**3.57**	30,955	1,485	4.80	25,346	1,069	4.22
	HSBC France	**39,428**	**1,583**	**4.01**	31,845	1,226	3.85	23,579	752	3.19
Hong Kong	Hang Seng Bank	**66,142**	**914**	**1.38**	61,227	1,900	3.10	54,267	1,712	3.15
	The Hongkong and Shanghai Banking Corporation	**139,169**	**1,365**	**0.98**	125,478	3,499	2.79	104,441	2,934	2.81
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**96,476**	**2,869**	**2.97**	76,052	2,645	3.48	56,760	1,903	3.35
	HSBC Bank Malaysia	**10,266**	**295**	**2.87**	8,823	260	2.95	7,260	212	2.92
	HSBC Bank Middle East	**19,922**	**422**	**2.12**	15,685	578	3.69	11,713	411	3.51
North America	HSBC Bank USA	**86,701**	**2,069**	**2.39**	78,138	3,051	3.90	71,031	2,490	3.51
	HSBC Bank Canada	**34,090**	**967**	**2.84**	30,060	1,090	3.63	25,277	804	3.18
Latin America	HSBC Mexico	**14,612**	**561**	**3.84**	14,230	548	3.85	13,625	471	3.46
	Brazilian operations[9]	**26,288**	**3,110**	**11.83**	19,581	2,163	11.05	14,887	2,056	13.81
	HSBC Bank Panama	**7,761**	**296**	**3.81**	7,604	314	4.13	998	34	3.41
	HSBC Bank Argentina	**2,266**	**145**	**6.40**	1,892	85	4.49	983	41	4.17
Other operations		**64,253**	**1,952**	**3.04**	55,351	2,297	4.15	49,846	1,811	3.63
		950,854	**27,989**	**2.94**	827,886	31,717	3.83	681,382	23,731	3.48

Debt securities in issue

Europe	HSBC Bank	**86,216**	**4,001**	**4.64**	64,168	3,753	5.85	45,870	2,047	4.46
	HSBC France	**30,815**	**1,447**	**4.70**	28,757	1,207	4.20	19,818	633	3.19
	HSBC Finance	**215**	**8**	**3.72**	240	18	7.50	548	32	5.84
Hong Kong	Hang Seng Bank	**1,685**	**57**	**3.38**	1,734	80	4.61	1,622	64	3.95
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**8,995**	**640**	**7.12**	8,979	559	6.23	7,990	438	5.48
	HSBC Bank Malaysia	**475**	**20**	**4.21**	318	13	4.09	371	13	3.50
	HSBC Bank Middle East	**2,650**	**90**	**3.40**	2,086	119	5.70	—	—	—
North America	HSBC Bank USA	**21,922**	**852**	**3.89**	25,724	1,232	4.79	28,832	1,407	4.88
	HSBC Finance	**98,096**	**3,765**	**3.84**	115,520	5,311	4.60	112,353	5,047	4.49
	HSBC Bank Canada	**16,957**	**604**	**3.56**	14,771	640	4.33	10,616	460	4.33
Latin America	HSBC Mexico	**2,693**	**243**	**9.02**	1,147	110	9.59	249	23	9.24
	Brazilian operations[9]	**1,859**	**156**	**8.39**	1,417	115	8.12	700	70	10.00
	HSBC Bank Panama	**556**	**33**	**5.94**	607	45	7.41	35	2	5.71
	HSBC Bank Argentina	**2**	—	—	12	—	—	—	—	—
Other operations		**13,691**	**66**	**0.48**	6,446	(13)	(0.20)	3,070	108	3.52
		286,827	**11,982**	**4.18**	271,926	13,189	4.85	232,074	10,344	4.46

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Total equity and liabilities (continued)

		2008			2007			2006		
		Average balance US$m	**Interest expense US$m**	**Cost %**	Average balance US$m	Interest expense US$m	Cost %	Average balance US$m	Interest expense US$m	C
Other interest-bearing liabilities										
Europe	HSBC Bank	**38,906**	**1,134**	**2.91**	22,035	1,302	5.91	23,196	1,026	4
	HSBC Private Banking Holdings (Suisse)	**4,203**	**135**	**3.21**	3,427	163	4.76	3,545	155	4
	HSBC France	**33,920**	**1,361**	**4.01**	27,830	979	3.52	13,476	488	3
	HSBC Finance	**3,712**	**191**	**5.15**	4,557	227	4.98	4,211	219	5
Hong Kong	Hang Seng Bank	**1,258**	**41**	**3.26**	2,278	114	5.00	1,378	64	4
	The Hongkong and Shanghai Banking Corporation	**10,557**	**288**	**2.73**	9,866	535	5.42	8,140	365	4
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**23,685**	**466**	**1.97**	12,631	580	4.59	13,425	629	4
	HSBC Bank Malaysia	**338**	**7**	**2.07**	232	6	2.59	235	9	3
	HSBC Bank Middle East	**1,918**	**89**	**4.64**	1,168	81	6.93	1,046	63	6
North America	HSBC Bank USA	**10,490**	**468**	**4.46**	13,602	587	4.32	11,966	1,211	10
	HSBC Finance	**4,670**	**141**	**3.02**	1,941	113	5.82	542	18	3
	HSBC Bank Canada	**1,306**	**19**	**1.45**	1,151	27	2.35	1,134	22	1

	HSBC Markets Inc	**10,349**	**78**	**0.75**	8,889	255	2.87	2,883	88	3
Latin America	HSBC Mexico	**187**	**20**	**10.70**	207	16	7.73	135	8	5
	Brazilian operations[9]	**2,340**	**207**	**8.85**	1,103	182	16.50	817	105	12
	HSBC Bank Panama	**917**	**3**	**0.33**	574	9	1.57	—	—	
	HSBC Bank Argentina	**92**	**6**	**6.52**	95	4	4.21	79	10	12
Other operations		**(134,269)**	**(3,979)**		(101,874)	(4,422)		(68,873)	(3,822)	
		14,579	**675**	**4.63**	9,712	758	7.80	17,335	658	3
Total interest-bearing liabilities										
Europe	HSBC Bank	**487,796**	**17,631**	**3.61**	411,862	18,304	4.44	331,148	11,788	3
	HSBC Private Banking Holdings (Suisse)	**46,474**	**1,589**	**3.42**	35,072	1,670	4.76	29,921	1,257	4
	HSBC France	**143,529**	**6,142**	**4.28**	119,391	4,781	4.00	80,044	2,759	3
	HSBC Finance	**3,927**	**199**	**5.07**	4,797	245	5.11	4,759	251	5
Hong Kong	Hang Seng Bank	**70,908**	**1,073**	**1.51**	68,358	2,223	3.25	59,298	1,924	3
	The Hongkong and Shanghai Banking Corporation	**153,391**	**1,723**	**1.12**	138,978	4,184	3.01	115,326	3,424	2
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**145,388**	**4,425**	**3.04**	107,909	4,229	3.92	84,451	3,216	3
	HSBC Bank Malaysia	**11,417**	**332**	**2.91**	9,748	291	2.99	8,146	243	2
	HSBC Bank Middle East	**26,170**	**630**	**2.41**	19,611	810	4.13	13,212	497	3
North America	HSBC Bank USA	**131,632**	**3,676**	**2.79**	126,017	5,409	4.29	117,416	5,432	4
	HSBC Finance	**134,892**	**5,469**	**4.05**	149,350	7,503	5.02	142,812	6,942	4
	HSBC Bank Canada	**53,744**	**1,631**	**3.03**	47,663	1,850	3.88	38,547	1,354	3
	HSBC Markets Inc	**10,349**	**78**	**0.75**	8,889	255	2.87	2,883	88	3
Latin America	HSBC Mexico	**18,314**	**856**	**4.67**	16,567	737	4.45	14,790	552	3
	Brazilian operations[9]	**33,277**	**3,663**	**11.01**	23,650	2,566	10.85	17,437	2,332	13

	HSBC Bank Panama	**10,250**	**375**	**3.66**	9,922	434	4.37	1,383	53	3
	HSBC Bank Argentina	**2,387**	**152**	**6.37**	2,116	98	4.63	1,134	56	4
Other operations		**(32,003)**	**(906)**		(20,440)	(1,025)		4,939	(775)	
		1,451,842	**48,738**	**3.36**	1,279,460	54,564	4.26	1,067,646	41,393	3

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Net interest margin[13]

		2008	2007	2006
		%	%	%
Europe	HSBC Bank	**1.71**	1.58	2.09
	HSBC Private Banking Holdings (Suisse)	**1.24**	1.10	1.11
	HSBC France	**0.26**	0.54	0.81
	HSBC Finance	**6.36**	6.66	7.08
Hong Kong	Hang Seng Bank	**2.59**	2.54	2.43
	The Hongkong and Shanghai Banking Corporation	**2.27**	2.27	2.29
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**2.15**	2.25	2.16
	HSBC Bank Malaysia	**3.02**	3.21	3.23
	HSBC Bank Middle East	**3.63**	3.63	4.11
North America	HSBC Bank USA	**2.93**	2.43	1.95
	HSBC Finance	**7.22**	6.84	6.83
	HSBC Bank Canada	**1.93**	2.23	2.36
Latin America	HSBC Mexico	**8.95**	8.60	7.92
	Brazilian operations[9]	**8.85**	10.55	11.78
	HSBC Bank Panama	**4.39**	4.29	3.94
	HSBC Bank Argentina	**10.25**	8.86	7.31
		2.90	2.91	3.10

Distribution of average total assets

		2008	2007	2006
		%	%	%
Europe	HSBC Bank	**36.7**	34.6	30.6
	HSBC Private Banking Holdings (Suisse)	**2.3**	2.2	2.3
	HSBC France	**13.8**	12.0	10.0
	HSBC Finance	**0.2**	0.3	0.5
Hong Kong	Hang Seng Bank	**3.9**	4.4	4.3
	The Hongkong and Shanghai Banking Corporation	**9.5**	10.1	10.7
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**8.8**	6.9	6.0
	HSBC Bank Malaysia	**0.6**	0.7	0.6
	HSBC Bank Middle East	**1.8**	1.4	1.3
North America	HSBC Bank USA	**11.2**	10.1	11.3
	HSBC Finance	**6.2**	8.3	10.0
	HSBC Bank Canada	**2.9**	3.3	2.4
Latin America	HSBC Mexico	**1.5**	2.5	1.7
	Brazilian operations[9]	**2.1**	1.6	1.5
	HSBC Bank Panama	**0.6**	0.7	0.2
	HSBC Bank Argentina	**0.2**	0.2	0.1
Other operations (including consolidation adjustments)		**(2.3)**	0.7	6.5

	100.0	100.0	100.0

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Analysis of changes in net interest income

The following table allocates changes in net interest income between volume and rate for 2008 compared with 2007, and for 2007 compared with 2006.

Interest income

			Increase/(decrease) in 2008 compared with 2007			Increase/(decrease) in 2007 compared with 2006		
		2008 US$m	**Volume US$m**	**Rate US$m**	2007 US$m	Volume US$m	Rate US$m	2006 US$m
Short-term funds and loans and advances to banks								
Europe	HSBC Bank	**2,187**	**(166)**	**(239)**	2,592	729	327	1,536
	HSBC Private Banking Holdings (Suisse)	**333**	**119**	**(15)**	229	13	26	190
	HSBC France	**1,495**	**173**	**28**	1,294	390	214	690
Hong Kong	Hang Seng Bank	**587**	**203**	**(225)**	609	126	—	483
	The Hongkong and Shanghai Banking Corporation	**1,344**	**(139)**	**(869)**	2,352	484	223	1,645
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**881**	**362**	**(291)**	810	229	61	520
	HSBC Bank Malaysia	**165**	**65**	**(3)**	103	13	3	87
	HSBC Bank Middle East	**188**	**(15)**	**(121)**	324	100	16	208
North America	HSBC Bank USA	**328**	**10**	**(159)**	477	54	(42)	465
	HSBC Bank Canada	**107**	**(21)**	**(46)**	174	28	8	138
Latin America	HSBC Mexico	**247**	**9**	**(1)**	239	11	1	227
	Brazilian operations[9]	**951**	**242**	**64**	645	230	(157)	572
	HSBC Bank Panama	**30**	**9**	**(12)**	33	24	—	9
	HSBC Bank Argentina	**43**	**16**	**11**	16	4	4	8
Other operations		**760**	**43**	**(181)**	898	89	191	618
		9,646	**915**	**(2,064)**	10,795	2,561	838	7,396

Loans and advances to customers								
Europe	HSBC Bank	**18,587**	**3,885**	**(3,376)**	18,078	669	3,243	14,166
	HSBC Private Banking Holdings (Suisse)	**494**	**132**	**(145)**	507	127	42	338
	HSBC France	**3,604**	**257**	**128**	3,219	699	57	2,463
	HSBC Finance	**505**	**(76)**	**(30)**	611	(50)	(10)	671
Hong Kong	Hang Seng Bank	**1,589**	**251**	**(782)**	2,120	193	(25)	1,952
	The Hongkong and Shanghai Banking Corporation	**2,291**	**392**	**(1,002)**	2,901	51	7	2,843
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**5,163**	**1,345**	**(503)**	4,321	471	401	3,449
	HSBC Bank Malaysia	**553**	**64**	**(18)**	507	80	(3)	430
	HSBC Bank Middle East	**1,549**	**680**	**(331)**	1,200	178	65	957
North America	HSBC Bank USA	**5,758**	**219**	**(1,046)**	6,585	106	338	6,141
	HSBC Finance	**15,835**	**(1,495)**	**(756)**	18,086	732	293	17,061
	HSBC Bank Canada	**2,455**	**284**	**(427)**	2,598	495	66	2,037
Latin America	HSBC Mexico	**2,565**	**104**	**274**	2,187	380	275	1,532
	Brazilian operations[9]	**4,879**	**1,744**	**(760)**	3,895	1,409	(758)	3,244
	HSBC Bank Panama	**810**	**49**	**(17)**	778	686	–	92
	HSBC Bank Argentina	**378**	**68**	**69**	241	106	28	107
Other operations		**1,707**	**564**	**(647)**	1,790	118	144	1,528
		68,722	**8,887**	**(9,789)**	69,624	5,891	4,722	59,011

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			Increase/(decrease) in 2008 compared with 2007			Increase/(decrease) in 2007 compared with 2006		
		2008 US$m	**Volume US$m**	**Rate US$m**	2007 US$m	Volume US$m	Rate US$m	2006 US$m
Financial investments								
Europe	HSBC Bank	**3,840**	**2,006**	**(597)**	2,431	146	308	1,977
	HSBC Private Banking Holdings (Suisse)	**553**	**81**	**(39)**	511	74	46	391
	HSBC France	**795**	**222**	**62**	511	291	125	95
Hong Kong	Hang Seng Bank	**1,063**	**(340)**	**(147)**	1,550	157	169	1,224
	The Hongkong and Shanghai Banking Corporation	**563**	**(263)**	**(191)**	1,017	16	90	911
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**1,507**	**371**	**71**	1,065	281	47	737
	HSBC Bank Malaysia	**36**	**(21)**	**1**	56	21	(1)	36
	HSBC Bank Middle East	**144**	**96**	**(126)**	174	118	(16)	72
North America	HSBC Bank USA	**1,232**	**87**	**(44)**	1,189	58	22	1,109
	HSBC Finance	**143**	**(65)**	**(21)**	229	19	10	200
	HSBC Bank Canada	**197**	**41**	**(102)**	258	69	15	174
Latin America	HSBC Mexico	**244**	**14**	**(89)**	319	(76)	(32)	427
	Brazilian operations[9]	**853**	**140**	**41**	672	225	(54)	501
	HSBC Bank Panama	**47**	**(7)**	**(4)**	58	37	–	21
	HSBC Bank Argentina	**47**	**(33)**	**12**	68	31	(1)	38
Other operations		**1,354**	**123**	**(176)**	1,407	121	95	1,191
		12,618	**2,450**	**(1,347)**	11,515	1,634	777	9,104
Interest expense								
Deposits by banks								
Europe	HSBC Bank	**1,875**	**162**	**(435)**	2,148	477	360	1,311
	HSBC Private Banking Holdings (Suisse)	**105**	**121**	**(38)**	22	(11)	–	33
	HSBC France	**1,672**	**310**	**4**	1,358	292	180	886
Hong Kong	Hang Seng Bank	**55**	**(53)**	**(15)**	123	40	(1)	84
	The Hongkong and Shanghai Banking Corporation	**70**	**1**	**(81)**	150	40	(15)	125
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**450**	**260**	**(255)**	445	156	43	246
	HSBC Bank Malaysia	**10**	**(1)**	**(1)**	12	3	–	9
		29	**48**	**(51)**	32	11	(2)	23

	HSBC Bank Middle East							
North America	HSBC Bank USA	**220**	**244**	**(438)**	414	182	24	208
	HSBC Bank Canada	**41**	**(16)**	**(36)**	93	7	18	68
Latin America	HSBC Mexico	**32**	**(10)**	**(21)**	63	13	—	50
	Brazilian operations[9]	**190**	**85**	**(1)**	106	50	(45)	101
	HSBC Bank Panama	**43**	**(7)**	**(16)**	66	49	—	17
	HSBC Bank Argentina	**1**	**(7)**	**(1)**	9	3	1	5
Other operations		**166**	**4**	**(129)**	291	(51)	8	334
		4,959	**1,183**	**(1,556)**	5,332	1,267	565	3,500

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Interest expense (continued)

			Increase/(decrease) in 2008 compared with 2007			Increase/(decrease) in 2007 compared with 2006		
		2008 US$m	**Volume US$m**	**Rate US$m**	2007 US$m	Volume US$m	Rate US$m	2006 US$m
Customer accounts								
Europe	HSBC Bank	**10,092**	**1,355**	**(1,839)**	10,576	1,577	1,968	7,031
	HSBC Private Banking Holdings (Suisse)	**1,349**	**328**	**(464)**	1,485	237	179	1,069
	HSBC France	**1,583**	**292**	**65**	1,226	264	210	752
Hong Kong	Hang Seng Bank	**914**	**152**	**(1,138)**	1,900	219	(31)	1,712
	The Hongkong and Shanghai Banking Corporation	**1,365**	**382**	**(2,516)**	3,499	591	(26)	2,934
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**2,869**	**711**	**(487)**	2,645	646	96	1,903
	HSBC Bank Malaysia	**295**	**43**	**(8)**	260	46	2	212
	HSBC Bank Middle East	**422**	**156**	**(312)**	578	139	28	411
North America	HSBC Bank USA	**2,069**	**334**	**(1,316)**	3,051	249	312	2,490
	HSBC Bank Canada	**967**	**146**	**(269)**	1,090	152	134	804
Latin America	HSBC Mexico	**561**	**15**	**(2)**	548	21	56	471
	Brazilian operations[9]	**3,110**	**741**	**206**	2,163	648	(541)	2,056
	HSBC Bank Panama	**296**	**6**	**(24)**	314	280	–	34
	HSBC Bank Argentina	**145**	**17**	**43**	85	38	6	41
Other operations		**1,952**	**369**	**(714)**	2,297	200	286	1,811
		27,989	**4,710**	**(8,438)**	31,717	5,098	2,888	23,731
		3,133	**304**	**(739)**	3,568	196	212	3,160

Financial liabilities designated at fair value – own debt issued								
Debt securities in issue								
Europe	HSBC Bank	**4,001**	**1,290**	**(1,042)**	3,753	816	890	2,047
	HSBC France	**1,447**	**86**	**154**	1,207	285	289	633
	HSBC Finance	**8**	**(2)**	**(8)**	18	(18)	4	32
Hong Kong	Hang Seng Bank	**57**	**(2)**	**(21)**	80	4	12	64
Rest of Asia-Pacific	The Hongkong and Shanghai Banking Corporation	**640**	**1**	**80**	559	54	67	438
	HSBC Bank Malaysia	**20**	**6**	**1**	13	(2)	2	13
	HSBC Bank Middle East	**90**	**32**	**(61)**	119	119	–	–
North America	HSBC Bank USA	**852**	**(182)**	**(198)**	1,232	(152)	(23)	1,407
	HSBC Finance	**3,765**	**(802)**	**(744)**	5,311	142	122	5,047
	HSBC Bank Canada	**604**	**95**	**(131)**	640	180	–	460
Latin America	HSBC Mexico	**243**	**148**	**(15)**	110	83	4	23
	Brazilian operations[9]	**156**	**36**	**5**	115	72	(27)	70
	HSBC Bank Panama	**33**	**(4)**	**(8)**	45	43	–	2
	HSBC Bank Argentina	–	–	–	–	–	–	–
Other operations		**66**	**(14)**	**93**	(13)	119	(240)	108
		11,982	**(723)**	**(1,930)**	13,189	1,777	1,068	10,344

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Share capital and reserves

Authorised share capital

The authorised share capital of HSBC Holdings at 31 December 2008 was US$7,500,100,000 divided into 15,000 million ordinary shares of US$0.50 each and 10 million non-cumulative preference shares of US$0.01 each; £401,500 divided into 10 million non-cumulative preference shares of £0.01 each and 301,500 non-voting deferred shares of £1 each; and €100,000 divided into 10 million non-cumulative preference shares of €0.01 each.

The percentage of the total authorised share capital of HSBC Holdings at 31 December 2008 represented by the numbers of ordinary shares of US$0.50 each, non-cumulative preference shares of £0.01 each, non-cumulative preference shares of US$0.01 each, non-cumulative preference shares of €0.01 each and non-voting deferred shares of £1 each was approximately 99.9890, 0.0019, 0.0013, 0.0019 and 0.0059 per cent respectively.

Issued share capital

The issued share capital of HSBC Holdings at 31 December 2008 was US$6,052,647,041 divided into 12,105,265,082 ordinary shares of US$0.50 each and 1,450,000 non-cumulative preference shares of US$0.01 each; and £301,500 comprising 301,500 non-voting deferred shares of £1 each.

The percentage of the total issued share capital of HSBC Holdings at 31 December 2008 represented by the ordinary shares of US$0.50 each, non-cumulative preference shares of US$0.01 each and non-voting deferred shares of £1 each was approximately 99.9925, 0.0002, and 0.0073 per cent respectively.

Rights and obligations attaching to shares

The rights and obligations attaching to each class of share in the authorised share capital of HSBC Holdings are set out in the Articles of Association of HSBC Holdings. Set out below is a summary of the rights and obligations attaching to each class of shares with respect to voting, dividends, capital and, in the case of the preference shares, redemption.

To be registered, a transfer of shares must be in relation to a share which is fully paid up and on which the Company has no lien and to one class of shares denominated in the same currency. The transfer must be in favour of a single transferee or no more than four joint transferees and it must be duly stamped (if required). The transfer must be delivered to the registered office of the Company or to its

Registrars accompanied by the certificate to which it relates or such other evidence that proves the title of the transferor.

If a shareholder or any person appearing to be interested in the Company’s shares has been sent a notice under section 793 of the Companies Act 2006 (which confers upon public companies the power to require information from any person whom the Company knows or has reasonable cause to believe to be interested in the shares) and has failed in relation to any shares (the ‘default shares’) to supply the information requested within the period set out in the notice, then the member is not entitled to be present at or to vote the default shares at any general meeting or to exercise any other right conferred by being a shareholder. If the default shares represent at least 0.25 per cent in nominal value of the issued shares of that class any dividend shall be withheld by the Company, without interest and no election for the scrip dividend alternative may be made. No transfer of any shares held by the member will be registered, except in limited circumstances.

Ordinary shares

Subject to the Companies Act 2006 and the Articles of Association of HSBC Holdings, in a general meeting of HSBC Holdings, every holder of ordinary shares who is present in person or by proxy shall on a show of hands have one vote and every holder of ordinary shares present in person or by proxy shall on a poll have one vote for every share he or she holds. Where any shareholder is, under the rules governing the listing of securities on any stock exchange on which all or any shares of HSBC Holdings are for the time being listed or traded, required to abstain from voting on any particular resolution or restricted to voting only for or only against any particular resolution, any votes cast by or on behalf of such holder in contravention of such requirement or restriction will not be counted.

Subject to the Companies Act 2006 and the Articles of Association of HSBC Holdings, HSBC Holdings may, by ordinary resolution, declare dividends to be paid to the holders of ordinary shares, however, no dividend shall exceed the amount recommended by the Board. The Board may pay interim dividends as appears to the Board to be justified by the profits of HSBC Holdings available for distribution. All dividends shall be apportioned and paid proportionately to the percentage of the nominal amount paid up on the shares during any portion or portions of the period in respect of which the dividend is paid, but if any share is issued on terms providing that it shall rank for dividend as from a particular date, it shall rank for dividend

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accordingly. Subject to the Articles of Association of HSBC Holdings, the Board may, with the prior authority of an ordinary resolution of HSBC Holdings and subject to such terms and conditions as the Board may determine, offer to any holders of ordinary shares the right to elect to receive ordinary shares of the same or a different currency, credited as fully paid, instead of cash in any currency in respect of the whole (or some part, to be determined by the Board) of any dividend specified by the ordinary resolution. At the 2007 Annual General Meeting shareholders gave authority to the Directors to offer a scrip dividend alternative until the conclusion of the Annual General Meeting in 2012.

Subject to the relevant insolvency laws and the Articles of Association of HSBC Holdings, if HSBC Holdings is wound up, the assets available for distribution among the holders of ordinary shares will be distributed among such holders in proportion to the number of ordinary shares held by them respectively, such distribution to be adjusted to take account of any amount remaining unpaid on a holder's share. On a winding up, the liquidator may, with the sanction of a special resolution of HSBC Holdings and any other sanction required by law, divide among the shareholders in specie the whole or any part of the assets of HSBC Holdings and may, for that purpose, value any assets and determine how the division shall be carried out as between the shareholders or different classes of shareholders.

Preference shares

The non-cumulative preference shares of £0.01 each, the non-cumulative preference shares of US$0.01 each (the 'Dollar Preference Shares') and the non-cumulative preference shares of €0.01 each carry the same rights and obligations under the Articles of Association save in respect of the timing of and payment of proceeds from the redemption of each class of share, to the extent issued, and certain rights and obligations that attach to each class of preference share as determined by the Board prior to allotment of the relevant preference shares. The Dollar Preference Shares are the only class of the preference shares which have been issued and allotted to date.

Holders of the preference shares will only be entitled to attend and vote at general meetings of HSBC Holdings if any dividend payable on the relevant preference shares in respect of such period as the Board shall determine prior to allotment thereof (which, in the case of the Dollar Preference Shares in issue at 2 March 2009, is four consecutive dividend payment dates) is not paid in full or in such other circumstances, and upon and subject to such

terms, as the Board may determine prior to allotment of the relevant preference shares. Whenever holders of the relevant preference shares are entitled to vote on a resolution at a general meeting, on a show of hands every such holder who is present in person or by proxy shall have one vote and on a poll every such holder who is present in person or by proxy shall have one vote per preference share held by him or her or such number of votes per share as the Board shall determine prior to allotment of such share.

Subject to the Articles of Association, holders of the relevant preference shares shall have the right to a non-cumulative preferential dividend at such rate, on such dates and on such other terms and conditions as may be determined by the Board prior to allotment thereof in priority to the payment of any dividend to the holders of ordinary shares and any other class of shares of HSBC Holdings in issue (other than (i) the other preference shares in issue and any other shares expressed to rank *pari passu* therewith as regards income; and (ii) any shares which by their terms rank in priority to the relevant preference shares as regards income). Dividends on the Dollar Preference Shares in issue at 2 March 2009 are paid quarterly at the sole and absolute discretion of the Board of Directors. The Board of Directors will not declare a dividend on the Dollar Preference Shares if payment of the dividend would cause HSBC Holdings not to meet the applicable capital adequacy requirements of the FSA or the profit of HSBC Holdings available for distribution as dividends is not sufficient to enable HSBC Holdings to pay in full both dividends on the relevant preference shares and dividends on any other shares that are scheduled to be paid on the same date and that have an equal right to dividends. 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 participate in the profits or assets of HSBC Holdings other than as set out in the Articles of Association and subject to the Companies Act 1985, do not confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares in HSBC Holdings, do no not confer any right of conversion and do not confer any right to participate in any issue or bonus shares or

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shares issued by way of capitalisation of reserves.

Subject to the relevant insolvency laws and the Articles of Association of HSBC Holdings, holders of the relevant preference shares have the right in a winding up of HSBC Holdings to receive out of the assets of HSBC Holdings available for distribution to its shareholders, in priority to any payment to the holders of the ordinary shares and any other class of shares of HSBC Holdings in issue (other than (i) the other relevant preference shares and any other shares expressed to rank *pari passu* therewith as regards repayment of capital; and (ii) any shares which by their terms rank in priority to the relevant preference shares as regards repayment of capital), a sum equal to any unpaid dividend on the relevant preference shares which is payable as a dividend in accordance with or pursuant to the Articles of Association and the amount paid up or credited as paid up on the relevant preference shares together with such premium (if any) as may be determined by the Board prior to allotment thereof.

HSBC Holdings may redeem the relevant preference shares in accordance with the Articles of Association and the terms on which the relevant preference shares were issued and allotted. In the case of the Dollar Preference Shares in issue at 2 March 2009, HSBC Holdings may redeem such shares in whole at any time on or after 16 December 2010, subject to prior notification to the FSA.

Non-voting deferred shares

The non-voting deferred shares are held by a subsidiary undertaking 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. The holders of the non-voting deferred shares are not entitled to receive notice of or to attend (either personally or by proxy) any general meeting of HSBC Holdings or to vote (either personally or by proxy) on any resolution to be proposed thereat.

The following events occurred during the year in relation to the share capital of HSBC Holdings:

Scrip dividends

1. 36,524,050 ordinary shares were issued at par in January 2008 to shareholders who elected to receive new shares in lieu of the third interim dividend for 2007. The market value per share used to calculate shareholders’ entitlements to new shares was US$16.821, being the US dollar equivalent of £8.132.

2. 136,165,605 ordinary shares were issued at par in May 2008 to shareholders who elected to receive new shares in lieu of the fourth interim dividend for 2007. The market value per share used to calculate shareholders’ entitlements to new shares was US$16.4022, being the US dollar equivalent of £8.132.

3. 15,191,514 ordinary shares were issued at par in July 2008 to shareholders who elected to receive new shares in lieu of the first interim dividend for 2008. The market value per share used to calculate shareholders’ entitlements to new shares was US$16.8421, being the US dollar equivalent of £8.519.

4. 47,687,930 ordinary shares were issued at par in October 2008 to shareholders who elected to receive new shares in lieu of the second interim dividend for 2008. The market value per share used to calculate shareholders’ entitlements to new shares was US$15.2466, being the US dollar equivalent of £8.266.

All-Employee share plans

5. In connection with the exercise of options under the HSBC Holdings savings-related share option plans: 27,491,176 ordinary shares were issued at prices ranging from £5.3496 to £7.6736 per share; 1,782,367 ordinary shares were issued at prices ranging from HK$103.4401 to HK$108.4483 per share; 805,885 ordinary shares were issued at prices ranging from US$13.3290 to US$14.7478 per share; and 46,698 ordinary shares were issued at €10.4217 per share. Options over 18,163,336 ordinary shares lapsed.

6. 2,667,632 ordinary shares were issued at €8.3124 per share in connection with a Plan d'Epargne Entreprise for the benefit of non-UK resident employees of HSBC France and its subsidiaries.

7. Options over 32,951,305 ordinary shares were granted at nil consideration on 30 April 2008 to nearly 70,000 HSBC employees resident in nearly 70 countries and territories under the HSBC Holdings savings-related share option plans.

Discretionary share incentive plans

8. 4,050,585 ordinary shares were issued at prices ranging from £6.2767 to £7.460 per share in connection with the exercise of options under

the HSBC Holdings Executive Share Option Scheme. Options over 223,951 ordinary shares lapsed.

9. 3,734,125 ordinary shares were issued at prices ranging from £6.9100 to £8.7120 per share in connection with the exercise of options under the HSBC Holdings Group Share Option Plan. Options over 5,889,067 ordinary shares lapsed.

10. No options were exercised under and no ordinary shares were issued in connection with the HSBC Share Plan. Options over 224,728 ordinary shares lapsed.

HSBC Finance

11. 65,198 ordinary shares were issued at prices ranging from US$14.59 to US$16.71 per share in connection with the vesting of Restricted Stock Rights under HSBC Finance share plans that have been converted into rights over HSBC Holdings ordinary shares.

Authority to purchase ordinary shares

12. At the Annual General Meeting in 2008, shareholders renewed the authority for the Company to make market purchases of ordinary shares. The authority is to make market purchases of up to 1,186,700,000 ordinary shares. The Directors have not exercised this authority. In accordance with the terms of a waiver granted by the Hong Kong Stock Exchange on 19 December 2005, HSBC Holdings will comply with the applicable law and regulation in the UK in relation to the holding of any shares in treasury and with the conditions of the waiver, in connection with any shares it may hold in treasury.

Authority to allot shares

13. At the Annual General Meeting in 2008 shareholders renewed the general authority for the Directors to allot new shares. The general authority is to allot up to 2,373,400,000 ordinary shares, 10,000,000 non-cumulative preference shares of £0.01 each, 8,550,000 non-cumulative preference shares of US$0.01 each and 10,000,000 non-cumulative preference shares of 0.01 each. Within this, the Directors have authority to allot up to a maximum of 593,350,000 ordinary shares wholly for cash to persons other than existing shareholders.

Other than as described in paragraphs 1 to 6 and 8 to 10 above, the Directors did not allot any shares during 2008.

Short-term borrowings

HSBC includes short-term borrowings within customer accounts, deposits by banks and debt securities in issue and does not show short-term borrowings separately on the balance sheet. Short- term borrowings are defined by the US Securities and Exchange Commission (SEC) as Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings. HSBCs only significant short-term borrowings are securities sold under agreements to repurchase and certain debt securities in issue. Additional information on these is provided in the tables below.

	2008 US$m	2007 US$m	2006 US$m
Securities sold under agreements to repurchase			
Outstanding at 31 December	**145,180**	140,001	97,139
Average amount outstanding during the year	**177,256**	129,779	102,715
Maximum quarter-end balance outstanding during the year	**190,651**	148,601	109,689
Weighted average interest rate during the year	**3.8%**	5.4%	4.3%
Weighted average interest rate at the year-end	**2.9%**	4.8%	4.6%
Short-term bonds			
Outstanding at 31 December	**40,279**	51,792	37,906
Average amount outstanding during the year	**45,330**	39,153	37,729
Maximum quarter-end balance outstanding during the year	**55,842**	51,792	38,907
Weighted average interest rate during the year	**5.0%**	7.0%	5.1%
Weighted average interest rate at the year-end	**3.1%**	6.5%	4.8%

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Contractual obligations

The table below provides details of HSBCs material contractual obligations as at 31 December 2008.

	Payments due by period			
	Total US$m	**Less than 1 year US$m**	**15 years US$m**	**More than 5 years US$m**
Long-term debt obligations	**254,946**	**92,191**	**99,353**	**63,402**
Term deposits and certificates of deposit	**256,661**	**245,672**	**10,989**	
Capital (finance) lease obligations	**979**	**55**	**188**	**736**
Operating lease obligations	**4,139**	**766**	**1,800**	**1,573**
Purchase obligations	**1,541**	**948**	**593**	
Short positions in debt securities and equity shares	**66,774**	**52,679**	**4,477**	**9,618**
Current tax liability	**1,822**	**1,822**		
Pension obligations	**15,137**	**1,208**	**5,393**	**8,536**
	601,999	**395,341**	**122,793**	**83,865**

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

	2008 %	2007 %	2006 %	2005 %	2004 %
Ratios of earnings to combined fixed charges and preference share dividends					
Ratios in accordance with IFRSs					
excluding interest on deposits	**2.97**	6.96	7.22	9.16	8.64
including interest on deposits	**1.13**	1.34	1.40	1.59	1.86
Ratios in accordance with UK GAAP					
excluding interest on deposits					8.07
including interest on deposits					1.81
Ratios of earnings to combined fixed charges					
Ratios in accordance with IFRSs					
excluding interest on deposits	**3.17**	7.52	7.93	9.60	8.64
including interest on deposits	**1.14**	1.34	1.41	1.59	1.86
Ratios in accordance with UK GAAP					
excluding interest on deposits					8.07
including interest on deposits					1.81

For the purpose of calculating the ratios, earnings consist of income from continuing operations before taxation and minority interests, plus fixed charges, and after deduction of the unremitted pre-tax income of associated undertakings. Fixed charges consist of total interest expense, including or excluding interest on deposits, as appropriate, dividends on preference shares and other equity instruments, as applicable, and the proportion of rental expense deemed representative of the interest factor.

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Loan maturity and interest sensitivity analysis

At 31 December 2008, the geographical analysis of loan maturity and interest sensitivity by loan type on a contractual repayment basis was as follows:

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific US$m	North America US$m	Latin America US$m	Total US$m
Maturity of 1 year or less						
Loans and advances to banks	**58,520**	**29,258**	**35,668**	**10,966**	**11,919**	**146,331**
Commercial loans to customers						
Commercial, industrial and international trade	**83,772**	**14,666**	**31,433**	**5,611**	**8,827**	**144,309**
Real estate and other property related	**18,430**	**6,253**	**6,071**	**9,527**	**1,497**	**41,778**
Non-bank financial institutions	**57,853**	**1,070**	**4,188**	**21,490**	**1,116**	**85,717**
Governments	**1,121**	**117**	**1,260**	**243**	**309**	**3,050**
Other commercial	**35,652**	**1,919**	**5,648**	**8,737**	**1,955**	**53,911**
	196,828	**24,025**	**48,600**	**45,608**	**13,704**	**328,765**
Hong Kong Government Home Ownership Scheme	**–**	**442**	**–**	**–**	**–**	**442**
Residential mortgages and other personal loans	**30,336**	**13,476**	**13,972**	**36,119**	**8,382**	**102,285**
Loans and advances to customers	**227,164**	**37,943**	**62,572**	**81,727**	**22,086**	**431,492**
	285,684	**67,201**	**98,240**	**92,693**	**34,005**	**577,823**
Maturity after 1 year but within 5 years						
Loans and advances to banks	**3,152**	**388**	**398**	**442**	**190**	**4,570**
Commercial loans to customers						
Commercial, industrial and international trade	**23,889**	**4,943**	**7,360**	**8,087**	**3,640**	**47,919**
Real estate and other property related	**13,760**	**13,716**	**6,182**	**8,002**	**790**	**42,450**
Non-bank financial institutions	**3,419**	**594**	**1,111**	**3,112**	**1,185**	**9,421**
Governments	**323**	**784**	**355**	**78**	**769**	**2,309**

Other commercial	**11,839**	**3,365**	**4,130**	**3,214**	**2,072**	**24,620**
	53,230	**23,402**	**19,138**	**22,493**	**8,456**	**126,719**
Hong Kong Government Home Ownership Scheme	—	**1,404**	—	—	—	**1,404**
Residential mortgages and other personal loans	**31,595**	**8,991**	**9,948**	**52,234**	**5,755**	**108,523**
Loans and advances to customers	**84,825**	**33,797**	**29,086**	**74,727**	**14,211**	**236,646**
	87,977	**34,185**	**29,484**	**75,169**	**14,401**	**241,216**

Interest rate sensitivity of loans and advances to banks and commercial loans to customers Fixed interest rate

11,333 185 2,734 5,066 2,460 21,778 Variable interest rate **45,049 23,605 16,802 17,869 6,186 109,511**

56,382 23,790 19,536 22,935 8,646 131,289

Maturity after 5 years Loans and advances to banks **340 —75 50 2,463 2,928**

Commercial loans to customers						
Commercial, industrial and international trade	**13,386**	**577**	**1,354**	**1,480**	**815**	**17,612**
Real estate and other property related	**8,180**	**4,560**	**1,019**	**3,209**	**512**	**17,480**
Non-bank financial institutions	**551**	**738**	**88**	**2,958**	**63**	**4,398**
Governments	**420**	**50**	**145**	**31**	**539**	**1,185**
Other commercial	**15,923**	**1,514**	**1,428**	**991**	**535**	**20,391**
	38,460	**7,439**	**4,034**	**8,669**	**2,464**	**61,066**
Hong Kong Government Home Ownership Scheme	–	**2,036**	–	–	–	**2,036**
Residential mortgages and other personal loans	**79,601**	**19,738**	**13,491**	**107,181**	**5,526**	**225,537**
Loans and advances to customers	**118,061**	**29,213**	**17,525**	**115,850**	**7,990**	**288,639**
	118,401	**29,213**	**17,600**	**115,900**	**10,453**	**291,567**

Interest rate sensitivity of loans and advances to banks and commercial loans to customers

Fixed interest rate	**7,607**	**—**	**942**	**1,128**	**619**	**10,296**
Variable interest rate	**31,193**	**7,439**	**3,167**	**7,591**	**4,308**	**53,698**
	38,800	**7,439**	**4,109**	**8,719**	**4,927**	**63,994**

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Deposits

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

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

	2008		2007		2006	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Deposits by banks						
Europe						
Demand and other non-interest bearing	**5,231**		6,359		9,814	
Demand interest bearing	**19,204**	**3.2**	11,036	3.8	8,368	3.7
Time	**43,695**	**3.9**	38,470	4.7	27,447	4.0
Other	**31,098**	**4.4**	28,770	4.8	23,396	3.5
	99,228		84,635		69,025	
Hong Kong						
Demand and other non-interest bearing	**1,375**		1,331		1,031	
Demand interest bearing	**2,780**	**2.0**	2,420	4.3	2,428	4.6
Time	**1,583**	**2.7**	3,267	4.5	2,016	4.3
Other	**178**	**3.4**	251	0.4	362	3.3
	5,916		7,269		5,837	
Rest of Asia-Pacific						
Demand and other non-interest bearing	**1,911**		1,897		1,618	
Demand interest bearing	**4,332**	**2.3**	3,167	2.4	1,960	2.4
Time	**10,342**	**3.5**	6,433	5.1	3,645	4.8
Other	**3,769**	**3.3**	2,768	4.8	2,157	4.5
	20,354		14,265		9,380	
North America						
Demand and other non-interest bearing	**761**		827		767	
Demand interest bearing	**5,684**	**1.7**	3,759	4.8	3,033	5.3

Time	**7,941**	**2.3**	6,746	6.0	3,543	5.4
Other	**449**	**1.6**	169	7.1	699	5.6
	14,835		11,501		8,042	
Latin America						
Demand and other — non-interest bearing	**366**	—	808	—	702	—
Demand — interest bearing	**81**	**2.5**	153	5.9	96	6.3
Time	**3,357**	**5.6**	2,690	6.5	1,732	5.5
Other	**1,254**	**7.8**	1,010	8.0	683	9.4
	5,058		4,661		3,213	
Total						
Demand and other — non-interest bearing	**9,644**	—	11,222	—	13,932	—
Demand — interest bearing	**32,081**	**2.7**	20,535	3.8	15,885	4.5
Time	**66,918**	**3.7**	57,606	4.9	38,383	4.5
Other	**36,748**	**4.5**	32,968	5.0	27,297	3.9
	145,391		122,331		95,497	

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

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

	2008		2007		2006	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Customer accounts						
Europe						
Demand and other – non-interest bearing	**39,610**	**–**	34,585	–	33,000	–
Demand – interest bearing	**225,034**	**2.9**	210,692	3.5	173,150	2.7
Savings	**73,479**	**4.3**	62,002	4.6	50,525	3.9
Time	**83,208**	**3.8**	69,476	4.9	59,374	4.2
Other	**26,651**	**3.9**	14,741	4.5	9,249	4.1
	447,982		391,496		325,298	
Hong Kong						
Demand and other – non-interest bearing	**15,620**	**–**	14,214	–	13,011	–
Demand – interest bearing	**126,199**	**0.4**	107,053	2.2	88,754	2.4
Savings	**65,068**	**2.4**	63,649	3.9	58,883	3.8
Time	**27,659**	**2.3**	26,712	3.9	20,454	3.6
Other	**1,563**	**1.2**	1,164	4.3	51	3.9
	236,109		212,792		181,153	
Rest of Asia-Pacific						
Demand and other – non-interest bearing	**22,721**	**–**	16,438	–	13,107	–
Demand – interest bearing	**55,653**	**1.9**	41,089	2.4	29,816	2.1
Savings	**68,968**	**3.6**	57,950	4.2	42,153	4.3
Time	**15,226**	**3.3**	11,538	4.6	10,246	4.5
Other	**1,359**	**2.8**	1,835	4.5	2,233	3.5
	163,927		128,850		97,555	
North America						
Demand and other – non-interest bearing	**16,759**	**–**	15,175	–	13,662	–
Demand – interest bearing	**18,261**	**1.6**	15,389	3.3	14,406	2.9
Savings	**87,001**	**2.5**	79,529	3.3	65,216	2.8
Time	**17,838**	**3.2**	17,655	5.9	21,124	5.4

Other	**5,123**	**2.4**	3,234	3.7	3,339	2.0
	144,982		130,982		117,747	
Latin America						
Demand and other — non-interest bearing	**12,507**	—	10,530	—	7,995	—
Demand — interest bearing	**4,994**	**1.9**	5,662	2.1	5,438	1.6
Savings	**31,442**	**10.3**	24,861	8.8	16,512	11.3
Time	**15,179**	**5.2**	12,443	5.9	7,665	5.9
Other	**949**	**8.2**	1,212	9.5	2,145	13.4
	65,071		54,708		39,755	
Total						
Demand and other — non-interest bearing	**107,217**	—	90,942	—	80,775	—
Demand — interest bearing	**430,141**	**1.9**	379,885	3.0	311,564	2.6
Savings	**325,958**	**3.9**	287,991	4.4	233,289	4.1
Time	**159,110**	**3.6**	137,824	4.9	118,863	4.5
Other	**35,645**	**3.6**	22,186	4.7	17,017	4.8
	1,058,071		918,828		761,508	
CDs and other money market instruments						
Europe	**74,007**	**4.5**	66,164	5.0	48,238	4.2
Hong Kong	**745**	**3.0**	941	3.9	1,191	3.5
Rest of Asia-Pacific	**7,614**	**6.4**	7,230	6.0	6,621	5.6
North America	**22,278**	**3.3**	23,735	5.4	23,472	4.6
Latin America	**3,036**	**7.8**	1,526	6.8	318	10.7
	107,680	**4.5**	99,596	5.2	79,840	4.5

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Certificates of deposit and other time deposits

At 31 December 2008, the maturity analysis of CDs and other wholesale time deposits, by remaining maturity, was as follows:

	3 months or less	After 3 months but within 6 months	After 6 months but within 12 months	After 12 months	Total
	US$m	**US$m**	**US$m**	**US$m**	**US$m**
Europe					
Certificates of deposit	**23,911**	**483**	**192**	**–**	**24,586**
Time deposits:					
– banks	**34,951**	**1,943**	**2,418**	**4,649**	**43,961**
– customers	**78,562**	**5,140**	**4,135**	**1,598**	**89,435**
	137,424	**7,566**	**6,745**	**6,247**	**157,982**
Hong Kong					
Certificates of deposit	**145**	**137**	**280**	**904**	**1,466**
Time deposits:					
– banks	**1,031**	**5**	**–**	**67**	**1,103**
– customers	**21,898**	**1,057**	**274**	**419**	**23,648**
	23,074	**1,199**	**554**	**1,390**	**26,217**
Rest of Asia-Pacific					
Certificates of deposit	**2,324**	**1,383**	**928**	**248**	**4,883**
Time deposits:					
– banks	**3,912**	**887**	**310**	**164**	**5,273**
– customers	**13,106**	**1,651**	**670**	**1,490**	**16,917**
	19,342	**3,921**	**1,908**	**1,902**	**27,073**
North America					
Time deposits:					
– banks	**10,209**	**2**	**5**	**201**	**10,417**
– customers	**13,882**	**720**	**248**	**310**	**15,160**
	24,091	**722**	**253**	**511**	**25,577**
Latin America					
Certificates of deposit	**1,161**	**640**	**60**	**316**	**2,177**
Time deposits:					
– banks	**2,360**	**1,446**	**389**	**264**	**4,459**
– customers	**10,357**	**1,389**	**1,071**	**359**	**13,176**

	13,878	**3,475**	**1,520**	**939**	**19,812**
Total					
Certificates of deposit	**27,541**	**2,643**	**1,460**	**1,468**	**33,112**
Time deposits:					
banks	**52,463**	**4,283**	**3,122**	**5,345**	**65,213**
customers	**137,805**	**9,957**	**6,398**	**4,176**	**158,336**
	217,809	**16,883**	**10,980**	**10,989**	**256,661**

The geographical analysis of deposits is based on the location of the office in which the deposits are recorded and excludes balances with HSBC companies. The majority of certificates of deposit and time deposits are in amounts of US$100,000 and over or the equivalent in other currencies.

Critical accounting policies

(Audited)
Introduction

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

When preparing the financial statements, it is the Directors responsibility under UK company law to select suitable accounting policies and to make judgements and estimates that are reasonable and prudent.

The accounting policies that are deemed critical to HSBCs results and financial position, in terms of the materiality of the items to which the policy is applied, and which involve a high degree of judgement including the use of assumptions and estimation, are discussed below.

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Critical accounting policies

Impairment of loans and advances

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

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment allowances on both individually and collectively assessed loans and advances. Of the Groups total loans and advances to customers before impairment allowances of US$957 billion (2007: US$1,001 billion), US$6.9 billion or 1 per cent (2007: US$6.5 billion; 1 per cent) were individually assessed for impairment, and US$950 billion or 99 per cent (2007: US$994 billion; 99 per cent) were collectively assessed for impairment.

The most significant judgemental area is the calculation of collective impairment allowances. HSBCs most significant geographical area of exposure to collectively assessed loans and advances is North America, which comprised US$271 billion or 29 per cent (2007: US$301 billion; 30 per cent) of HSBCs total collectively assessed loans and advances. Collective impairment allowances in North America were US$15.9 billion, representing 77 per cent (2007: US$11.9 billion; 72 per cent) of the total collectively assessed loan impairment allowance.

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

- when appropriate empirical information is available, HSBC utilises roll-rate methodology. This methodology employs statistical analysis of historical data and experience of delinquency and default to estimate the likelihood that loans will progress through the various stages of delinquency and ultimately prove irrecoverable. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio; and

- 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 customers loan is overdue. Loss rates are based on historical experience.

Both methodologies are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis because of the large number of individually insignificant loans in the portfolio.

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

This key area of judgement is subject to uncertainty and is highly sensitive to factors such as loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographic concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other factors that can affect customer payment patterns. Different factors are applied in different regions and countries to reflect different economic conditions and laws and regulations. The assumptions underlying this judgement are highly subjective. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

The total amount of the Group's impairment allowances on homogeneous groups of loans is inherently uncertain because it is highly sensitive to changes in economic and credit conditions across a

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large number of geographical areas. Economic and credit conditions within geographical areas are influenced by many factors with a high degree of interdependency so that there is no single factor to which the Groups loan impairment allowances as a whole are sensitive. However, HSBCs loan impairment allowances are particularly sensitive to general economic and credit conditions in North America. For example, a 10 per cent increase in impairment allowances on collectively assessed loans and advances in North America would increase loan impairment allowances by US$1.6 billion at 31 December 2008 (2007: US$1.2 billion). It is possible that the outcomes within the next financial year could be different from the assumptions built into the models, resulting in a material adjustment to the carrying amount of loans and advances.

Goodwill impairment

HSBCs accounting policy for goodwill is described in Note 2(p) on the Financial Statements. Note 22 on the Financial Statements lists the Groups cash generating units (CGUs) by geographical region and global business. Total goodwill for the Group amounted to US$22 billion as at 31 December 2008 (2007: US$34 billion).

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

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available, and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data in future years; however, the cash flow forecasts necessarily and appropriately reflect managements view of future business prospects at the time of the assessment; and

- the discount rate used to discount the future expected cash flows is based on the cost of capital assigned to an individual CGU, and can have a significant effect on the CGUs valuation. The cost of capital percentage is generally derived from a Capital Asset Pricing Model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium to reflect the inherent risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic conditions outside of managements control and are therefore established on the basis of significant management judgement and are subject to uncertainty.

When this exercise demonstrates that the expected cash flows of a CGU have declined and/or that its cost of capital has increased, the effect is to reduce the CGUs estimated recoverable amount. If this results in an estimated recoverable amount that is lower than the carrying value of the CGU, a charge for impairment of goodwill will be recognised in HSBCs income statement for the year.

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

Given the extraordinary market events experienced globally during the second half of 2008, HSBC performed an additional impairment test on all the CGUs within the Group as at 31 December 2008. As a result, HSBC recognised an impairment charge of US$10.6 billion on Personal Financial Services North America as at 31 December 2008 (2007: nil). Management concluded that the recoverable amount of the other CGUs to which goodwill has been allocated exceeded their carrying value. However, in the event of further significant deterioration in the economic and credit conditions beyond the levels already reflected by management in the cash flow forecasts for the CGUs, a material adjustment to a CGUs recoverable amount may occur which may result in the recognition of an impairment charge in the income statement.

Note 22 on the Financial Statements includes details of the CGUs with significant balances of goodwill, states the key assumptions used to assess the goodwill in each of those CGUs for impairment, and provides a discussion of the sensitivity of the carrying value of goodwill to changes in key assumptions.

Valuation of financial instruments

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

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

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

The main assumptions and estimates which management considers when applying a model with valuation techniques are:

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

- selecting an appropriate discount rate for the instrument. Management bases the determination of this rate on its assessment of what a market participant would regard as the appropriate spread of the rate for the instrument over the appropriate risk-free rate; and

- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

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

An analysis of the basis for valuation of financial instruments measured at fair value in the financial statements is provided on page 162. The value of financial assets and liabilities that use a valuation technique are US$876 billion (2007: US$626 billion) and US$671 billion (2007: US$401 billion) or 71 per cent (2007: 66 per cent) and 83 per cent (2007: 68 per cent) of total assets and total liabilities measured at fair value, respectively. A sensitivity analysis of fair values for financial instruments with significant unobservable inputs to reasonably possible alternative assumptions and a range of assumptions and inputs used in valuation models in respect of instruments of particular interest in the current market turmoil can be found on page 164. Given the uncertainty and subjective nature of valuing financial instruments at fair value, it is possible that the outcomes in the next financial year could differ from the assumptions used, and this could result in a material adjustment to the carrying amount of financial instruments measured at fair value.

Impairment of available-for-sale financial assets

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

Available-for-sale financial assets are measured at fair value, and changes in fair value are recognised in equity in the available-for-sale fair value reserve until the financial assets are either sold or become impaired. An impairment loss is recognised if there is objective evidence of impairment as a result of loss events which have an impact on the estimated future cash flows of the financial asset that can be reliably estimated. If an available-for-sale financial asset becomes impaired, the entire balance in equity

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relating to that asset is removed from equity and recognised in the income statement as an impairment loss. A further decline in the fair value of an available-for-sale debt security subsequent to the initial impairment is recognised in the income statement when there is further objective evidence of impairment.

At 31 December 2008 the Groups total available-for-sale financial assets amounted to US$286 billion (2007: US$273 billion), of which US$279 billion or 98 per cent (2007: US$261 billion; 95 per cent) were debt securities. At 31 December 2008, the available-for-sale fair value reserve relating to debt securities amounted to a deficit of US$21.4 billion (2007: deficit of US$2.4 billion). A deficit in the available-for-sale fair value reserve occurs on an available-for-sale debt security when the fair value of the security is less than the securitys acquisition cost (net of any principal repayments and amortisation) less any previous impairment loss recognised in the income statement, but there is no evidence of any impairment or, if an impairment was previously recognised, any subsequent impairment.

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

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

The most significant judgements concern more complex instruments, such as asset-backed securities (ABSs), where it is necessary to consider factors such as the estimated future cash flows on underlying pools of collateral, the extent and depth of market price declines and changes in credit ratings. The review of estimated future cash flows on underlying collateral is subject to estimation uncertainties where the assessment is based on historical information on pools of assets, and

judgement is required to determine whether historical performance is likely to be representative of current economic and credit conditions. A description of these securities is included in the Impact of market turmoil section under Nature and extent of HSBCs exposures on page 150 and a more detailed description of the assumptions and estimates used in assessing these securities for impairment is disclosed in the section Assessing available-for-sale assets for impairment on page 170.

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

Managements current assessment of the holdings of available-for-sale ABSs with the most sensitivity to possible future impairment is focused on sub-prime and Alt-A residential mortgage-backed securities (MBSs). The Groups principal exposure to these securities is in the Global Banking and Markets business. Excluding holdings in certain special purpose entities where significant first loss risks are borne by external investors, the available-for-sale holdings in these categories within Global Banking and Markets amounted to US$5.2 billion at 31 December 2008 (2007: US$11.8 billion). The deficit in the available-for-sale fair value reserve as at 31 December 2008 in relation to these securities was US$5.9 billion (2007: US$1.1 billion).

The main factors in the reduction in fair value of these securities over the period were the effects of reduced market liquidity and negative market sentiment. The level of actual credit losses experienced was low in 2008, notwithstanding the deterioration in the performance of the underlying mortgages in the period as US house prices fell and defaults increased. The absence of material credit losses is judged to be attributable to the seniority of the tranches held by HSBC as well as the priority for cash flow held by these tranches.

Further details of the nature and extent of HSBCs exposures to asset backed securities classified as available-for-sale are provided in Impact of market turmoilnature and extent of HSBCs exposures on page 150.

It is reasonably possible that outcomes in the next financial year could be different from the assumptions and estimates used in identifying

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impairment on available-for-sale debt securities, as a result of which, evidence of impairment may be identified in available-for-sale debt securities which had previously been determined not to be impaired. It is possible that this could result in the recognition of material impairment losses in the next financial year.

Deferred tax assets

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

HSBC's most significant judgements are around the US deferred tax assets, where there has been a recent history of losses in HSBC's US operations. Net US deferred tax assets amounted to US$5.0 billion or 71 per cent (2007: US$3.7 billion; 70 per cent) of total net deferred tax assets recognised on the Group's balance sheet.

The amount of US deferred tax assets recognised is based on the evidence available about conditions at the balance sheet date, and requires significant judgements to be made by management, especially those based on management's projections of credit losses and the timing of recovery in the US economy. Management's judgement takes into consideration the impact of both positive and negative evidence, including historical financial performance, projections of future taxable income, future reversals of existing taxable temporary differences, and the availability of loss carrybacks. The recognition of the deferred tax asset is mainly dependent upon the projection of future taxable profits, future reversals of existing taxable temporary differences and the capacity to carry back net operating losses arising in 2009.

Tax losses were incurred in HSBC's US operations in 2008. Management has evaluated the factors contributing to the losses to determine whether the factors leading to the losses are temporary or indicative of a permanent decline in earnings. Based on its analysis, management has determined that the losses were primarily caused by increases in credit losses in the US due to the current housing and credit market conditions, as well as continued weakening in the general economy, which has led to higher unemployment levels and, consequently, higher credit losses.

In the US, management's projections of future taxable income are based on business plans, future capital requirements and ongoing tax planning strategies. These projections include assumptions about the depth and severity of further house price depreciation, assumptions about the US recession, including unemployment levels and their related impact on credit losses, and assumptions about ongoing capital support from HSBC.

The assumptions surrounding future expected credit losses in the US represent the most subjective areas of judgement in management's projections of future taxable income.

Management's forecasts support the assumption that it is probable that the results of future operations will generate sufficient taxable income to utilise the deferred tax assets. In management's judgement, the recent market conditions, which have resulted in losses being incurred in the US over the last two years, will create significant downward pressure and volatility on the profit or loss before tax in the next few years. To reflect this, the assessment of recoverability of the deferred tax asset in the US significantly discounts any future expected taxable income and relies to a greater extent on continued capital support to the US operations from HSBC, including tax planning strategies implemented in relation to such support. The most significant tax planning strategy is HSBCs investment of capital into its US operations to ensure the utilisation of the net operating loss carry forwards. This strategy provides substantial support for the recoverability of the deferred tax assets. HSBC expects that its US operations will continue to be dependent upon its capital support, and will continue to execute their business strategies and plans until they return to profitability. Based on managements forecasts, HSBC expects to provide capital support to its US operations in each of the next three years. If HSBC were to decide, however, not to provide this ongoing support, the full recovery of the deferred tax asset may no longer be probable and could result in a material adjustment to the deferred tax asset which would be recognised in the income statement.

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Disclosure controls

The Group Chairman and Group Finance Director, with the assistance of other members of management, carried out an evaluation of the effectiveness of the design and operation of HSBC Holdings’ disclosure controls and procedures as of 31 December 2008. Based upon that evaluation, the Group Chairman and Group Finance Director concluded that HSBC’s disclosure controls and procedures as of 31 December 2008 were effective to provide reasonable assurance that information required to be disclosed in the reports which the company files and submits under the US Securities Exchange Act of 1934, as amended, is recorded, processed, summarised and reported as and when required. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

There has been no change in HSBC Holdings’ internal control over financial reporting during the year ended 31 December 2008 that has materially affected, or is reasonably likely to materially affect, HSBC Holdings’ internal control over financial reporting.

Management’s assessment of internal control over financial reporting

Management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and has completed an assessment of the effectiveness of the Group’s internal control over financial reporting as of 31 December 2008. In making the assessment, management used the framework for Director’s internal control evaluation contained within the Combined Code (‘The Revised Turnbull Guidance’), as well as the criteria established by the Committee of Sponsoring Organisations of the Treadway Commission (‘COSO’) in ‘Internal Control-Integrated Framework’.

Based on the assessment performed, management concluded that as at 31 December 2008, the Group’s internal control over financial reporting was effective.

KPMG Audit Plc, which has audited the consolidated financial statements of the Group for the year ended 31 December 2008, has also audited the effectiveness of the Group’s internal control over financial reporting under Auditing Standard No.5 of the Public Company Accounting Oversight Board (United States) as stated in their report on pages 330 and 331.

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Customer groups and global businesses

Summary

HSBC manages its business through two customer groups, Personal Financial Services and Commercial Banking, and two global businesses, Global Banking and Markets (previously Corporate, Investment Banking and Markets), and Private Banking. Personal Financial Services incorporates the Group's consumer finance businesses; the largest of these is HSBC Finance Corporation ('HSBC Finance').

All commentaries on the customer groups and global businesses are on an underlying basis unless stated otherwise.

Profit/(loss) before tax

	2008		2007		2006	
	US$m	**%**	US$m	%	US$m	%
Personal Financial Services	**(10,974)**	(117.9)	5,900	24.4	9,457	42.8
Commercial Banking	**7,194**	77.3	7,145	29.5	5,997	27.2
Global Banking and Markets	**3,483**	37.4	6,121	25.3	5,806	26.3
Private Banking	**1,447**	15.6	1,511	6.2	1,214	5.5
Other[13]	**8,157**	87.6	3,535	14.6	(388)	(1.8)
	9,307	100.0	24,212	100.0	22,086	100.0

Total assets[15]

	At 31 December			
	2008		2007	
	US$m	**%**	US$m	%
Personal Financial Services	**514,419**	**20.4**	621,356	26.4
Commercial Banking	**249,218**	**9.9**	307,944	13.1
Global Banking and Markets	**1,896,630**	**75.0**	1,561,468	66.3
Private Banking	**133,216**	**5.3**	130,893	5.6

Other	**135,001**	**5.3**	155,685	6.6
Intra-HSBC items	**(401,019)**	**(15.9)**	(423,080)	(18.0)
	2,527,465	**100.0**	2,354,266	100.0

For footnotes, see page 145.

Basis of preparation

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

can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve a degree of subjectivity.

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

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

Customer groups > Personal Financial Services

Personal Financial Services

Profit/(loss) before tax

	2008	2007	2006
	US$m	US$m	US$m
Net interest income	**29,419**	29,069	26,076
Net fee income	**10,107**	11,742	8,762
Trading income excluding net interest income	**175**	38	391
Net interest income on trading activities	**79**	140	220
Net trading income[16]	**254**	178	611
Net income/(expense) from financial instruments designated at fair value	**(2,912)**	1,333	739
Gains less losses from financial investments	**663**	351	78
Dividend income	**90**	55	31
Net earned insurance premiums	**10,083**	8,271	5,130
Other operating income	**259**	387	782
Total operating income	**47,963**	51,386	42,209
Net insurance claims[17]	**(6,474)**	(8,147)	(4,365)
Net operating income[5]	**41,489**	43,239	37,844
Loan impairment charges and other credit risk provisions	**(21,220)**	(16,172)	(9,949)
Net operating income	**20,269**	27,067	27,895
Operating expenses (excluding goodwill impairment)	**(21,140)**	(21,757)	(18,818)
Goodwill impairment	**(10,564)**	–	–
Operating profit/(loss)	**(11,435)**	5,310	9,077
Share of profit in associates and joint ventures	**461**	590	380
Profit/(loss) before tax	**(10,974)**	5,900	9,457
By geographical region			
Europe	**1,658**	1,581	1,909
Hong Kong	**3,428**	4,212	2,880
Rest of Asia-Pacific	**500**	760	477
North America	**(17,228)**	(1,546)	3,391
Latin America	**668**	893	800

	(10,974)	5,900	9,457
	%	%	%
Share of HSBC□s profit before tax	**(117.9)**	24.4	42.8
Cost efficiency ratio	**76.4**	50.3	49.7

Balance sheet data[15]

	US$m	US$m	US$m
Loans and advances to customers (net)	**401,402**	464,726	448,545
Total assets	**514,419**	621,356	602,342
Customer accounts	**440,338**	450,071	388,468

For footnotes, see page 143.

Strategic direction

HSBC□s strategy for Personal Financial Services is to use its global reach and local knowledge to grow profitably in selected markets. The strategy focuses on growth in:

– markets where HSBC already has scale, such as Hong Kong and the UK; and

– markets where HSBC can build or acquire scale, particularly in Asia-Pacific, Latin America, Turkey and the Middle East.

Within these markets, there are two key target segments:

– customers who value seamless international banking and wealth management; and

– customers who are confident about using direct channels (internet, ATM, telephone, mobile) to access financial services.

Financial performance in 2008

- The reported loss before tax of US$11.0 billion compared with a profit of US$5.9 billion in 2007, driven substantially by higher loan impairment charges and a goodwill impairment charge of US$10.6 billion which wrote down in full the goodwill relating to the North American Personal Financial Services business. Excluding the loss before tax incurred in this business, pre- tax profits fell by 17 per cent on an underlying basis, with an increase in loan impairments and lower fee income more than offsetting an increase in revenue from deposit growth and higher gains on the sale of MasterCard and Visa shares.

- Net fee income fell by 13 per cent. This was driven by weak market sentiment, which resulted in lower fees from retail securities and investments, particularly in Hong Kong, and changes in fee billing practices in the credit card business to improve the customer proposition in North America.

- A net expense of US$2.9 billion was recorded on financial instruments designated at fair value, compared with income of US$1.3 billion in 2007. This was largely due to the fall in value of assets held to meet liabilities under insurance and investment contracts driven by poor equity market performances, predominantly affecting operations in Hong Kong, the UK and France.
  For assets held to meet liabilities under unit- linked and, to a certain extent, participating insurance contracts, the movement from income to expense was offset by a corresponding

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reduction in policyholder liabilities where investment losses can be passed to policyholders.

- Loan impairment charges rose by 32 per cent, primarily due to further deterioration in credit quality in the North American Personal Financial Services business. Delinquency rates increased across all portfolios in HSBC Finance, particularly consumer lending, and in the real estate secured portfolios in HSBC USA, following the sustained downturn in the housing market and the onset of economic recession.

- A rise in loan impairments in Mexico, Turkey and India was attributable to higher delinquencies following growth of the credit card and personal loan portfolios. Actions taken to curtail asset growth in these markets focused on tightening lending criteria and deploying advanced credit analytics.

- Operating expenses were 48 per cent higher, largely due to the goodwill impairment charge. Excluding this, operational costs were slightly lower, driven by a 12 per cent reduction in North America following initiatives taken since 2007 to cease originations in mortgage services, limit new originations in consumer lending and reduce marketing spend in cards. This benefit was partially offset by investment in business expansion in mainland China and Japan and an increase in restructuring costs and union-agreed salaries in Latin America.

- Profit before tax increased in Europe, with a solid performance in the UK partially offset by a fall in Turkey as an investment in 98 additional branches was made in order to attain nationwide coverage. Profits were lower in France.

- In the Middle East, profit rose by 17 per cent on 2007, with strong growth in revenue from cards.

Business highlights in 2008

- HSBC Premier (Premier), which offers mass affluent customers a seamless international banking and wealth management service, grew to 2.6 million customers in 2008. During the year, the service was extended to a further six countries, taking the total to 41. 472,000 net new customers joined Premier, of whom 80 per cent were new to the Group.
- The strength of the HSBC brand helped attract an increase in customer accounts of US$50 billion, or 13 per cent, to US$440 billion, despite the low interest rate environment. In North America, net loans and advances to customers fell by 16 per cent as HSBC reduced its balance sheet and lowered its risk profile in the US. Excluding North America, lending increased by 10 per cent, demonstrating HSBC's commitment to supporting its core customer base. At 31 December 2008, the advances-to-deposits ratio was 91 per cent, compared with 106 per cent at the end of December 2007.

- The HSBC Direct online savings offering in the US performed well in difficult market conditions. Average balances increased by US$2.0 billion to US$13.2 billion, reducing the overall funding costs of the US Personal Financial Services business.

- In the UK, HSBC launched a RateMatcher mortgage promotion to attract quality customers facing an interest rate reset in the near term. HSBC attracted a strong flow of new business totalling US$9.9 billion during the campaign. In December 2008, HSBC announced that the bank will make available up to £15 billion of UK residential mortgages in 2009.

- Consistent with HSBC's strategy to increase the sale of insurance products to existing customers, the major life businesses in Europe and Asia grew and underlying net premium income rose by 15 per cent. However, declining worldwide equity markets led to a reduction in insurance profits compared with 2007.

- In the US, declining house prices, rising unemployment and increasing bankruptcies fuelled growing customer delinquencies. HSBC continued to take measures to help customers manage their mortgage repayments and avoid foreclosure. During 2008, HSBC Finance expanded its mortgage loan modification programme which included longer-term modifications. The loan obligations of over 92,000 customers with aggregate mortgages of US$13.5 billion were modified during 2008, helping to maximise cash flow for HSBC and preserve home ownership for customers.

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Subsequent developments

The branch-based US consumer lending business of HSBC Finance has historically focused on sub-prime customers who rely on drawing cash against the equity in their homes to help meet their cash needs. Unsecured consumer lines of credit have served as a means of generating new customer accounts, with the potential to subsequently provide the customer with a mortgage product, typically a secured debt consolidation loan. As a result, the bulk of the mortgage lending products sold in the US consumer lending branch network have been for refinancing and debt consolidation rather than for house purchase.

The unprecedented deterioration in the US housing market over the last two years, including declining property values and lower secondary market demand for sub-prime mortgages, has undermined the ability of many real estate loan customers to make payments or refinance their loans. In many cases, there is no equity in their homes or, if there is, few institutions are willing to finance its withdrawal. As a result, loan originations in this business have fallen dramatically for both HSBC Finance and the industry as a whole. Management believes it will take years before property values return to the levels seen prior to the decline and, as such, has concluded that recovery in the sub-prime mortgage lending business is uncertain and the industry is unlikely to stabilise for a number of years. Management also expects that changes in regulation and practice will make it problematic to plan and execute a sub-prime lending business strategy with a reasonable degree of confidence.

Given the above, in 2008 HSBC began to reposition its US consumer lending business to reduce risk by tightening lending criteria and expanding its lending to include government sponsored entity and conforming loan products. As part of this repositioning, HSBC intended to place greater emphasis on unsecured loan products while decreasing secured loan production. To date, the results of this repositioning effort have not met expectations, in part due to the continued deterioration in the economy, leading management to re-evaluate whether, given the Groups risk appetite, the initiative can produce the volume necessary to ensure that the consumer lending business will return to profitability in the foreseeable future.

As a consequence, at the end of February 2009, the Board of HSBC endorsed managements recommendation to discontinue as soon as practicable originations of all products by the branch-based US consumer lending business of HSBC Finance. At 31 December 2008 this business had outstanding balances of US$62 billion comprising US$46 billion in real estate secured and US$16 billion in unsecured loan balances. HSBC will continue to service and collect the existing loan portfolio as it runs off, and will continue the Groups efforts to help customers in need of loan modification and other account management programmes to maximise collection and preserve, as far as possible, home ownership. In the US, substantially all consumer lending branches branded HFC and Beneficial will cease taking loan applications and will be closed. HSBC Finance will also continue to run-off the loan portfolios of its mortgage services business and its vehicle finance business. HSBC will provide all necessary support to HSBC Finance to enable it to run off these businesses in a measured way and to meet all its commitments.

The operations of HSBCs other US Personal Financial Services businesses, including its card business, and the retail bank branch business of HSBC USA are unaffected by this decision. HSBC USA will continue to service its customers with real estate secured and unsecured products.

HSBC expects as a result of this decision affecting the US consumer lending business of HSBC Finance that total revenue will fall by approximately US$50 million in 2009 and operating expenses by approximately US$700 million on an annualised basis. Closure costs of up to US$195 million will be incurred, predominantly related to one-off termination and other employee benefit costs, a substantial portion of which will be recorded in the first half of 2009.

In addition, a non-cash charge of approximately US$70 million is expected to be incurred in relation to the impairment of fixed assets associated with the consumer lending branch network, also to be recognised in the first half of 2009.

Employees supporting originations operations will be evaluated for service elsewhere in HSBCs operations, but it is currently expected that approximately 6,100 employees will be displaced.

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

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

	2007 compared with 2006								
Personal Financial Services	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006 at 2007 exchange rates[6] US$m	2007 acquisitions, disposals & dilution gains[1] US$m	Under-lying change US$m	2007 as reported US$m	Re-ported change %	Under-lying change %

Net interest income	26,076	(3)	746	26,819	653	1,597	29,069	11	6
Net fee income	8,762	53	322	9,137	(77)	2,682	11,742	34	30
Other income[4]	3,006	(53)	87	3,040	(38)	(574)	2,428	(19)	(19)
Net operating income[5]	37,844	(3)	1,155	38,996	538	3,705	43,239	14	10
Loan impairment charges and other credit risk provisions	(9,949)	–	(205)	(10,154)	(72)	(5,946)	(16,172)	(63)	(59)
Net operating income	27,895	(3)	950	28,842	466	(2,241)	27,067	(3)	(8)
Operating expenses	(18,818)	2	(753)	(19,569)	(285)	(1,903)	(21,757)	(16)	(10)
Operating profit	9,077	(1)	197	9,273	181	(4,144)	5,310	(42)	(45)
Income from associates	380	–	13	393	6	191	590	55	49
Profit before tax	9,457	(1)	210	9,666	187	(3,953)	5,900	(38)	(41)

For footnotes, see page 143.

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Commercial Banking

Profit before tax

	2008 US$m	2007 US$m	2006 US$m
Net interest income	**9,494**	9,055	7,514
Net fee income	**4,097**	3,972	3,207
Trading income excluding net interest income	**369**	265	204
Net interest income on trading activities	**17**	31	20
Net trading income[16]	**386**	296	224
Net income/(expense) from financial instruments designated at fair value	**(224)**	22	(22)
Gains less losses from financial investments	**193**	90	44
Dividend income	**88**	8	6
Net earned insurance premiums	**679**	733	258
Other operating income	**939**	165	250
Total operating income	**15,652**	14,341	11,481
Net insurance claims[17]	**(335)**	(391)	(96)
Net operating income[5]	**15,317**	13,950	11,385
Loan impairment charges and other credit risk provisions	**(2,173)**	(1,007)	(697)
Net operating income	**13,144**	12,943	10,688
Total operating expenses	**(6,581)**	(6,252)	(4,979)
Operating profit	**6,563**	6,691	5,709
Share of profit in associates and joint ventures	**631**	454	288
Profit before tax	**7,194**	7,145	5,997
By geographical region			
Europe	**2,722**	2,516	2,234
Hong Kong	**1,315**	1,619	1,321
Rest of Asia-Pacific	**1,793**	1,350	1,034
North America	**658**	920	957

Latin America	**706**	740	451
	7,194	7,145	5,997
	%	%	%
Share of HSBC's profit before tax	**77.3**	29.5	27.2
Cost efficiency ratio	**43.0**	44.8	43.7

Balance sheet data[15]

	US$m	US$m	US$m
Loans and advances to customers (net)	**203,949**	220,068	172,976
Total assets	**249,218**	307,944	228,668
Customer accounts	**235,879**	237,987	190,853

For footnotes, see page 143.

Strategic direction

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

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

- to be the best bank for small businesses in target markets, building global scale and creating efficiencies by sharing best practice, including customer experience and credit scoring, and selectively rolling out the direct banking model.

Financial performance in 2008

- Reported pre-tax profit was broadly in line with 2007 at US$7.2 billion as revenue growth was offset by the rise in loan impairment charges and operating costs. Pre-tax profit growth was evident in emerging markets, with their contribution increasing to 56 per cent excluding a gain of US$425 million on the disposal of the UK merchant acquiring division, recorded in 'Other operating income'. Profit growth was most significant in Australia, India, mainland China, United Arab Emirates ('UAE'), Turkey, Brazil and Argentina.

- HSBC remained committed to new lending, increasing lending balances by 10 per cent. Deposit growth of 15 per cent was driven by brand strength, particularly in the UK, the US and Hong Kong.

- Balance sheet growth drove a 7 per cent rise in net interest income, notwithstanding the adverse affect of widespread reductions in interest rates on liability spreads. This was partly offset by higher lending spreads from improved pricing.

- Net fee income rose by 8 per cent with income from trade services and foreign exchange growing particularly strongly.

- Other income was boosted by a number of significant gains, notably from the sale of shares in MasterCard and Visa.

- Loan impairment charges increased from US$1.0 billion in 2007 to US$2.2 billion, as the previously benign credit environment was replaced by economic slowdown in most countries. Loan impairment charges increased by 44 basis points to 1 per cent of average reported assets, with most of the increase coming in the second half of 2008.

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- The cost efficiency ratio improved to 44.2 per cent excluding the US$425 million gains noted above. Costs were tightly controlled in Europe and North America, but grew elsewhere as the Group continued to expand operations in emerging markets, particularly in Asia.

- Customer numbers grew to 2.9 million, with continuing recruitment of new customers through existing operations and gains from the acquisition of the assets, liabilities and operations of The Chinese Bank in Taiwan, despite a reduction from the sale of the French regional banks.

Business highlights in 2008

Commercial Banking achieved key objectives toward its international business strategy in 2008 as the proportion of its total revenues derived from international customers and products increased.

- Revenue from foreign exchange and trade and supply chain products grew strongly, with increases of 66 per cent and 27 per cent, respectively. This was driven by improved cross-selling of products, particularly in foreign exchange, as customers sought protection from volatile currency movements. A number of initiatives were launched to extend foreign exchange services, which included enhancing relationship management in the US and UAE, and introducing dedicated sales desks in India.

- The volume of international trade finance increased significantly and revenue grew commensurately as HSBC benefited from higher commodity prices, the reintermediation of traditional trade instruments in respect of which the Group demonstrated continued capacity to lend, and improved pricing reflecting market trends. HSBC’s growth outpaced market growth in a number of key countries, particularly in Asia and the Middle East.

- Successful Global Links referrals nearly doubled to 5,600, with the aggregate transaction value exceeding US$11 billion, an increase of 96 per cent. The use of electronic account opening ‘SmartForms’ improved customer experience.

  In support of its strategy to be the best bank for small businesses, HSBC focused on deposit gathering and transaction banking, and was particularly successful in attracting customer deposits.

- With over US$100 billion in customer deposits, HSBC’s small and micro segments are a significant source of funding for Commercial Banking, generating over twice as much in liabilities as loans and advances to customers. Customer numbers in the small and micro segments rose by 7 per cent to 2.6 million. In Taiwan, the acquisition of the assets, liabilities and operations of The Chinese Bank expanded the branch network to 33 and added over 15,000 small business customers.

- Customer loyalty was evidenced by an increase in the use of internet banking, with the number of active users of Business Internet Banking growing by 16 per cent and the number of transactions by 18 per cent.

- New small business offerings continued to be initiated. BusinessDirect was extended to seven countries and total customer numbers exceeded 180,000. BusinessVantage was launched in Indonesia while, in the US, the autumn marketing campaign led to over 9,000 new accounts. New business card products were rolled out in a further six countries.

- The announcement of HSBC’s US$5 billion International SME Fund in December under- scored the Group’s commitment to lending to small and medium-sized enterprises, and led to significant interest from existing and prospective customers. Specific initiatives were launched in the UK, Hong Kong, France and Malta.

Commercial Banking increased its intra-Group referrals, in part by extending the Global Links platform to facilitate cross-customer group referrals.

- In Hong Kong and India, an initiative to increase referrals across customer groups resulted in a two-fold rise in the number of Premier account referrals, and significant growth in referrals from Personal Financial Services to Commercial Banking. Similar programmes in the UK contributed to sales of Premier accounts and mortgage products, and plans are underway to extend these programmes to other regions in 2009.

- Referrals to Private Banking grew by 30 per cent, and led to US$2.7 billion in new assets under management, while referrals from Private Banking led to a three-fold increase in new relationships.

- Sales of Global Markets products were particularly strong in foreign exchange under Commercial Banking's strategy to be the leading bank for international business.

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

Customer groups > Commercial Banking / Global Banking and Markets

Reconciliation of reported and underlying profit before tax

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

Commercial Banking	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006 at 2007 exchange rates[6] US$m	2007 acquisitions, disposals & dilution gains[1] US$m	Under-lying change US$m	2007 as reported US$m	Re-ported change %	Under-lying change %
	2007 compared with 2006								
Net interest income	7,514	–	382	7,896	114	1,045	9,055	21	13
Net fee income	3,207	–	189	3,396	17	559	3,972	24	16
Other income[4]	664	–	27	691	48	184	923	39	27
Net operating income[5]	11,385	–	598	11,983	179	1,788	13,950	23	15
Loan impairment charges and other credit risk provisions	(697)	–	(47)	(744)	(61)	(202)	(1,007)	(44)	(27)
Net operating income	10,688	–	551	11,239	118	1,586	12,943	21	14
Operating expenses	(4,979)	–	(291)	(5,270)	(73)	(909)	(6,252)	(26)	(17)
Operating profit	5,709	–	260	5,969	45	677	6,691	17	11
Income from associates	288	–	9	297	1	156	454	58	53
Profit before tax	5,997	–	269	6,266	46	833	7,145	19	13

For footnotes, see page 143.

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Global Banking and Markets

Profit before tax

	2008	2007	2006
	US$m	US$m	US$m
Net interest income	**8,541**	4,430	3,168
Net fee income	**4,291**	4,901	3,718
Trading income excluding net interest income	**157**	3,503	4,890
Net interest income/ (expense) on trading activities	**324**	(236)	(379)
Net trading income[16]	**481**	3,267	4,511
Net income/(expense) from financial instruments designated at fair value	**(438)**	(164)	20
Gains less losses from financial investments	**(327)**	1,313	534
Dividend income	**76**	222	235
Net earned insurance premiums	**105**	93	73
Other operating income	**868**	1,218	1,378
Total operating income	**13,597**	15,280	13,637
Net insurance claims[17]	**(79)**	(70)	(62)
Net operating income[5]	**13,518**	15,210	13,575
Loan impairment (charges)/ recoveries and other credit risk provisions	**(1,471)**	(38)	119
Net operating income	**12,047**	15,172	13,694
Total operating expenses	**(9,092)**	(9,358)	(7,991)
Operating profit	**2,955**	5,814	5,703
Share of profit in associates and joint ventures	**528**	307	103
Profit before tax	**3,483**	6,121	5,806
By geographical region			
Europe	**195**	2,527	2,304
Hong Kong	**1,436**	1,578	955
Rest of Asia-Pacific	**3,786**	2,464	1,649
North America	**(2,575)**	(965)	423
Latin America	**641**	517	475
	3,483	6,121	5,806
	%	%	%
Share of HSBC's profit before tax	**37.4**	25.3	26.3
Cost efficiency ratio	**67.3**	61.5	58.9

For footnotes, see page 143.

Strategic direction

In 2008, Global Banking and Markets continued to pursue its emerging markets-led and financing-focused strategy, which was introduced in 2006 and fully implemented in 2007. HSBCs strategy is to be a leading wholesale bank by:

– utilising HSBCs extensive distribution network;

– developing Global Banking and Markets hub-and-spoke business model; and

– continuing to build capabilities in major hubs to support the delivery of an advanced suite of services to corporate, institutional and government clients across the HSBC network.

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

Financial performance in 2008

- Global Banking and Markets delivered a pre-tax profit of US$3.5 billion, a decline of US$2.6 billion or 43 per cent compared with 2007. Although credit trading was significantly impacted by the adverse market conditions, revenues in other core businesses grew strongly in both developed and emerging markets. At constant exchange rates, total operating expenses were slightly below 2007 with a progressive decline over the last four half-years.

- Core businesses such as foreign exchange, Rates, Balance Sheet Management and financing and equity capital markets posted record revenues.

- In 2008, some US$5.4 billion of write-downs were absorbed on legacy positions in credit trading, leveraged and acquisition financing and monoline credit exposures. This compared with US$2.1 billion of write-downs recorded in 2007. Results for 2008 included a US$529 million fair value gain on the widening of credit spreads on structured liabilities.

- In addition, because of an alleged fraud, HSBC wrote off the value of units in funds which had invested with Madoff Securities, and took a charge against trading income of US$984 million in the equities business in December 2008. The units had been acquired in connection with various financing transactions entered into with institutional clients.

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

Customer groups > Global Banking and Markets

Management view of total operating income

	2008 US$m	2007 US$m	2006 US$m
Global Markets[18]	**2,676**	5,720	6,059
Credit	**(5,502)**	(1,319)	931
Rates	**2,033**	1,291	1,207
Foreign exchange	**3,842**	2,178	1,552
Equities	**(64)**	1,177	721
Securities services	**2,116**	1,926	1,378
Asset and structured finance	**251**	467	270
Global Banking	**5,718**	4,190	3,388
Financing and equity capital markets	**3,572**	2,186	1,730
Payments and cash management	**1,665**	1,632	1,257
Other transaction services	**481**	372	401
Balance Sheet Management	**3,618**	1,226	713
Global Asset Management	**934**	1,336	1,061
Principal Investments	**(415)**	1,253	686
Other[19]	**1,066**	1,555	1,730
Total operating income	**13,597**	15,280	13,637

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

For footnotes, see page 143.

- Loan impairment charges and other credit risk provisions of US$1.5 billion were higher than in 2007, reflecting loan impairment charges resulting from the deteriorating credit environment, coupled with a relatively modest impairment charge within the available-for-sale portfolio, taken through the income statement and detailed below.

- Within the Groups available-for-sale portfolio,continuing illiquidity in asset-backed securities markets led to further write-downs. However, due to the underlying credit quality and seniority of the tranches held by HSBC, only a relatively modest impairment charge of US$279 million was identified on securities with a nominal value of US$570 million and was taken to the income statement. The expected cash flow impairment on these securities was US$86 million. A further US$293 million impairment was absorbed by income note holders who take the first loss on positions within the securities investment conduits (SICs) now consolidated in HSBCs accountsFurther details on the SICs are provided on pages 174 to 179.
  Business highlights in 2008

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The success of Global Banking and Markets two-year-old emerging markets-led and financing-focused strategy was recognised by a number of key industry awards, including Sterling Bond House, Islamic Bond House, Middle East Loan House and Latin America Bond House in *International Financing Review*; Best Emerging Markets Bank, Best Investment Bank in the Middle East and Best Debt House in Europe in *Euromoney*; Best Bond House in Asia in *FinanceAsia*, *Asiamoney* and *The Asset*; Bond House of the Year in *Latin Finance*; and Emerging Markets Manager of the Year in *European Pensions.*

- In Global Markets, foreign exchange revenues rose by 76 per cent to a record US$3.8 billion due to increased market volatility and higher levels of customer activity. While foreign exchange revenues rose in all regions, performance was notably strong in Europe, where revenues rose by 75 per cent to US$1.4 billion, in the Rest of Asia-Pacific region, and in North America, where revenues more than doubled.

- The Rates business also reported record revenues, reflecting increased customer activity against a backdrop of greater market volatility.

- Securities services revenues grew despite the lower interest rate environment, benefiting from new customer flows and additional business from existing customers. Assets under custody decreased by 34 per cent to US$3.6 trillion, driven by the downturn in the equity markets and the net redemptions experienced across the industry in the final quarter.

- Growth in Global Banking was driven by improved margins in the credit and lending business and substantial gains on credit default swap transactions in certain portfolios. Payments and cash management continued to deliver revenue growth, primarily due to strong growth in liability balances, although margins narrowed in the latter part of the year.

- Balance Sheet Management income rose in Europe, Asia and North America, reflecting positioning ahead of rate reductions by a number of central banks.

- In Principal Investments, markets remained closed for realisations and certain private equity holdings were marked down to reflect market conditions.

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- In Global Asset Management, although underlying management fees remained strong, overall revenues fell, primarily due to the costs associated with the provision of support to certain money market funds. A fall in performance fees reflected a 20 per cent decrease in funds under management following recent equity market declines. Nevertheless, HSBC remained one of the leading emerging markets asset managers.

Reconciliation of reported and underlying profit before tax

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

	2007 compared with 2006								
	2006 as reported	2006 acquisitions and disposals[1]	Currency translation[2]	2006 at 2007 exchange rates[6]	2007 acquisitions, disposals & dilution gains[1]	Under-lying change	2007 as reported	Re-ported change	Under-lying change
Global Banking and Markets	US$m	US$m	US$m	US$m	US$m	US$m	US$m	%	%
Net interest income	3,168	—	175	3,343	25	1,062	4,430	40	32
Net fee income	3,718	—	182	3,900	9	992	4,901	32	25
Other income[4]	6,689	—	360	7,049	10	(1,180)	5,879	(12)	(17)
Net operating income[5]	13,575	—	717	14,292	44	874	15,210	12	6
Loan impairment charges and other credit risk provisions	119	—	6	125	—	(163)	(38)	(132)	(130)
Net operating income	13,694	—	723	14,417	44	711	15,172	11	5
Operating expenses	(7,991)	—	(406)	(8,397)	(35)	(926)	(9,358)	(17)	(11)
Operating profit	5,703	—	317	6,020	9	(215)	5,814	2	(4)
Income from associates	103	—	(4)	99	2	206	307	198	208
Profit before tax	5,806	—	313	6,119	11	(9)	6,121	5	—

For footnotes, see page 143.

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

Customer groups > Global Banking and Markets / Private Banking

Balance sheet data significant to Global Banking and Markets[15]

	Year ended 31 December 2008					
	Europe US$m	**Hong Kong US$m**	**Rest of Asia-Pacific US$m**	**North America US$m**	**Latin America US$m**	**Total US$m**
Trading assets[20]	**281,089**	**45,398**	**19,606**	**74,498**	**5,004**	**425,595**
Derivative assets	**303,265**	**26,989**	**26,506**	**125,848**	**5,145**	**487,753**
Loans and advances to:						
– customers (net)	**185,818**	**23,042**	**34,590**	**35,583**	**8,273**	**287,306**
– banks (net)	**49,508**	**20,970**	**26,710**	**9,238**	**12,574**	**119,000**
Financial investments[20]	**105,546**	**46,964**	**37,346**	**39,841**	**8,179**	**237,876**
Total assets	**1,131,721**	**225,853**	**172,049**	**318,139**	**48,868**	**1,896,630**
Deposits by banks	**79,509**	**11,509**	**13,205**	**16,244**	**3,871**	**124,338**
Customer accounts	**199,687**	**30,866**	**50,605**	**23,844**	**15,384**	**320,386**
Trading liabilities	**144,759**	**13,056**	**3,687**	**72,325**	**2,546**	**236,373**
Derivative liabilities	**300,200**	**28,536**	**26,481**	**122,699**	**4,615**	**482,531**

	Year ended 31 December 2007					
	Europe	Hong Kong	Rest of Asia-Pacific	North America	Latin America	Total
Trading assets[20]	294,078	26,877	19,732	93,395	8,570	442,652
Derivative assets	102,409	11,492	10,234	56,531	1,814	182,480
Loans and advances to:						
– customers (net)	163,066	19,171	32,106	26,186	9,935	250,464
– banks (net)	89,651	53,725	30,853	14,938	10,339	199,506
Financial investments[20]	94,416	46,765	39,448	33,273	10,155	224,057
Total assets	892,712	215,801	155,106	252,804	45,045	1,561,468
Deposits by banks	85,315	6,251	17,174	14,825	2,830	126,395
Customer accounts	163,713	37,364	54,120	30,732	13,950	299,879
Trading liabilities	201,010	15,939	8,601	73,081	4,998	303,629
Derivative liabilities	104,687	10,865	9,656	53,058	1,986	180,252

	Year ended 31 December 2006			
	Hong	Rest of Asia-	North	Latin

	Europe	Kong	Pacific	America	America	Total
Trading assets[20]	165,116	30,895	14,726	105,645	7,575	323,957
Derivative assets	53,223	6,259	6,575	32,357	1,230	99,644
Loans and advances to:						
customers (net)	140,277	20,270	24,311	17,215	8,147	210,220
banks (net)	63,788	45,023	22,171	15,862	9,704	156,548
Financial investments[20]	54,009	48,407	20,890	30,496	8,169	161,971
Total assets	526,468	182,540	109,535	203,639	37,564	1,059,746
Deposits by banks	65,963	4,363	9,849	9,664	3,115	92,954
Customer accounts	139,416	24,530	36,623	23,711	11,685	235,965
Trading liabilities	97,015	17,292	6,243	88,275	4,898	213,723
Derivative liabilities	55,581	6,376	6,149	32,148	1,266	101,520

For footnotes, see page 143.

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Private Banking

Profit before tax

	2008 US$m	2007 US$m	2006 US$m
Net interest income	**1,612**	1,216	1,011
Net fee income	**1,476**	1,615	1,323
Trading income excluding net interest income	**408**	525	362
Net interest income on trading activities	**14**	9	2
Net trading income[16]	**422**	534	364
Net income/(expense) from financial instruments designated at fair value	–	(1)	1
Gains less losses from financial investments	**64**	119	166
Dividend income	**8**	7	5
Other operating income	**49**	58	61
Total operating income	**3,631**	3,548	2,931
Net insurance claims[17]	–	–	–
Net operating income[5]	**3,631**	3,548	2,931
Loan impairment charges and other credit risk provisions	**(68)**	(14)	(33)
Net operating income	**3,563**	3,534	2,898
Total operating expenses	**(2,116)**	(2,025)	(1,685)
Operating profit	**1,447**	1,509	1,213
Share of profit in associates and joint ventures	–	2	1
Profit before tax	**1,447**	1,511	1,214
By geographical region			
Europe	**998**	915	805
Hong Kong	**237**	305	201
Rest of Asia-Pacific	**113**	92	80
North America	**83**	174	114
Latin America	**16**	25	14
	1,447	1,511	1,214
	%	%	%
Share of HSBC's profit before tax	**15.6**	6.2	5.5
Cost efficiency ratio	**58.3**	57.1	57.5

Balance sheet data[15]

	US$m	US$m	US$m
Loans and advances to customers (net)	**37,590**	43,612	34,297
Total assets	**133,216**	130,893	106,178

Customer accounts	**116,683**	106,197	80,303

For footnotes, see page 143.

Strategic direction

The strategy for Private Banking is to be the world's leading international private bank, known for excellent client experience and global connections.

- HSBC's global network, strong capital position and recognised brand provide a base from which Private Banking attracts and retains clients and serves their complex international needs. It uses both traditional and innovative ways of managing and preserving the wealth of high net worth individuals while optimising returns.

- Private Banking has built a network of domestic and international operations that provide diversified revenue streams, helped by product leadership in areas such as credit, hedge funds, emerging markets, investment advice and estate planning. This is achieved by attracting, retaining and motivating talented individuals, by providing close communication between clients and staff, and by making targeted investments in IT, marketing and branding initiatives.

Financial performance in 2008

- Reported pre-tax profit fell by 4 per cent as clients moved progressively to a more conservative investment stance in the turbulent markets. This trend was reflected in reduced trading income in Asia, lower fee income in Europe and higher loan impairment charges and other credit risk provisions. By contrast, net interest income grew strongly in Europe. On an underlying basis, pre-tax profit decreased by 3 per cent.

- Net interest income rose by 34 per cent to US$1.6 billion as a result of an increase in customer deposit balances in Switzerland, the UK and Hong Kong as customers reduced risk in response to market turbulence, choosing HSBC for its strength and switching from investment securities to cash deposits. Spreads improved as interest rates declined sharply.

- Net fee income decreased by 4 per cent to US$1.5 billion, driven by a fall in funds under management in all regions as a result of equity market declines and clients switching from securities into cash deposits. Transaction volumes also fell, particularly in the fourth quarter.

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- Trading income fell by 21 per cent to US$422 million, driven by lower demand for structured products in Asia following the decline in the Hong Kong stock market which led to clients preferring more stable cash deposits. Partly offsetting this was an increase in foreign exchange trading revenue in the volatile currency markets.

- Gains less losses from financial investments decreased by 47 per cent to US$64 million due to lower gains from the disposal of HSBC's residual holding in the Hermitage Fund in 2008, compared with 2007.

- Loan impairment charges and other credit risk provisions increased by US$54 million to US$68 million, primarily due to a loss on a bond position in a failed US bank and higher provisions on real estate-related products.

- Operating expenses grew by 9 per cent to US$2.1 billion, mainly due to the non-recurrence of a one-off pension-related credit recognised in 2007. Staff numbers increased in Asia and Europe in late 2007 and the first half of 2008, leading to higher costs, although these reduced in the second half of the year. As a result, the cost efficiency ratio worsened by 1.9 percentage points to 58.3 per cent.

Client assets

	2008	2007
	US$bn	US$bn
At 1 January	**421**	333
Net new money	**24**	36
Value change	**(71)**	19
Exchange and other	**(22)**	33
At 31 December	**352**	421

Client assets by investment class

	2008	2007
	US$bn	US$bn
Equities	**53**	81
Bonds	**57**	64
Structured products	**7**	12
Funds	**87**	123
Cash, fiduciary deposits and other	**148**	141
	352	421

- Reported client assets decreased by 16 per cent to US$352 billion in 2008, due to the decline in equity market values in all regions. Net new money flows continued to be strong, particularly in Europe, as clients were attracted by HSBCs strong capital base during the market turbulence. However, reduced leverage had a US$5.9 billion effect on net new money flows compared with 2007 and some outflows of client deposits were experienced in the fourth quarter following the introduction of government guarantees to certain competitor banks.

- Total client assets declined by 12 per cent on a reported basis to US$433 billion, with net new money of US$30 billion. Total client assets is a measure equivalent to many industry definitions of assets under management which include some non-financial assets held in client trusts.

Business highlights in 2008

- Inward referrals from other customer groups in HSBC resulted in US$6.8 billion of net new money compared with US$5.7 billion in 2007.

- The proportion of trading volumes that were transacted with Global Banking and Markets increased as more systems and processes were connected.

- Investments in emerging markets continued as Private Banking clients invested over US$1 billion in various HSBC Private Equity and fund offerings.

- The *Euromoney* 2009 Private Banking Survey placed HSBC Private Bank second overall in the Global Private Bank category, up from third in 2008. HSBC Private Bank was also awarded Best Private Bank in Asia and Best Private Bank in the Middle East. At the International Wealth Management Summit, HSBC won Outstanding Global Private Banker awarded to the Global CEO of HSBC Private Bank, and Outstanding Private Bank in the Middle East.

- In 2008, HSBC announced that it would merge its two Swiss private banks under the HSBC Private Bank brand. The merger is expected to result in future strategic and cost benefits.

- Following a comprehensive review in 2008, HSBC Private Bank launched a fresh image campaign in 2009, including the aim to be The worlds private bank in alignment with the Groups recognised global brand strategy. The launch was combined with a targeted advertising and marketing campaign.

- Offices in Guangzhou, Shanghai and Beijing were formally opened as part of the launch of Private Banking operations in mainland China. Preparations were also made for a launch of domestic operations in Russia in 2009.

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Reconciliation of reported and underlying profit before tax

	2008 compared with 2007							
Private Banking	**2007 as reported US$m**	**2007 acquisitions, disposals & dilution gains[1] US$m**	**Currency translation[2] US$m**	**2007 at 2008 exchange rates[3] US$m**	**2008 acquisitions and disposals[1] US$m**	**Underlying change US$m**	**2008 as reported US$m**	**Report chan**
Net interest income	**1,216**	**1**	**(12)**	**1,205**	**–**	**407**	**1,612**	
Net fee income	**1,615**	**(105)**	**26**	**1,536**	**–**	**(60)**	**1,476**	
Other income[4]	**717**	**(18)**	**5**	**704**	**–**	**(161)**	**543**	**(**
Net operating income[5]	**3,548**	**(122)**	**19**	**3,445**	**–**	**186**	**3,631**	
Loan impairment charges and other credit risk provisions	**(14)**	**–**	**–**	**(14)**	**–**	**(54)**	**(68)**	**(3**
Net operating income	**3,534**	**(122)**	**19**	**3,431**	**–**	**132**	**3,563**	
Operating expenses	**(2,025)**	**98**	**(17)**	**(1,944)**	**–**	**(172)**	**(2,116)**	
Operating profit	**1,509**	**(24)**	**2**	**1,487**	**–**	**(40)**	**1,447**	
Income from associates	**2**	**–**	**–**	**2**	**–**	**(2)**	**–**	**(1**
Profit before tax	**1,511**	**(24)**	**2**	**1,489**	**–**	**(42)**	**1,447**	

	2007 compared with 2006							
Private Banking	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006 at 2007 exchange rates[6] US$m	2007 acquisitions, disposals & dilution gains[1] US$m	Underlying change US$m	2007 as reported US$m	Reported change %

Net interest income	1,011	—	24	1,035	2	179	1,216	20
Net fee income	1,323	—	32	1,355	4	256	1,615	22
Other income[4]	597	—	7	604	1	112	717	20
Net operating income[5]	2,931	—	63	2,994	7	547	3,548	21
Loan impairment charges and other credit risk provisions	(33)	—	—	(33)	—	19	(14)	58
Net operating income	2,898	—	63	2,961	7	566	3,534	22
Operating expenses	(1,685)	—	(40)	(1,725)	(4)	(296)	(2,025)	(20)
Operating profit	1,213	—	23	1,236	3	270	1,509	24
Income from associates	1	—	—	1	—	1	2	100
Profit before tax	1,214	—	23	1,237	3	271	1,511	24

For footnotes, see page 143.

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Other

Profit/(loss) before tax

	2008	2007	2006
	US$m	US$m	US$m
Net interest expense	**(956)**	(542)	(625)
Net fee income/(expense)	**53**	(228)	172
Trading income/(expense) excluding net interest income	**(262)**	127	(228)
Net interest income/(expense) on trading activities	**(268)**	(1)	82
Net trading income/(expense)[16]	**(530)**	126	(146)
Changes in fair value of long-term debt issued and related derivatives	**6,679**	2,812	(35)
Net income/(expense) from other financial instruments designated at fair value	**747**	81	(46)
Net income/(expense) from financial instruments designated at fair value	**7,426**	2,893	(81)
Gains less losses from financial investments	**(396)**	83	147
Gains arising from dilution of interests in associates	**–**	1,092	–
Dividend income	**10**	32	63
Net earned insurance premiums	**(17)**	(21)	207
Gains on disposal of French regional banks	**2,445**	–	–
Other operating income	**4,261**	3,523	3,254
Total operating income	**12,296**	6,958	2,991
Net insurance claims[17]	**(1)**	–	(181)
Net operating income[5]	**12,295**	6,958	2,810
Loan impairment charges and other credit risk provisions	**(5)**	(11)	(13)
Net operating income	**12,290**	6,947	2,797
Total operating expenses	**(4,174)**	(3,562)	(3,259)
Operating profit/(loss)	**8,116**	3,385	(462)
Share of profit in joint ventures and associates	**41**	150	74
Profit/(loss) before tax	**8,157**	3,535	(388)
By geographical region			
Europe	**5,296**	1,056	(278)
Hong Kong	**(955)**	(375)	(175)
Rest of Asia-Pacific	**276**	1,343	287

North America	**3,534**	1,508	(217)
Latin America	**6**	3	(5)
	8,157	3,535	(388)
	%	%	%
Share of HSBCs profit before tax	**87.6**	14.6	(1.8)
Cost efficiency ratio	**33.9**	51.2	116.0

For footnotes, see page 143.

Notes

- Reported profit before tax in Other was US$8.2 billion, compared with US$3.5 billion in 2007. For a description of the main items reported under Other, see footnote 14 on page 143.
- Net income from financial instruments designated at fair value amounted to US$7.4 billion in 2008, compared with US$2.9 billion in 2007. This largely related to fair value gains on own debt issued by HSBC Holdings and its North American and European subsidiaries and resulted primarily from the widening of credit spreads. These gains will reverse over the life of the debt.
- A loss of US$396 million reported in Gains less losses from financial investments included impairments related to non-trading strategic equity investments, classified as available for sale, following significant declines in equity market prices. These investments were primarily in Asian financial services companies which are held for the long term.
- In 2007, the results included dilution gains of US$1.1 billion following share offerings made by HSBCs associates, Ping An Insurance, Bank of Communications and Industrial Bank in mainland China, Financiera Independencia in Mexico and Techcombank in Vietnam.
- Other gains included a US$2.4 billion pre-tax profit from the sale of seven regional banks in France.
- HSBC recognised a gain of US$416 million in respect of the purchase of the subsidiary of Metrovacesa which owned the property and long leasehold land comprising 8 Canada Square, London. See Note 23 on the Financial Statements for further details.
- HSBC continued to increase the scope of activities undertaken at its Group Service Centres (GSCs) which are accounted for within Other. Employee numbers increased accordingly and an additional GSC was opened which, together, contributed to a rise in operating expenses. In North America, costs at the IT Service Centres declined in line with reduced operations in the region. Substantially all service centre costs are recharged to HSBCs customer groups and reported under Other operating income.

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Balance sheet data[15]

	2008 **US$m**	2007 US$m	2006 US$m
Loans and advances to customers (net)	**2,621**	2,678	2,095
Total assets	**135,001**	155,685	137,291
Customer accounts	**2,041**	2,006	1,245

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

	2008 compared with 2007							
Other	**2007 as reported US$m**	**2007 acquisitions, disposals & dilution gains[1] US$m**	**Currency translation[2] US$m**	**2007 at 2008 exchange rates[3] US$m**	**2008 acquisitions and disposals[1] US$m**	**Underlying change US$m**	**2008 as reported US$m**	**Reporte chang**
Net interest expense	**(542)**		**(38)**	**(580)**	**(6)**	**(370)**	**(956)**	**(7**
(Net fee income/(expense)	**(228)**		**49**	**(179)**		**232**	**53**	**12**
Other income[4]	**7,728**	**(1,116)**	**36**	**6,648**	**2,540**	**4,010**	**13,198**	**7**
Net operating income[5]	**6,958**	**(1,116)**	**47**	**5,889**	**2,534**	**3,872**	**12,295**	**7**
Loan impairment charges and other credit risk provisions	**(11)**	**24**	**1**	**14**		**(19)**	**(5)**	**5**
Net operating income	**6,947**	**(1,092)**	**48**	**5,903**	**2,534**	**3,853**	**12,290**	**7**
Operating expenses	**(3,562)**		**(15)**	**(3,577)**	**6**	**(603)**	**(4,174)**	**(1**
Operating profit	**3,385**	**(1,092)**	**33**	**2,326**	**2,540**	**3,250**	**8,116**	**14**
Income from associates	**150**	**(12)**	**11**	**149**		**(108)**	**41**	**(7**

Profit before tax	**3,535**	**(1,104)**	**44**	**2,475**	**2,540**	**3,142**	**8,157**	**13**

	2007 compared with 2006							
Other	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006, at 2007 exchange rates[6] US$m	2007 acquisitions disposals & dilution gains[1] US$m	Underlying change US$m	2007 as reported US$m	Reported change %
Net interest income	(625)	—	(22)	(647)	—	105	(542)	13
Net fee income	172	—	25	197	—	(425)	(228)	(233)
Other income[4]	3,263	—	77	3,340	1,092	3,296	7,728	137
Net operating income[5]	2,810	—	80	2,890	1,092	2,976	6,958	148
Loan impairment charges and other credit risk provisions	(13)	—	3	(10)	—	(1)	(11)	15
Net operating income	2,797	—	83	2,880	1,092	2,975	6,947	148
Operating expenses	(3,259)	—	(90)	(3,349)	—	(213)	(3,562)	(9)
Operating profit/(loss)	(462)	—	(7)	(469)	1,092	2,762	3,385	833
Income from associates	74	—	2	76	(50)	124	150	103
Profit/(loss) before tax	(388)	—	(5)	(393)	1,042	2,886	3,535	1,011

For footnotes, see page 143.

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Analysis by customer group and global business

Profit/(loss) before tax

	2008						
Total	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other[14] US$m**	**Inter-segment elimination[21] US$m**	**Total US$m**
Net interest income/(expense)	**29,419**	**9,494**	**8,541**	**1,612**	**(956)**	**(5,547)**	**42,563**
Net fee income	**10,107**	**4,097**	**4,291**	**1,476**	**53**	**–**	**20,024**
Trading income/(expense) excluding net interest income	**175**	**369**	**157**	**408**	**(262)**	**–**	**847**
Net interest income/(expense) on trading activities	**79**	**17**	**324**	**14**	**(268)**	**5,547**	**5,713**
Net trading income/(expense)[16]	**254**	**386**	**481**	**422**	**(530)**	**5,547**	**6,560**
Changes in fair value of long-term debt issued and related derivatives	**–**	**–**	**–**	**–**	**6,679**	**–**	**6,679**
Net income/(expense) from other financial instruments designated at fair value	**(2,912)**	**(224)**	**(438)**	**–**	**747**	**–**	**(2,827)**
Net income/(expense) from financial instruments designated at fair value	**(2,912)**	**(224)**	**(438)**	**–**	**7,426**	**–**	**3,852**
Gains less losses from financial investments	**663**	**193**	**(327)**	**64**	**(396)**	**–**	**197**
Dividend income	**90**	**88**	**76**	**8**	**10**	**–**	**272**
Net earned insurance premiums	**10,083**	**679**	**105**	**–**	**(17)**	**–**	**10,850**
Gains on disposal of French regional banks	**–**	**–**	**–**	**–**	**2,445**	**–**	**2,445**

Other operating income	**259**	**939**	**868**	**49**	**4,261**	**(4,568)**	**1,808**
Total operating income	**47,963**	**15,652**	**13,597**	**3,631**	**12,296**	**(4,568)**	**88,571**
Net insurance claims[17]	**(6,474)**	**(335)**	**(79)**	****	**(1)**	****	**(6,889)**
Net operating income[5]	**41,489**	**15,317**	**13,518**	**3,631**	**12,295**	**(4,568)**	**81,682**
Loan impairment charges and other credit risk provisions	**(21,220)**	**(2,173)**	**(1,471)**	**(68)**	**(5)**	****	**(24,937)**
Net operating income	**20,269**	**13,144**	**12,047**	**3,563**	**12,290**	**(4,568)**	**56,745**
Operating expenses (excluding goodwill impairment)	**(21,140)**	**(6,581)**	**(9,092)**	**(2,116)**	**(4,174)**	**4,568**	**(38,535)**
Goodwill impairment	**(10,564)**	****	****	****	****	****	**(10,564)**
Operating profit/(loss)	**(11,435)**	**6,563**	**2,955**	**1,447**	**8,116**	****	**7,646**
Share of profit in associates and joint ventures	**461**	**631**	**528**	****	**41**	****	**1,661**
Profit/(loss) before tax	**(10,974)**	**7,194**	**3,483**	**1,447**	**8,157**	****	**9,307**
	%	**%**	**%**	**%**	**%**		**%**
Share of HSBCs profit before tax	**(117.9)**	**77.3**	**37.4**	**15.6**	**87.6**		**100.0**
Cost efficiency ratio	**76.4**	**43.0**	**67.3**	**58.3**	**33.9**		**60.1**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Balance sheet data[15]							
Loans and advances to customers (net)	**401,402**	**203,949**	**287,306**	**37,590**	**2,621**		**932,868**
Total assets	**514,419**	**249,218**	**1,896,630**	**133,216**	**135,001**	**(401,019)**	**2,527,465**
Customer accounts	**440,338**	**235,879**	**320,386**	**116,683**	**2,041**		**1,115,327**

For footnotes, see page 143.

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	2007						
Total	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other[14] US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income/(expense)	29,069	9,055	4,430	1,216	(542)	(5,433)	37,795
Net fee income/(expense)	11,742	3,972	4,901	1,615	(228)	—	22,002
Trading income excluding net interest income	38	265	3,503	525	127	—	4,458
Net interest income/(expense) on trading activities	140	31	(236)	9	(1)	5,433	5,376
Net trading income[16]	178	296	3,267	534	126	5,433	9,834
Changes in fair value of long-term debt issued and related derivatives	—	—	—	—	2,812	—	2,812
Net income/(expense) from other financial instruments designated at fair value	1,333	22	(164)	(1)	81	—	1,271
Net income/(expense) from financial instruments 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 of interests in associates	—	—	—	—	1,092	—	1,092
Dividend income	55	8	222	7	32	—	324
Net earned insurance premiums .	8,271	733	93	—	(21)	—	9,076
Other operating income	387	165	1,218	58	3,523	(3,912)	1,439
Total operating income	51,386	14,341	15,280	3,548	6,958	(3,912)	87,601
Net insurance claims[17]	(8,147)	(391)	(70)	—	—	—	(8,608)

Net operating income[5]	43,239	13,950	15,210	3,548	6,958	(3,912)	78,993
Loan impairment charges and other credit risk provisions	(16,172)	(1,007)	(38)	(14)	(11)	—	(17,242)
Net operating income	27,067	12,943	15,172	3,534	6,947	(3,912)	61,751
Total operating expenses	(21,757)	(6,252)	(9,358)	(2,025)	(3,562)	3,912	(39,042)
Operating profit	5,310	6,691	5,814	1,509	3,385	—	22,709
Share of profit in associates and joint ventures	590	454	307	2	150	—	1,503
Profit before tax	5,900	7,145	6,121	1,511	3,535	—	24,212
	%	%	%	%	%		%
Share of HSBC’s profit before tax	24.4	29.5	25.3	6.2	14.6		100.0
Cost efficiency ratio	50.3	44.8	61.5	57.1	51.2		49.4
	US$m	US$m	US$m	US$m	US$m		US$m
Balance sheet data[15]							
Loans and advances to customers (net)	464,726	220,068	250,464	43,612	2,678		981,548
Total assets	621,356	307,944	1,561,468	130,893	155,685	(423,080)	2,354,266
Customer accounts	450,071	237,987	299,879	106,197	2,006		1,096,140

For footnotes, see page 143.

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

Profit/(loss) before tax *(continued)*

	2006						
Total	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other[14] US$m	Inter-segment elimination[21] US$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)[16]	611	224	4,511	364	(146)	2,658	8,222
Changes in fair value of long-term debt issued and related derivatives	—	—	—	—	(35)	—	(35)
Net income/(expense) from other financial instruments designated at fair value	739	(22)	20	1	(46)	—	692
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
	42,209	11,481	13,637	2,931	2,991	(3,179)	70,070

Total operating income							
Net insurance claims[17]	(4,365)	(96)	(62)	—	(181)	—	(4,704)
Net operating income[5]	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	27,895	10,688	13,694	2,898	2,797	(3,179)	54,793
Total 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
	%	%	%	%	%		%
Share of HSBC’s profit before tax	42.8	27.2	26.3	5.5	(1.8)		100.0
Cost efficiency ratio	49.7	43.7	58.9	57.5	116.0		51.3
	US$m	US$m	US$m	US$m	US$m		US$m
Balance sheet data[15]							
Loans and advances to customers (net)	448,545	172,976	210,220	34,297	2,095		868,133
Total assets	602,342	228,668	1,059,746	106,178	137,291	(273,467)	1,860,758
Customer accounts	388,468	190,853	235,965	80,303	1,245		896,834

For footnotes, see page 143.

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Geographical regions

Additional information on results in 2008 may be found in the ‘Financial Summary’ on pages 23 to 38.

Summary

Europe

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

Hong Kong

HSBC's principal banking subsidiaries in Hong Kong are The Hongkong and Shanghai Banking Corporation Limited (‘The Hongkong and Shanghai Banking Corporation’) and Hang Seng Bank Limited (‘Hang Seng Bank’). The former is the largest bank incorporated in Hong Kong and is HSBC's flagship bank in the Asia-Pacific region. It is one of Hong Kong's three note-issuing banks, accounting for more than 65 per cent by value of banknotes in circulation in 2007.

Rest of Asia-Pacific (including the Middle East)

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

Outside Hong Kong and mainland China, HSBC conducts business in 20 countries in the Asia-Pacific region, primarily through branches and subsidiaries of The Hongkong and Shanghai Banking Corporation, with particularly strong coverage in India, Indonesia, South Korea, Singapore and Taiwan. HSBC's presence in the Middle East is led by HSBC Bank Middle East Limited (‘HSBC Bank Middle East’), whose network of branches, together with HSBC's subsidiaries and associates, gives it the widest coverage in the region; in Australia by HSBC Bank Australia Limited; and in Malaysia by HSBC Bank Malaysia Berhad (‘HSBC Bank Malaysia’), which is the largest foreign-owned bank in the country by operating income and pre-tax profits. HSBC's associate in Saudi Arabia, The Saudi British Bank (40 per cent owned), is the Kingdom's fifth largest bank by total assets.

North America

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

Latin America

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

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

Geographical regions > Summary / Europe

In the analysis of profit by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US$2,492 million (2007: US$1,985 million; 2006: US$1,494 million).

Profit/(loss) before tax

	2008		2007		2006	
	US$m	**%**	US$m	%	US$m	%
Europe	**10,869**	**116.7**	8,595	35.5	6,974	31.5
Hong Kong	**5,461**	**58.7**	7,339	30.3	5,182	23.5
Rest of Asia-Pacific	**6,468**	**69.5**	6,009	24.8	3,527	16.0
North America	**(15,528)**	**(166.8)**	91	0.4	4,668	21.1
Latin America	**2,037**	**21.9**	2,178	9.0	1,735	7.9
	9,307	**100.0**	24,212	100.0	22,086	100.0

Total assets[15]

	At 31 December			
	2008 **US$m**	**%**	2007 US$m	%
Europe	**1,343,011**	**53.1**	1,236,633	52.5
Hong Kong	**407,151**	**16.1**	356,894	15.2
Rest of Asia-Pacific	**262,305**	**10.4**	243,205	10.3
North America	**552,612**	**21.9**	549,285	23.3
Latin America	**97,944**	**3.9**	101,088	4.3
Intra-HSBC items	**(135,558)**	**(5.4)**	(132,839)	(5.6)
	2,527,465	**100.0**	2,354,266	100.0

For footnote, see page 143.

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Europe

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

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets[21] US$m	Private Banking US$m	Other US$m	Total US$m
2008						
United Kingdom	**1,546**	**2,361**	**(469)**	**250**	**2,997**	**6,685**
France[22]	**139**	**176**	**273**	**10**	**2,242**	**2,840**
Germany	**–**	**31**	**184**	**32**	**(22)**	**225**
Malta	**59**	**67**	**16**	**–**	**–**	**142**
Switzerland	**–**	**–**	**–**	**553**	**–**	**553**
Turkey	**3**	**91**	**130**	**–**	**–**	**224**
Other	**(89)**	**(4)**	**61**	**153**	**79**	**200**
	1,658	**2,722**	**195**	**998**	**5,296**	**10,869**
2007						
United Kingdom	1,221	2,064	1,214	317	976	5,792
France[22]	173	192	692	25	(49)	1,033
Germany	–	36	195	45	19	295
Malta	45	67	45	–	–	157
Switzerland	–	–	–	475	–	475
Turkey	144	75	118	(1)	–	336
Other	(2)	82	263	54	110	507
	1,581	2,516	2,527	915	1,056	8,595
2006						
United Kingdom	1,496	1,801	1,299	380	(185)	4,791
France[22]	174	236	545	22	(107)	870
Germany	–	29	114	41	16	200
Malta	42	50	29	–	–	121
Switzerland	–	–	–	305	–	305
Turkey	121	50	64	–	(18)	217
Other	76	68	253	57	16	470
	1,909	2,234	2,304	805	(278)	6,974

Loans and advances to customers (net) by country

	At 31 December		
	2008	2007	2006
	US$m	US$m	US$m

United Kingdom	**313,065**	326,927	305,758
France[22]	**70,896**	81,473	55,491
Germany	**5,756**	6,411	4,439
Malta	**4,343**	4,157	3,456
Switzerland	**12,708**	13,789	9,151
Turkey	**6,125**	7,974	5,233
Other	**13,298**	11,544	8,971
	426,191	452,275	392,499

Customer accounts by country

	At 31 December		
	2008	2007	2006
	US$m	US$m	US$m
United Kingdom	**351,253**	367,363	318,614
France[22]	**74,826**	64,905	43,372
Germany	**11,611**	10,282	11,607
Malta	**5,604**	5,947	4,529
Switzerland	**44,643**	41,015	30,062
Turkey	**5,845**	6,473	4,140
Other	**8,694**	8,969	7,041
	502,476	504,954	419,365

For footnotes, see page 143.

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

Geographical regions > Europe > 2008

Profit before tax

Europe	**2008 US$m**	2007 US$m	2006 US$m
Net interest income	**9,696**	7,746	8,289
Net fee income	**7,492**	8,431	7,108
Net trading income	**5,357**	6,943	4,529
Changes in fair value of long-term debt issued and related derivatives	**2,939**	1,059	28
Net income/(expense) from other financial instruments designated at fair value	**(1,826)**	167	116
Net income from financial instruments designated at fair value	**1,113**	1,226	144
Gains less losses from financial investments	**418**	1,326	624
Dividend income	**130**	171	183
Net earned insurance premiums	**5,299**	4,010	1,298
Gains on disposal of French regional banks	**2,445**	—	—
Other operating income	**2,096**	1,193	1,428
Total operating income	**34,046**	31,046	23,603
Net insurance claims incurred and movement in liabilities to policyholders	**(3,367)**	(3,479)	(531)
Net operating income before loan impairment charges and other credit risk provisions	**30,679**	27,567	23,072
Loan impairment charges and other credit risk provisions	**(3,754)**	(2,542)	(2,155)
Net operating income	**26,925**	25,025	20,917
Total operating expenses	**(16,072)**	(16,525)	(13,871)
Operating profit	**10,853**	8,500	7,046
Share of profit/(loss) in associates and joint ventures	**16**	95	(72)
Profit before tax	**10,869**	8,595	6,974
	%	%	%
Share of HSBC's profit before tax	**116.7**	35.5	31.5
Cost efficiency ratio	**52.4**	59.9	60.1
Year-end staff numbers (full-time equivalent)	**82,093**	82,166	78,311

Balance sheet data[15]

	At 31 December		
	2008	2007	2006

	US$m	US$m	US$m
Loans and advances to customers (net)	**426,191**	452,275	392,499
Loans and advances to banks (net)	**61,949**	104,527	76,830
Trading assets, financial assets designated at fair value and financial investments[20]	**433,885**	445,258	242,010
Total assets	**1,343,011**	1,236,633	867,032
Deposits by banks	**80,847**	87,491	67,821
Customer accounts	**502,476**	504,954	419,365

For footnotes, see page 143.
All commentaries on Europe are on an underlying basis unless stated otherwise.

2008 compared with 2007

Economic briefing

In the **UK**, growth in gross domestic product (GDP) decelerated markedly in 2008 to 0.7 per cent from 3.0 per cent in 2007, with a technical recession of two successive quarterly contractions in GDP confirmed during the second half of the year. Weakness proved widespread across most of the

economy, prompting a sharp deterioration in labour market conditions as unemployment hit a 9-year high of 6.1 per cent in November 2008. Consumer Price Index (CPI) inflation reached a decade-long high of 5.2 per cent in September 2008 before falling back to 3.1 per cent by the year-end, still some way above the Bank of Englands 2 per cent target. House prices continued to fall throughout the year and housing activity decreased sharply. The Bank of

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England reduced interest rates by 350 basis points during 2008, to finish the year at 2 per cent, as policymakers sought to mitigate the worst effects of the economic slowdown.

The expansion of the **eurozone** economy slowed sharply in 2008, with GDP growth of 0.7 per cent following a 2.6 per cent expansion in 2007. As in the UK, conditions deteriorated markedly as the year progressed and three successive quarterly declines in GDP were recorded during 2008, confirming that the economy had entered a period

of recession. Consumer spending growth proved subdued following the sharp rise in oil prices during the first of half of 2008 and a progressive increase in the unemployment rate towards the year-end. Inflation remained a concern for much of 2008, hitting a peak of 4.0 per cent in July before falling rapidly to 1.6 per cent in December. The European Central Bank, having initially raised interest rates by 25 basis points in July, cut them by 175 basis points to finish the year at 2.5 per cent.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007							
Europe	**2007 as reported US$m**	**2007 acquisitions, disposals & dilution gains[1] US$m**	**Currency translation[2] US$m**	**2007 at 2008 exchange rates[3] US$m**	**2008 acquisitions and disposals[1] US$m**	**Under-lying change US$m**	**2008 as reported US$m**	**Reported change %**
Net interest income	**7,746**	**(390)**	**(224)**	**7,132**	**219**	**2,345**	**9,696**	**25**
Net fee income	**8,431**	**(134)**	**(244)**	**8,053**	**15**	**(576)**	**7,492**	**(11)**
Other income[4]	**11,390**	**(121)**	**(380)**	**10,889**	**3,007**	**(405)**	**13,491**	**18**
Net operating income[5]	**27,567**	**(645)**	**(848)**	**26,074**	**3,241**	**1,364**	**30,679**	**11**
Loan impairment charges and other credit risk provisions	**(2,542)**	**30**	**152**	**(2,360)**	**(6)**	**(1,388)**	**(3,754)**	**(48)**
Net operating income	**25,025**	**(615)**	**(696)**	**23,714**	**3,235**	**(24)**	**26,925**	**8**
Operating expenses	**(16,525)**	**416**	**531**	**(15,578)**	**(88)**	**(406)**	**(16,072)**	**3**
Operating profit	**8,500**	**(199)**	**(165)**	**8,136**	**3,147**	**(430)**	**10,853**	**28**
Income from	**95**	**(12)**	**14**	**97**	**–**	**(81)**	**16**	**(83)**

associates								
Profit before tax	**8,595**	**(211)**	**(151)**	**8,233**	**3,147**	**(511)**	**10,869**	**26**

For footnotes, see page 143.

Review of business performance

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

These results included gains of US$2.4 billion on the disposal of seven regional banks in France in July 2008, and of US$425 million on the sale of the card acquiring business in the UK to a joint venture with Global Payments, Inc. in June 2008. Excluding these disposals and, in 2007, the acquisition of HSBC Assurances and the disposal of Hamilton Insurance Company Limited and Hamilton Life Assurance Company Limited and substantial fair value gains on own debt, underlying pre-tax profits fell by 33 per cent. This primarily reflected a sharp decline in Global Banking and Markets revenues, which was mainly attributable to the deterioration in credit markets, the continuing illiquidity in asset-backed securities markets which led to further

write-downs, and a US$854 million charge within the equities business following the alleged fraud at Madoff Securities. Personal Financial Services and Private Banking delivered underlying growth.

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

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

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

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

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

Net income from financial instruments designated at fair value increased by 36 per cent, primarily due to fair value gains from the effect of widening credit spreads on certain fixed-rate long-term debt issued by HSBC Holdings. This movement was partly offset by a reduction in the value of assets held to meet liabilities under insurance and

investment contracts. The reduction in fair value of assets held to meet liabilities under unit-linked insurance contracts is offset by a corresponding reduction in Net insurance claims and liabilities to policyholders. The fair value gains on HSBCs own debt will fully reverse over the life of the debt.

Gains less losses from financial investments of US$418 million were US$915 million lower than in 2007 as there were fewer disposal opportunities in 2008 and the significant realisations from equity investments in the UK and France in 2007 did not recur. Gains largely reflected the sale of MasterCard shares in 2008.

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

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

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

Loan impairment charges and credit risk provisions rose by 59 per cent to US$3.8 billion; in the UK, primarily in Global Banking and Markets. The deteriorating credit environment resulted in a rise in loan impairment charges, largely reflecting an

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exposure to a single European property company, and additional credit risk provisions on debt securities held within the Group's available-for-sale portfolio, mainly in Solitaire Funding Limited ('Solitaire'), a special purpose entity managed by HSBC. A modest improvement in the UK personal finance sector reflected the non-recurrence of a change in the methodology in the consumer finance business which resulted in a higher charge in 2007. Excluding this factor, delinquency rates in cards were marginally higher and there was a rise in impairments in the consumer finance business driven by worsening economic conditions and credit quality deterioration, partly offset by action taken to mitigate risk through the continued application of strict lending criteria and the sale of non-core credit card portfolios.

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

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

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

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

Share of profit in associates and joint ventures declined by 84 per cent to US$16 million with 2007

benefiting from an adjustment to the embedded value of HSBC Assurances. The absence of this gain was partially offset by increased joint venture profits following the sale of the card acquiring business in the UK.

2007 compared with 2006

Economic briefing

In the **UK**, GDP growth accelerated in 2007 to 3.1 per cent from 2.9 per cent in 2006, mainly as a result of buoyant consumer and investment spending. Net trade depressed GDP growth through 2007, and the current account deficit reached a record 5.7 per cent of GDP in the third quarter of the year. Employment growth was fairly subdued, rising by approximately 0.7 per cent during the year. CPI inflation reached a decade-long high of 3.1 per cent in March but subsequently fell back to 2.1 per cent by the year-end, close to the Bank of England's 2 per cent target. After a strong start to the year, nominal house prices declined and housing activity diminished in the final months of 2007. The Bank of England raised interest rates by 75 basis points during 2007 to a peak of 5.75 per cent, but subsequently reduced them to 5.5 per cent at the end of 2007.

The expansion of the **eurozone** economy continued steadily in 2007, with GDP growth of 2.7 per cent. As in the UK, much of the momentum came from strength in business investment and exports as global demand remained strong, particularly from emerging markets. Consumption was relatively subdued, despite declining unemployment, although fiscal reforms (particularly in Germany) are believed to have depressed household expenditure. Eurozone inflation increased steadily during the second half of the year to an annual rate of 3.1 per cent in December, driven largely by rises in food and energy prices. The European Central Bank ('ECB') raised interest rates by 50 basis points during 2007, to finish the year at 4 per cent.

Review of business performance

European operations reported a pre-tax profit of US$8.6 billion, compared with US$7.0 billion in 2006, an increase of 23 per cent. On an underlying basis, pre-tax profits improved by 13 per cent.

In March 2007, HSBC acquired its partner's shares in life, property and casualty insurer, HSBC Assurances. The results of HSBC Assurances are excluded from the commentary below, which is on an underlying basis.

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

Geographical regions > Europe > 2007

Reconciliation of reported and underlying profit before tax

	2007 compared with 2006								
Europe	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006 at 2007 exchange rates[6] US$m	2007 acquisitions, disposals & dilution gains[1] US$m	Under-lying change US$m	2007 as reported US$m	Re-ported change %	Unde lyin chang
Net interest income	8,289	(3)	635	8,921	419	(1,594)	7,746	(7)	(1
Net fee income	7,108	53	586	7,747	(133)	817	8,431	19	1
Other income[4]	7,675	(53)	576	8,198	(90)	3,282	11,390	48	4
Net operating income[5]	23,072	(3)	1,797	24,866	196	2,505	27,567	19	1
Loan impairment charges and other credit risk provisions	(2,155)	–	(147)	(2,302)	–	(240)	(2,542)	(18)	(1
Net operating income	20,917	(3)	1,650	22,564	196	2,265	25,025	20	1
Operating expenses	(13,871)	2	(1,076)	(14,945)	(51)	(1,529)	(16,525)	(19)	(1
Operating profit	7,046	(1)	574	7,619	145	736	8,500	21	1
Income/(expense) from associates	(72)	–	(6)	(78)	(50)	223	95	232	28
Profit before tax	6,974	(1)	568	7,541	95	959	8,595	23	1

For footnotes, see page 143.

In Commercial Banking, growth in deposit and lending balances in the UK and ongoing business expansion in Turkey and Malta led to steady growth in revenues. This was partly offset by increased loan impairment charges and higher costs associated with business expansion. In Global Banking and Markets, higher income from most businesses was offset by trading losses in Credit and Rates and increased costs. Strong profit growth in Private Banking was driven by an increased client appetite for discretionary portfolios, a rise in lending volumes and further improvements in cross-referrals. In Personal Financial Services, a fall in pre-tax profits reflected ex gratia payments expensed in respect of overdraft fees applied in previous years and a provision for reimbursement of certain charges on historic will trusts and other related services. The 'Other' segment benefited from a US$1.3

billion fair value gain in HSBCs own debt.

Net interest income declined by 18 per cent, mainly because the expansion of trading activities in both the UK and France resulted in higher funding costs, with the related revenues reported in the trading income line. This was partly offset by higher net interest income in the personal and commercial businesses.

In the UK, Personal Financial Services spreads widened in a rising interest rate environment and competitive pricing attracted higher balances. This was mitigated by lower spreads on mortgages as customers switched to fixed rate products. In

Commercial Banking, higher net interest income was largely driven by growth in the UK, Turkey, Germany and Malta. In the UK, a negotiated rate deposit product launched in previous years continued to be instrumental in driving higher deposit balances. Strong growth in corporate and structured banking for micro customers, together with expansion in lending to small and mid-market customers, contributed to higher lending balances although this benefit was partially constrained by spread compression in the competitive market.

Revenues from transactional balances held within the payments and cash management business increased by 13 per cent, as credit market dislocation in the second half of the year caused customers to hold higher cash balances. After several years of decline, balance sheet management revenues in Europe increased.

In Turkey, higher net interest income was driven by new customer acquisition. In Switzerland, the Private Banking business earned higher net interest income from lending to existing clients as they further leveraged their portfolios.

Net fee income rose by 11 per cent. Account services increased on higher customer balances and volumes of transactions in the UK and France, supported by sales of fee-earning packaged accounts. Card fees increased in the UK, mainly on interchange and acquiring fees, and in Turkey, on interchange and cash advance fees. This was partly offset by a reduction in credit card default fees in the

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UK following regulatory intervention by the OFT in 2006. Broking income increased in the UK, Germany and Switzerland, mainly driven by growth in client assets and transaction volumes. Funds under management fell on lower income from the Hermitage Fund following the part sale of HSBCs investment in it.

Trading income rose by 41 per cent, driven by the equities business and foreign exchange trading, where income increased strongly, with volume and profitability reflecting market volatility. The increase was partly offset by write-downs in credit, structured derivatives and leveraged and acquisition finance. Net trading income increased following the strategic decision to expand the collateralised lending and structured derivatives businesses, the funding costs of which are reported in net interest income.

Credit spreads, primarily on certain fixed-rate long-term debt issued by HSBC Holdings and its subsidiaries, widened significantly in the second half of 2007, leading to a sevenfold increase in *net income from financial instruments designated at fair value* compared with 2006. These cumulative gains will fully reverse over the life of the debt.

The sale of shareholdings and various equity investments in the UK and France, including Euronext (the European stock exchange), contributed to *gains from financial investments* of US$1.3 billion, an increase of 101 per cent on 2006.

Net earned insurance premiums increased by 50 per cent to US$4.0 billion, including growth of the Guaranteed Income Bond and motor insurance, and the introduction of enhanced death benefits to pension contracts in the UK. Premiums also grew in the UK because of a higher retention of risk in the non-life business compared with 2006, when a greater proportion of risk and corresponding premiums were ceded to reinsurers. There were also significant contributions from the reinsurance business in Ireland and the life assurance business in Malta.

Other operating income declined by 25 per cent. This largely resulted from a fall in the value of in-force business in UK insurance, driven by a change in the calculation methodology of the PVIF business in the first half of 2007 when HSBC implemented regulatory changes to the rules governing the

calculation of insurance liabilities. This had a marginally positive effect on profit as there was a corresponding reduction in policyholder liabilities.

Net insurance claims incurred and movement in liabilities to policyholders grew by 121 per cent to US$3.5 billion. This growth, which paralleled the growth in net earned insurance premiums, included the effect of higher risk retention in the non-life business, although it was offset by FSA rule changes which led to lower claims valuations on life policies. There was also a rise in flood-related claims in the UK after record rainfalls during the summer.

Loan impairment charges rose by 10 per cent to US$2.5 billion. Overall credit quality remained broadly stable. In the UK, loan impairment charges rose, primarily in consumer finance lending outside HSBC Bank; within HSBC Bank, steps taken in 2006 to tighten underwriting standards led to an improvement in loan impairment trends. Corporate loan impairment charges remained low in absolute terms, although they were 23 per cent higher than in 2006, principally reflecting the effect of Individual Voluntary Arrangements on micro businesses and impairments on two large corporate accounts in the UK.

Operating costs increased by 10 per cent to US$16.5 billion, in line with the growth in net operating income before loan impairment charges. In the UK, a change in actuarial assumptions regarding the principal staff defined benefit pension scheme led to increased costs. Ex-gratia payments were expensed in respect of overdraft fees applied in previous years and a provision for reimbursement of certain charges on historic will trusts and other related services was raised which totalled US$396 million. Cost increases also reflected investments in technology, higher payments and cash management transaction volumes, investments in the French structured derivatives business to support revenue growth and, in Turkey, technical infrastructure and additional headcount in support of business expansion.

Share of profit in associates and joint ventures rose by US$167 million, largely as a result of a US$73 million adjustment to the embedded value of HSBC Assurances in France prior to the acquisition of its remaining share capital, following which it was accounted for as a subsidiary.

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

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

Analysis by customer group and global business

Profit/(loss) before tax

	2008						
Europe	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[21] US$m**	**Total US$m**
Net interest income/(expense)	**6,464**	**3,435**	**3,488**	**1,046**	**(459)**	**(4,278)**	**9,696**
Net fee income	**2,612**	**2,025**	**1,763**	**1,020**	**72**	–	**7,492**
Trading income/(expense) excluding net interest income	**47**	**71**	**1,513**	**198**	**(138)**	–	**1,691**
Net interest income/(expense) on trading activities	–	**12**	**(655)**	**14**	**17**	**4,278**	**3,666**
Net trading income/(expense)[16]	**47**	**83**	**858**	**212**	**(121)**	**4,278**	**5,357**
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	**2,939**	–	**2,939**
Net income/(expense) from other financial instruments designated at fair value	**(1,634)**	**(214)**	**(611)**	–	**633**	–	**(1,826)**
Net income/(expense) from financial instruments designated at fair value	**(1,634)**	**(214)**	**(611)**	–	**3,572**	–	**1,113**
Gains less losses from financial investments	**281**	**132**	**(30)**	**62**	**(27)**	–	**418**
Dividend income	**35**	**74**	**25**	**5**	**(9)**	–	**130**

Net earned insurance premiums .	**4,927**	**391**	–	–	**(19)**	–	**5,299**
Gains on disposal of French regional banks	–	–	–	–	**2,445**	–	**2,445**
Other operating income	**230**	**620**	**398**	**16**	**832**	–	**2,096**
Total operating income	**12,962**	**6,546**	**5,891**	**2,361**	**6,286**	–	**34,046**
Net insurance claims[17]	**(3,224)**	**(143)**	–	–	–	–	**(3,367)**
Net operating income[5]	**9,738**	**6,403**	**5,891**	**2,361**	**6,286**	–	**30,679**
Loan impairment charges and other credit risk provisions	**(1,971)**	**(867)**	**(875)**	**(38)**	**(3)**		**(3,754)**
Net operating income	**7,767**	**5,536**	**5,016**	**2,323**	**6,283**	–	**26,925**
Total operating expenses	**(6,107)**	**(2,830)**	**(4,823)**	**(1,325)**	**(987)**	–	**(16,072)**
Operating profit	**1,660**	**2,706**	**193**	**998**	**5,296**	–	**10,853**
Share of profit/(loss) in associates and joint ventures	**(2)**	**16**	**2**	–	–	–	**16**
Profit before tax	**1,658**	**2,722**	**195**	**998**	**5,296**	–	**10,869**
	%	**%**	**%**	**%**	**%**		**%**
Share of HSBC's profit before tax	**17.8**	**29.2**	**2.1**	**10.7**	**56.9**		**116.7**
Cost efficiency ratio	**62.7**	**44.2**	**81.9**	**56.1**	**15.7**		**52.4**
Balance sheet data[15]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**126,909**	**87,245**	**185,818**	**25,722**	**497**		**426,191**
Total assets	**171,962**	**107,495**	**1,131,721**	**84,485**	**64,423**	**(217,075)**	**1,343,011**
Customer accounts	**145,411**	**91,188**	**199,687**	**66,007**	**183**		**502,476**

For footnotes, see page 143.

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Europe	2007 Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income	6,604	3,419	1,361	793	86	(4,517)	7,746
Net fee income/(expense)	3,060	2,194	2,316	1,032	(171)	–	8,431
Trading income excluding net interest income	60	36	2,657	161	89	–	3,003
Net interest income/(expense) on trading activities	(7)	30	(610)	9	1	4,517	3,940
Net trading income[16]	53	66	2,047	170	90	4,517	6,943
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	1,059	–	1,059
Net income/(expense) from other financial instruments designated at fair value	126	31	(185)	–	195	–	167
Net income/(expense) from financial instruments designated at fair value	126	31	(185)	–	1,254	–	1,226
Gains less losses from financial investments	50	36	1,100	115	25	–	1,326
Dividend income	1	4	155	7	4	–	171
Net earned insurance premiums .	3,511	521	–	–	(22)	–	4,010
Other operating income/ (expense)	54	(35)	853	8	301	12	1,193
Total operating income	13,459	6,236	7,647	2,125	1,567	12	31,046
Net insurance claims[17]	(3,214)	(265)	–	–	–	–	(3,479)
Net operating income[5]	10,245	5,971	7,647	2,125	1,567	12	27,567
Loan impairment (charges)/recoveries and other credit risk provisions	(2,044)	(515)	26	(4)	(5)	–	(2,542)

Net operating income	8,201	5,456	7,673	2,121	1,562	12	25,025
Total operating expenses	(6,635)	(2,941)	(5,150)	(1,208)	(579)	(12)	(16,525)
Operating profit	1,566	2,515	2,523	913	983	—	8,500
Share of profit in associates and joint ventures	15	1	4	2	73	—	95
Profit before tax	1,581	2,516	2,527	915	1,056	—	8,595
	%	%	%	%	%		%
Share of HSBC's profitbefore tax	6.5	10.4	10.4	3.8	4.4		35.5
Cost efficiency ratio	64.8	49.3	67.3	56.8	36.9		59.9
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	151,687	106,846	163,066	30,195	481		452,275
Total assets	240,361	168,846	892,712	83,740	96,346	(245,372)	1,236,633
Customer accounts	178,757	99,704	163,713	62,055	725		504,954

For footnotes, see page 143.

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

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

Analysis by customer group and global business *(continued)*

Profit/(loss) before tax

	2006						
Europe	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income	5,653	2,923	1,222	675	14	(2,198)	8,289
Net fee income	2,533	1,707	1,673	869	326	–	7,108
Trading income/(expense) excluding net interest income	119	27	2,636	99	(39)	–	2,842
Net interest income/(expense) on trading activities	(6)	15	(523)	2	1	2,198	1,687
Net trading income/(expense)[16]	113	42	2,113	101	(38)	2,198	4,529
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	28	–	28
Net income/(expense) from other financial instruments designated at fair value	80	27	11	–	(2)	–	116
Net income/(expense) from financial instruments designated at fair value	80	27	11	–	26	–	144
Gains less losses from financial investments	37	22	413	149	3	–	624
Dividend income	2	3	171	5	2	–	183
Net earned insurance premiums .	979	110	–	–	209	–	1,298

Other operating income	128	103	957	13	256	(29)	1,428
Total operating income	9,525	4,937	6,560	1,812	798	(29)	23,603
Net insurance claims[17]	(331)	(19)	—	—	(181)	—	(531)
Net operating income[5]	9,194	4,918	6,560	1,812	617	(29)	23,072
Loan impairment (charges)/recoveries and other credit risk provisions	(1,838)	(386)	64	2	3	—	(2,155)
Net operating income	7,356	4,532	6,624	1,814	620	(29)	20,917
Total operating expenses	(5,447)	(2,298)	(4,224)	(1,010)	(921)	29	(13,871)
Operating profit/(loss)	1,909	2,234	2,400	804	(301)	—	7,046
Share of profit/(loss) in associates and joint ventures	—	—	(96)	1	23	—	(72)
Profit/(loss) before tax	1,909	2,234	2,304	805	(278)	—	6,974
	%	%	%	%	%		%
Share of HSBC's profit before tax	8.6	10.1	10.4	3.6	(1.2)		31.5
Cost efficiency ratio	59.2	46.7	64.4	55.7	149.3		60.1
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	147,507	81,430	140,277	23,283	2		392,499
Total assets	227,609	111,510	526,468	68,380	85,183	(152,118)	867,032
Customer accounts	152,411	80,312	139,416	47,223	3		419,365

For footnotes, see page 143.

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Hong Kong

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

	2008 US$m	2007 US$m	2006 US$m
Personal Financial Services	**3,428**	4,212	2,880
Commercial Banking	**1,315**	1,619	1,321
Global Banking and Markets	**1,436**	1,578	955
Private Banking	**237**	305	201
Other	**(955)**	(375)	(175)
	5,461	7,339	5,182

Profit before tax

	2008 US$m	2007 US$m	2006 US$m
Net interest income	**5,698**	5,483	4,685
Net fee income	**2,580**	3,362	2,056
Net trading income	**1,193**	1,242	617
Changes in fair value of long-term debt issued and related derivatives	**3**	2	
Net income/(expense) from other financial instruments designated at fair value	**(1,194)**	674	260
Net income/(expense) from financial instruments designated at fair value	**(1,191)**	676	260
Gains less losses from financial investments	**(309)**	94	162
Dividend income	**41**	31	61
Net earned insurance premiums	**3,247**	2,797	2,628
Other operating income	**817**	845	834
Total operating income	**12,076**	14,530	11,303
Net insurance claims incurred and movement in liabilities to policyholders	**(1,922)**	(3,208)	(2,699)
Net operating income before loan impairment charges and other credit risk provisions	**10,154**	11,322	8,604
Loan impairment charges and other credit risk provisions	**(765)**	(231)	(172)
Net operating income	**9,389**	11,091	8,432
Total operating expenses	**(3,943)**	(3,780)	(3,269)
Operating profit	**5,446**	7,311	5,163
Share of profit in associates and joint ventures	**15**	28	19
Profit before tax	**5,461**	7,339	5,182
	%	%	%
Share of HSBC's profit before tax	**58.7**	30.3	23.5
Cost efficiency ratio	**38.8**	33.4	38.0
Year-end staff numbers (full-time equivalent)	**29,330**	27,655	27,586

Balance sheet data15

	At 31 December		
	2008 **US$m**	2007 US$m	2006 US$m
Loans and advances to customers (net)	**100,220**	89,638	84,282
Loans and advances to banks (net)	**29,646**	63,737	50,359
Trading assets, financial assets designated at fair value, and financial investments	**122,602**	102,180	103,734
Total assets	**407,151**	356,894	318,857
Deposits by banks	**11,769**	6,420	4,799
Customer accounts	**250,517**	234,488	196,691

For footnote, see page 143.

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

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2008 compared with 2007

Economic briefing

Hong Kong's GDP growth slowed to 2.5 per cent in 2008 from 6.4 per cent in 2007. After performing strongly during the early months of the year, the economy slowed sharply and a technical recession was confirmed with the release of the third quarter GDP statistics. External demand proved especially weak during the second half of 2008 and the growth in private consumption also slowed sharply. The unemployment rate rose from a ten-year low of

3.2 per cent in August 2008 to 4.1 per cent by the year-end. Consumer price inflation proved volatile during the year, rising to a ten-year high of 6.3 per cent in July before slowing to 2.1 per cent by December 2008, although this movement largely reflected the trends in food and energy prices. In response to interest rate cuts in the US, Hong Kong cut its base interest rate on seven occasions during 2008, finishing the year at 0.5 per cent compared with 5.75 per cent at the end of 2007. The Hang Seng Index fell by 48 per cent during 2008.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007							
Hong Kong	**2007 as reported**	**2007 acquisitions, disposals & dilution gains[1]**	**Currency translation[2]**	**2007 at 2008 exchange rates[3]**	**2008 acquisitions and disposals[1]**	**Under-lying change**	**2008 as reported**	**Re-ported change**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**%**
Net interest income	**5,483**	–	**15**	**5,498**	–	**200**	**5,698**	**4**
Net fee income	**3,362**	–	**9**	**3,371**	–	**(791)**	**2,580**	**(23)**
Other income[4]	**2,477**	**(1)**	**3**	**2,479**	–	**(603)**	**1,876**	**(24)**
Net operating income[5]	**11,322**	**(1)**	**27**	**11,348**	–	**(1,194)**	**10,154**	**(10)**
Loan impairment charges and	**(231)**	**1**	**(1)**	**(231)**	–	**(534)**	**(765)**	**(231)**

other credit risk provisions								
Net operating income	**11,091**	**—**	**26**	**11,117**	**—**	**(1,728)**	**9,389**	**(15)**
Operating expenses	**(3,780)**	**—**	**(9)**	**(3,789)**	**—**	**(154)**	**(3,943)**	**(4)**
Operating profit	**7,311**	**—**	**17**	**7,328**	**—**	**(1,882)**	**5,446**	**(26)**
Income from associates	**28**	**—**	**—**	**28**	**—**	**(13)**	**15**	**(46)**
Profit before tax	**7,339**	**—**	**17**	**7,356**	**—**	**(1,895)**	**5,461**	**(26)**

For footnotes, see page 143.

Review of business performance

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

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

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

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

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of trade finance grew strongly, driven by demand from corporates with international trade requirements, and commercial lending balances rose, particularly during the first half of the year.

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

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

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

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

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

Net insurance claims and movement in liabilities to policyholders fell by 40 per cent, reflecting the decline in asset values noted above

partly offset by increases due to growth in premiums.

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

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

2007 compared with 2006

Economic briefing

Hong Kong's economy remained robust during 2007, with the annual rate of growth of 6.3 per cent. Domestic consumption was the major contributor to economic expansion, supported by the strong labour market. The unemployment rate fell to 3.4 per cent, a nine year low, as the supply of labour remained very tight. Global increases in food and oil prices affected Hong Kong, but the territory also experienced wage inflation, rising import prices and growth in property rental costs. Inflation increased as a result, exceeding 3 per cent in the final quarter of the year.

In response to interest rate cuts in the US and capital inflows into the local market, Hong Kong's

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main interest rate was cut on three separate occasions during the final months of 2007, with the prime rate ending the year at 6.75 per cent, down by one per cent from its high for the year. Local asset markets benefited accordingly. The previously very strong levels of export growth slowed in the second half of 2007, as demand from the US moderated and

the reduction in mainland China's export tax rebate in July temporarily affected Hong Kong's re-exports. Despite relatively modest trade growth, external demand for Hong Kong's services remained strong due to the buoyant tourism sector and increasing cross-border business activities, especially within the financial sector.

Reconciliation of reported and underlying profit before tax

	2007 compared with 2006								
Hong Kong	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006 at 2007 exchange rates[6] US$m	2007 acquisitions, disposals & dilution gains[1] US$m	Underlying change US$m	2007 as reported US$m	Reported change %	Underlying change %
Net interest income	4,685	–	(15)	4,670	–	813	5,483	17	17
Net fee income	2,056	–	(6)	2,050	–	1,312	3,362	64	64
Other income[4]	1,863	–	(6)	1,857	–	620	2,477	33	33
Net operating income[5]	8,604	–	(27)	8,577	–	2,745	11,322	32	32
Loan impairment charges and other credit risk provisions	(172)	–	1	(171)	–	(60)	(231)	(34)	(35)
Net operating income	8,432	–	(26)	8,406	–	2,685	11,091	32	32
	(3,269)	–	9	(3,260)	–	(520)	(3,780)	(16)	(16)

Operating expenses									
Operating profit	5,163	–	(17)	5,146	–	2,165	7,311	42	42
Income from associates	19	–	–	19	–	9	28	47	47
Profit before tax	5,182	–	(17)	5,165	–	2,174	7,339	42	42

For footnotes, see page 143.

Review of business performance

HSBC's operations in Hong Kong reported a record pre-tax profit of US$7.3 billion, an increase of 42 per cent compared with US$5.2 billion in 2006. The underlying change was in line with the reported change. Net operating income increased by 32 per cent, double the rate of growth in operating expenses.

In Personal Financial Services, record results reflected increased fee income, particularly from retail brokerage and investment products, as well as growth in net interest income from higher deposit balances and lending. In Commercial Banking, results were driven by balance sheet growth from customer acquisition, increased trade flows and the expansion of supporting businesses into mainland China. In Global Banking and Markets, income growth reflected improved performance in balance sheet management and strong results from the trading businesses and securities services in the buoyant economic environment. Higher demand for structured products and mutual funds drove the increase in Private Banking profits. Cost efficiency ratios improved in all customer groups.

Net interest income rose by 17 per cent, driven by growth in asset and liability products in the personal, commercial and corporate businesses. Net interest income from Global Banking and Markets increased by 79 per cent as balance sheet management revenues recovered and deposits grew strongly with higher spreads. A rise in liabilities to fund trading activities reduced net interest income, with a corresponding rise in trading income. Personal Financial Services' net interest income grew by 16 per cent as wider spreads were recorded on higher deposit balances, with the relaunch of HSBC Premier contributing to the growth in deposit balances. Card balances were also higher following a number of promotional programmes during the year. In Commercial Banking, strong economic growth helped generate demand for savings products and this, combined with strong customer acquisition, resulted in higher net interest from the investment of deposits.

Buoyant stock market activity drove an increase in *fee income*. Broking and global custody income rose as larger trading volumes were registered on higher stock exchange daily turnover. This was

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enhanced by the launch of new investment schemes, awareness campaigns and the adoption of a new portfolio wealth management sales tool in the branch network. An increase in IPO activity in Hong Kong, mainly derived from mainland China, had a positive effect on underwriting fees. Life insurance commission income increased, boosted by new product offerings. Credit card fee income also rose, driven by increased cards in circulation and a rise in cardholder balances.

Trading income growth was achieved throughout the Global Markets business and particularly in foreign exchange, assisted by investments made in recent years to extend the product range and customer base. Structured equity growth continued, driven by the bank's product offering linked to the Hong Kong Stock Exchange, which rose significantly. HSBC had only very limited exposure to asset-based securities and structured credit products in Hong Kong.

Net earned insurance premiums increased by 7 per cent to US$2.8 billion, as the life assurance business expanded with the launch of new products.

Other operating income was largely in line with 2006, notwithstanding the non-recurrence of income on the sale of the former head office building of Hang Seng Bank and the transfer of the credit card

acquiring business into a joint venture with Global Payments Inc.

Net insurance claims incurred and movement in liabilities to policyholders increased by 19 per cent to US$3.2 billion. The increase was more significant than premium growth because many of the liabilities were related to life policies. Policyholders participate in the investment performance of assets supporting these liabilities and the investment return on these assets is shown in 'Net income from financial instruments designated at fair value'.

Loan impairment charges continued at a low level and in line with 2006 at US$231 million, despite strong balance sheet growth. This reflected good credit quality and robust economic conditions.

Operating expenses increased by 16 per cent. Staff costs rose by 23 per cent on wage inflation and the recruitment of additional staff, mainly in Commercial Banking and Global Banking and Markets. Performance-related bonuses grew in response to revenue growth. Higher marketing and IT costs reflected business growth and the launch of new initiatives. As commercial rents rose in Hong Kong's dynamic economy, property rental costs increased, the effect magnified by the sale and leaseback agreement on Hang Seng Bank's head office in 2006.

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

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

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

Analysis by customer group and global business

Profit/(loss) before tax

	2008						
Hong Kong	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[21] US$m**	**Total US$m**
Net interest income/(expense)	**3,381**	**1,498**	**1,524**	**214**	**(669)**	**(250)**	**5,698**
Net fee income	**1,441**	**548**	**414**	**163**	**14**	–	**2,580**
Trading income excluding net interest income	**143**	**79**	**483**	**120**	**30**	–	**855**
Net interest/(expense) income on trading activities	**11**	**1**	**244**	–	**(168)**	**250**	**338**
Net trading income/(expense)[16]	**154**	**80**	**727**	**120**	**(138)**	**250**	**1,193**
Changes in fair value of long- term debt issued and related derivatives	–	–	–	–	**3**	–	**3**
Net income/(expense) from other financial instruments designated at fair value	**(1,291)**	**(10)**	**39**	–	**68**	–	**(1,194)**
Net income/(expense) from financial instruments designated at fair value	**(1,291)**	**(10)**	**39**	–	**71**	–	**(1,191)**
Gains less losses from financial investments	**156**	**32**	**(109)**	–	**(388)**	–	**(309)**
Dividend income	**3**	**2**	**17**	–	**19**	–	**41**
	3,047	**181**	**17**	–	**2**	–	**3,247**

Net earned insurance premiums							
Other operating income	**132**	**38**	**101**	**8**	**906**	**(368)**	**817**
Total operating income	**7,023**	**2,369**	**2,730**	**505**	**(183)**	**(368)**	**12,076**
Net insurance claims[17]	**(1,773)**	**(136)**	**(11)**	**–**	**(2)**	**–**	**(1,922)**
Net operating income[5]	**5,250**	**2,233**	**2,719**	**505**	**(185)**	**(368)**	**10,154**
Loan impairment (charges)/recoveries and other credit risk provisions	**(134)**	**(335)**	**(284)**	**(13)**	**1**	**–**	**(765)**
Net operating income/(expense)	**5,116**	**1,898**	**2,435**	**492**	**(184)**	**(368)**	**9,389**
Total operating expenses	**(1,691)**	**(584)**	**(1,000)**	**(255)**	**(781)**	**368**	**(3,943)**
Operating profit/(loss)	**3,425**	**1,314**	**1,435**	**237**	**(965)**	**–**	**5,446**
Share of profit in associates and joint ventures	**3**	**1**	**1**	**–**	**10**	**–**	**15**
Profit/(loss) before tax	**3,428**	**1,315**	**1,436**	**237**	**(955)**	**–**	**5,461**
	%	**%**	**%**	**%**	**%**		**%**
Share of HSBC's profit before tax	**36.9**	**14.1**	**15.4**	**2.6**	**(10.3)**		**58.7**
Cost efficiency ratio	**32.2**	**26.2**	**36.8**	**50.5**	**(422.2)**		**38.8**
Balance sheet data[15]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**41,447**	**30,331**	**23,042**	**3,605**	**1,795**		**100,220**
Total assets	**75,419**	**36,428**	**225,853**	**28,800**	**66,192**	**(25,541)**	**407,151**
Customer accounts	**145,002**	**54,869**	**30,866**	**19,416**	**364**		**250,517**

For footnotes, see page 143.

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	2007						
Hong Kong	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income/(expense)	3,342	1,540	986	70	(767)	312	5,483
Net fee income	1,973	526	682	179	2	—	3,362
Trading income excluding net interest income	188	63	553	280	186	—	1,270
Net interest income on trading activities	5	—	241	—	38	(312)	(28)
Net trading income[16]	193	63	794	280	224	(312)	1,242
Changes in fair value of long-term debt issued and related derivatives	—	—	—	—	2	—	2
Net income/(expense) from other financial instruments designated at fair value	820	(13)	7	—	(140)	—	674
Net income/(expense) from financial instruments designated at fair value	820	(13)	7	—	(138)	—	676
Gains less losses from financial investments	—	—	38	1	55	—	94
Dividend income	2	1	6	—	22	—	31
Net earned insurance premiums	2,654	130	13	—	—	—	2,797
Other operating income	153	28	114	6	881	(337)	845
Total operating income	9,137	2,275	2,640	536	279	(337)	14,530
Net insurance claims[17]	(3,116)	(82)	(10)	—	—	—	(3,208)
Net operating income[5]	6,021	2,193	2,630	536	279	(337)	11,322

Loan impairment charges and other credit risk provisions	(175)	(28)	(28)	—	—	—	(231)
Net operating income	5,846	2,165	2,602	536	279	(337)	11,091
Total operating expenses	(1,639)	(547)	(1,025)	(231)	(675)	337	(3,780)
Operating profit/(loss)	4,207	1,618	1,577	305	(396)	—	7,311
Share of profit in associates and joint ventures	5	1	1	—	21	—	28
Profit/(loss) before tax	4,212	1,619	1,578	305	(375)	—	7,339
	%	%	%	%	%		%
Share of HSBC's profit before tax	17.4	6.7	6.5	1.3	(1.6)		30.3
Cost efficiency ratio	27.2	24.9	39.0	43.1	241.9		33.4
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	38,197	25,890	19,171	4,329	2,051		89,638
Total assets	66,002	32,059	215,801	17,484	53,227	(27,679)	356,894
Customer accounts	129,159	51,562	37,364	15,649	754		234,488

For footnotes, see page 143.

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Analysis by customer group and global business *(continued)*

Profit/(loss) before tax

	2006						
Hong Kong	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income/(expense)	2,882	1,344	553	76	(646)	476	4,685
Net fee income/(expense)	977	454	534	123	(32)	–	2,056
Trading income excluding net interest income	84	57	573	176	34	–	924
Net interest income on trading activities	4	–	88	–	77	(476)	(307)
Net trading income[16]	88	57	661	176	111	(476)	617
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	–	–	–
Net income/(expense) from other financial instruments designated at fair value	373	(53)	5	1	(66)	–	260
Net income/(expense) from financial instruments designated at fair value	373	(53)	5	1	(66)	–	260
Gains less losses from financial investments	14	–	(1)	9	140	–	162

Dividend income	1	1	2	–	57	–	61
Net earned insurance premiums	2,519	95	14	–	–	–	2,628
Other operating income	202	33	81	13	781	(276)	834
Total operating income	7,056	1,931	1,849	398	345	(276)	11,303
Net insurance claims[17]	(2,638)	(50)	(11)	–	–	–	(2,699)
Net operating income[5]	4,418	1,881	1,838	398	345	(276)	8,604
Loan impairment (charges)/recoveries and other credit risk provisions	(119)	(69)	27	–	(11)	–	(172)
Net operating income	4,299	1,812	1,865	398	334	(276)	8,432
Total operating expenses	(1,422)	(491)	(911)	(197)	(524)	276	(3,269)
Operating profit/(loss)	2,877	1,321	954	201	(190)	–	5,163
Share of profit in associates and joint ventures	3	–	1	–	15	–	19
Profit/(loss) before tax	2,880	1,321	955	201	(175)	–	5,182
	%	%	%	%	%		%
Share of HSBC's profit before tax	13.0	6.0	4.3	0.9	(0.7)		23.5
Cost efficiency ratio	32.2	26.1	49.6	49.5	151.9		38.0
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	35,445	23,520	20,270	3,081	1,966		84,282
Total assets	57,977	30,137	182,540	22,492	49,866	(24,155)	318,857
Customer accounts	118,201	41,493	24,530	11,991	476		196,691

For footnotes, see page 143.

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Rest of Asia-Pacific (including the Middle East)

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

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Total US$m
2008						
Australia	**19**	**68**	**102**	**–**	**(13)**	**176**
India	**(155)**	**118**	**578**	**2**	**123**	**666**
Indonesia	**(22)**	**17**	**126**	**–**	**–**	**121**
Japan	**(88)**	**(1)**	**88**	**1**	**4**	**4**
Mainland China	**284**	**622**	**688**	**(5)**	**16**	**1,605**
Associates	**393**	**558**	**335**	**–**	**–**	**1,286**
Other mainland China	**(109)**	**64**	**353**	**(5)**	**16**	**319**
Malaysia	**94**	**96**	**171**	**–**	**8**	**369**
Middle East	**289**	**558**	**816**	**4**	**79**	**1,746**
Egypt	**16**	**68**	**90**	**–**	**49**	**223**
United Arab Emirates	**133**	**330**	**388**	**4**	**6**	**861**
Other Middle East	**80**	**125**	**161**	**–**	**1**	**367**
Middle East (excluding Saudi Arabia)	**229**	**523**	**639**	**4**	**56**	**1,451**
Saudi Arabia	**60**	**35**	**177**	**–**	**23**	**295**
Singapore	**104**	**83**	**337**	**110**	**(37)**	**597**
South Korea	**(16)**	**(13)**	**304**	**–**	**38**	**313**
Taiwan	**(41)**	**45**	**179**	**–**	**(8)**	**175**
Other	**32**	**200**	**397**	**1**	**66**	**696**
	500	**1,793**	**3,786**	**113**	**276**	**6,468**
2007						
Australia	41	37	42	–	4	124
India	(70)	88	429	(1)	83	529
Indonesia	(7)	29	86	–	(4)	104
Japan	(34)	(3)	75	–	5	43
Mainland China	494	397	369	–	1,101	2,361
Associates	516	351	220	–	1,093	2,180
Other mainland China	(22)	46	149	–	8	181
Malaysia	81	90	146	–	13	330
Middle East	245	482	495	3	82	1,307
Egypt	10	46	65	–	32	153
United Arab Emirates	108	262	242	3	2	617
Other Middle East	83	101	116	–	–	300
Middle East (excluding Saudi Arabia)	201	409	423	3	34	1,070

Saudi Arabia	44	73	72	–	48	237
Singapore	101	112	240	90	7	550
South Korea	(44)	(20)	159	–	28	123
Taiwan	(52)	27	144	–	4	123
Other	5	111	279	–	20	415
	760	1,350	2,464	92	1,343	6,009

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

Geographical regions > Rest of Asia-Pacific > 2008

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

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Total US$m
2006						
Australia	76	32	46	—	—	154
India	(24)	46	277	2	92	393
Indonesia	(22)	46	69	—	(22)	71
Japan	(3)	(2)	49	(1)	80	123
Mainland China	276	241	167	—	24	708
Associates	274	210	86	—	5	575
Other mainland China	2	31	81	—	19	133
Malaysia	77	87	99	(1)	12	274
Middle East	235	356	396	2	46	1,035
Egypt	9	41	41	—	20	111
United Arab Emirates	70	209	145	3	(2)	425
Other Middle East	59	67	70	(1)	(1)	194
Middle East (excluding Saudi Arabia)	138	317	256	2	17	730
Saudi Arabia	97	39	140	—	29	305
Singapore	73	90	145	68	(11)	365
South Korea	(55)	(20)	115	—	19	59
Taiwan	(179)	37	118	—	1	(23)
Other	23	121	168	10	46	368
	477	1,034	1,649	80	287	3,527

Loans and advances to customers (net) by country

	At 31 December		
	2008 US$m	2007 US$m	2006 US$m
Australia	**9,321**	11,339	8,775
India	**6,244**	7,220	4,915
Indonesia	**1,904**	1,642	1,337
Japan	**5,839**	4,258	3,391
Mainland China	**11,440**	11,647	6,065
Malaysia	**9,404**	8,856	7,747
Middle East (excluding Saudi Arabia)	**27,295**	21,607	15,622

Egypt	**2,473**	1,853	965
United Arab Emirates	**17,537**	14,103	10,148
Other Middle East	**7,285**	5,651	4,509
Singapore	**13,441**	11,505	9,610
South Korea	**5,336**	7,124	6,260
Taiwan	**4,329**	3,658	3,974
Other	**13,403**	12,996	9,878
	107,956	101,852	77,574

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Customer accounts by country

	At 31 December		
	2008 **US$m**	2007 US$m	2006 US$m
Australia	**9,201**	11,418	8,491
India	**9,767**	12,021	7,936
Indonesia	**2,896**	2,574	2,082
Japan	**6,204**	4,657	4,186
Mainland China	**19,171**	14,537	6,941
Malaysia	**11,963**	11,701	9,640
Middle East (excluding Saudi Arabia)	**35,166**	30,937	21,196
Egypt	**5,363**	4,056	2,703
United Arab Emirates	**19,808**	18,455	11,166
Other Middle East	**9,995**	8,426	7,327
Singapore	**32,748**	28,962	23,517
South Korea	**4,383**	5,760	3,890
Taiwan	**9,689**	9,426	7,675
Other	**18,171**	18,240	13,441
	159,359	150,233	108,995

2008 compared with 2007

Economic briefing

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

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

The economies of the **Middle East** performed strongly for much of 2008, although inflationary concerns were a feature for much of the year, driven by the surge in oil prices to record levels and private and public investment expenditure. High oil revenues continued to boost fiscal and current account surpluses throughout the region during 2008, although the impact of the decline in oil prices during the final months of the year, together with the OPEC-mandated production cuts, are expected to lead to slower growth in 2009.

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

Inflation also proved the predominant concern in **Vietnam** during the first half of 2008 as the annual rate of consumer price inflation more than doubled to 28.3 per cent, prompting the State Bank of Vietnam to sanction substantial interest rate

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HSBC HOLDINGS PLC

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

Geographical regions > Rest of Asia-Pacific > 2008

Profit before tax

Rest of Asia-Pacific (including the Middle East)	**2008 US$m**	2007 US$m	2006 US$m
Net interest income	**5,493**	4,143	3,047
Net fee income	**2,558**	2,246	1,622
Net trading income	**2,444**	1,643	1,181
Changes in fair value of long-term debt issued and related derivatives	**1**	1	–
Net income/(expense) from other financial instruments designated at fair value	**(172)**	110	79
Net income/(expense) from financial instruments designated at fair value	**(171)**	111	79
Gains less losses from financial investments	**32**	38	41
Gains arising from dilution of interests in associates	–	1,081	–
Dividend income	**4**	8	5
Net earned insurance premiums	**197**	226	174
Other operating income	**1,064**	798	765
Total operating income	**11,621**	10,294	6,914
Net insurance claims incurred and movement in liabilities to policyholders	**28**	(253)	(192)
Net operating income before loan impairment charges and other credit risk provisions	**11,649**	10,041	6,722
Loan impairment charges and other credit risk provisions	**(1,131)**	(616)	(512)
Net operating income	**10,518**	9,425	6,210
Total operating expenses	**(5,663)**	(4,764)	(3,548)
Operating profit	**4,855**	4,661	2,662
Share of profit in associates and joint ventures	**1,613**	1,348	865
Profit before tax	**6,468**	6,009	3,527

	%	%	%
Share of HSBC's profit before tax	**69.5**	24.8	16.0
Cost efficiency ratio	**48.6**	47.4	52.8
Year-end staff numbers (full-time equivalent)	**98,159**	88,573	72,265

Balance sheet data[15]

	At 31 December		
	2008 **US$m**	2007 US$m	2006 US$m
Loans and advances to customers (net)	**107,956**	101,852	77,574
Loans and advances to banks (net)	**36,141**	39,861	27,517
Trading assets, financial assets designated at fair value, and financial investments	**61,223**	64,381	41,585
Total assets	**262,305**	243,205	175,010
Deposits by banks	**13,689**	17,560	10,323
Customer accounts	**159,359**	150,233	108,995

For footnote, see page 143.

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

increases, before these measures were rapidly reversed during the final months of the year. Interest rate increases were also forthcoming in **Indonesia** between May and October 2008, although with growth levels maintaining a relatively robust level during much of the year, a tentative easing cycle was only initiated during the final weeks of 2008. Bank Negara **Malaysia** proved the exception by refraining

from interest rate increases during the year, even as consumer price inflation accelerated to 8.5 per cent in July 2008, before cutting the policy rate to 3.25 per cent in November. The outlook for the **South Korean** economy was affected by the open nature of the economy and the relatively high levels of household and corporate sector indebtedness. Full year GDP rose by 2.5 per cent in 2008, down from

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5.0 per cent in 2007 and the weakest performance for ten years, while fourth quarter GDP fell by 3.4 per cent on a year-on-year basis. Rising food prices proved particularly problematic for the **Philippines** during the first half of the year as inflation moved

well above the central bank's targeted range, although the earlier tightening of monetary policy was partially reversed at the end of 2008. Growth slowed sharply in **Taiwan** during the course of the year, driven by deteriorating conditions overseas.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007							
Rest of Asia-Pacific (including the Middle East)	**2007 as reported US$m**	**2007 acquisitions, disposals & dilution gains[1] US$m**	**Currency translation[2] US$m**	**2007 at 2008 exchange rates[3] US$m**	**2008 acquisitions and disposals[1] US$m**	**Underlying change US$m**	**2008 as reported US$m**	**Report chan**
Net interest income	**4,143**	–	**43**	**4,186**	**31**	**1,276**	**5,493**	
Net fee income	**2,246**	–	**24**	**2,270**	**3**	**285**	**2,558**	
Other income[4]	**3,652**	**(1,081)**	**18**	**2,589**	**70**	**939**	**3,598**	
Net operating income[5]	**10,041**	**(1,081)**	**85**	**9,045**	**104**	**2,500**	**11,649**	
Loan impairment charges and other credit risk provisions	**(616)**	–	**14**	**(602)**	–	**(529)**	**(1,131)**	**(**
Net operating income	**9,425**	**(1,081)**	**99**	**8,443**	**104**	**1,971**	**10,518**	
Operating expenses	**(4,764)**	–	**(17)**	**(4,781)**	**(110)**	**(772)**	**(5,663)**	**(**
Operating profit	**4,661**	**(1,081)**	**82**	**3,662**	**(6)**	**1,199**	**4,855**	
Income from associates	**1,348**	–	**93**	**1,441**	–	**172**	**1,613**	

Profit before tax	**6,009**	**(1,081)**	**175**	**5,103**	**(6)**	**1,371**	**6,468**

For footnotes, see page 143.

Review of business performance

HSBCs operations in Rest of Asia-Pacific performed strongly, reporting a pre-tax profit of US$6.5 billion compared with US$6.0 billion in 2007, an increase of 8 per cent. HSBC continued to increase its presence in key markets, augmenting organic growth with the integration of the operations of The Chinese Bank in Taiwan and the purchase of IL&FS Investsmart Ltd in India, which was completed in September. On an underlying basis, excluding the dilution gains on Chinese associates of US$1.1 billion recorded in 2007 and the acquisitions noted above, profit before tax increased by 27 per cent, with notable growth in the Middle East, South Korea, mainland China, India, and an increased contribution from associates in the region. Branches were added in mainland China, Indonesia, Japan, Malaysia and Bangladesh.

Net interest income increased by 30 per cent, with growth across most major countries and all customer groups. Deposit acquisition and related asset deployment across the region drove net interest income, though this volume growth was partly offset by deposit spread compression in the second half of the year due to declining interest rates, compounded by strong competition to acquire deposits.

In the Middle East, net interest income increased by 42 per cent, with deposit growth, notably in Personal Financial Services. This supported a strong rise in corporate lending balances aligned to trade and infrastructure investments, as well as increased personal lending, in particular credit cards. Asset spreads benefited from declines in local base rates following US dollar interest rate cuts, which resulted in a lower cost of funds.

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

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

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

Net fee income rose by 13 per cent, driven by a growth in fees from personal credit cards and trade and supply chain services. Credit card fees rose, particularly in the Middle East and India, driven by increases in interchange fees from higher cardholder spending and late payment and over-limit fees from higher delinquencies (see below). Trade and supply chain services contributed strongly to fee income growth with an increase of 34 per cent in the Middle East, in part reflecting the significant rise in commodity prices in the first half of the year, demonstrably in the construction and infrastructure industries in the UAE. There were lower fees from investment products and broking across the region, driven by a decline in equity markets and weakened investor sentiment.

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

Net trading income rose by 51 per cent, predominantly due to strong Rates and foreign exchange trading across the region as volatile market conditions continued, encouraging increased corporate hedging activity.

Growth was particularly strong in South Korea, mainland China and Australia due to strategic positioning of HSBC's balance sheet to benefit from the interest rate cuts and foreign exchange volatility in 2008, and increased activity in these local markets. In the Middle East, market uncertainty regarding possible currency revaluations drove volatility and, together with robust client demand, led to growth in foreign exchange income. In India, foreign exchange and, to a lesser extent, Rates revenues rose, driven mainly by increased customer activity and high levels of market volatility.

A net loss from *financial instruments designated at fair value* of US$171 million was recorded compared with income of US$111 million in 2007. Declines in equity markets affected unit-linked insurance products, particularly in Singapore. This was largely offset by a corresponding decrease in liabilities to policyholders reflected in *net insurance claims incurred and movement in liabilities to policyholders.*

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

Loan impairment charges rose sharply, increasing by 88 per cent to US$1.1 billion, following a marked deterioration in credit quality across the region in the final quarter of the year. These charges rose most significantly in India, the Middle East and, to a lesser extent, in Australia.

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

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

Operating expenses increased by 16 per cent to US$5.7 billion. Significant investment in the region continued, notably in mainland China where 29 new outlets were opened and staff numbers increased. Related premises and equipment costs rose accordingly. Expansion was also pursued in Indonesia with the addition of new branches, and in Japan with the rollout of seven HSBC Premier centres. In the Middle East, operating expenses were 22 per cent higher in line with substantially increased levels of operating volumes and related headcount growth. In India, the rise in operating expenses was driven mainly by investment in IT, premises costs and an increase in collection activities as default rates rose. Business growth contributed to higher operating expenses in Australia. Litigation costs in the region rose.

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

Profit from associates and joint ventures in the region increased by 12 per cent, notwithstanding a significant impairment recorded in Ping An Insurance in respect of its stake in Fortis Bank. Growth was strong across HSBC's other principal associates, the Bank of Communications, Industrial Bank, and the Saudi British Bank.

2007 compared with 2006

Economic briefing

Mainland China's economy continued to grow strongly, with GDP rising by 11.4 per cent in 2007, the fifth consecutive year of double-digit growth; this was despite a combination of measures aimed at curbing investment, such as increases in interest rates and reserve ratios required for banks. Economic performance remained primarily dependent on investment and exports. Bank loan growth also remained very strong. Export growth slowed from very high levels as the year progressed, reflecting the mild downturn in global trade. Consumer spending grew steadily in 2007, with retail sales rising by about 16 per cent. Inflationary pressures increased, with consumer price inflation exceeding 6 per cent towards the end of the year, mainly due to higher food prices. Mainland China's foreign exchange reserves rose further, to more than US$1.5 trillion, while the renminbi appreciated by over 5 per cent against the US dollar in 2007.

Japan's economy, the largest in the region, expanded modestly in 2007. Private capital investment decelerated after five years of firm growth but a rise in exports, especially to Asia, drove overall growth. Private consumption also made a positive contribution, helped by a gradual increase in employees' income. Core consumer price inflation remained around zero throughout the course of the year.

In the **Middle East,** economies continued to grow, although growth rates slowed slightly on those recorded in 2006, largely as a result of OPEC-mandated cuts in oil production. Underlying economic performance was robust, however, led by continued non-oil sector growth. The catalyst for expansion was a fifth consecutive year of rising oil prices, which facilitated continued growth in public and private investment. Consumption rose as employment levels increased and low interest rates supported an ongoing expansion in credit. Strong population growth, accelerated in parts of the region by high levels of immigration, also boosted demand for credit. High oil revenues resulted in a further year of fiscal and current account surpluses throughout the Middle East, boosting reserves and holdings of overseas assets. Rapid economic growth, low interest rates and currency weakness increased inflation, however, fuelling demands in some quarters for adjustments to the long-standing dollar pegs. Regional equity markets recovered from their 2005-06 downturns to perform strongly in 2007.

Elsewhere in the region, the Indian economy expanded by 8.7 per cent in 2007, although there was evidence that recent interest rate rises and the strength of the rupee were slowing some areas of the economy, and inflationary pressures eased in 2007. The economies of Vietnam and Singapore recorded strong performances too, expanding by 8.5 per cent and 7.7 per cent, respectively in 2007. Growth was approximately 6 per cent in Indonesia and Malaysia. Domestic demand in all these countries has become an increasingly important source of GDP growth with investment, particularly in the construction sector, expanding rapidly. Inflationary pressures intensified in 2007, largely as a result of higher oil and food prices, but remained under control. The South Korean economy accelerated in 2007 as exports continued to flourish and household spending recovered from levels recorded in 2006. Concerns over liquidity growth prompted the central bank to increase interest rates by 50 basis points to 5 per cent during the year. A gradual cooling of demand and concerns over rapid exchange rate appreciation are expected to limit the scope for further interest rate rises in 2008. Buoyant exports supported economic growth in Taiwan, while domestic demand remained lacklustre due to a lack of government initiatives which is expected to continue beyond the presidential and parliamentary elections scheduled for 2008. Generally robust economic performances in the Philippines, Thailand, and Pakistan in 2007 were overshadowed to varying degrees by political risks.

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Reconciliation of reported and underlying profit before tax

	2007 compared with 2006								
Rest of Asia-Pacific (including the Middle East)	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006 at 2007 exchange rates[6] US$m	2007 acquisitions, disposals & dilution gains[1] US$m	Under-lying change US$m	2007 as reported US$m	Reported change %	Unde ch
Net interest income	3,047	–	140	3,187	–	956	4,143	36	
Net fee income	1,622	–	58	1,680	–	566	2,246	38	
Other income[4]	2,053	–	108	2,161	1,081	410	3,652	78	
Net operating income[5]	6,722	–	306	7,028	1,081	1,932	10,041	49	
Loan impairment charges and other credit risk provisions	(512)	–	(13)	(525)	–	(91)	(616)	(20)	
Net operating income	6,210	–	293	6,503	1,081	1,841	9,425	52	
Operating expenses	(3,548)	–	(179)	(3,727)	–	(1,037)	(4,764)	(34)	
Operating profit	2,662	–	114	2,776	1,081	804	4,661	75	
Income from associates	865	–	25	890	–	458	1,348	56	
Profit before tax	3,527	–	139	3,666	1,081	1,262	6,009	70	

For footnotes, see page 143.

Review of business performance

HSBCs operations in Rest of Asia-Pacific reported a pre-tax profit of US$6.0 billion compared with US$3.5 billion in 2006, an increase of 70 per cent. On an underlying basis, excluding dilution gains of US$1.1 billion, profit before tax increased by 34 per cent, bolstered by sustained growth and business expansion across the region.

In Global Banking and Markets, profit before tax increased significantly, driven by an enhanced product offering combined with buoyant local markets. Commercial Banking revenue benefited from increased customer volumes as a result of new and enhanced banking services. In Personal Financial Services, profit before tax rose as a result of strong balance sheet growth and increased contributions from associates. Private Banking delivered a solid performance, underpinned by robust stock markets and increasing wealth in the region.

HSBCs three associates in mainland China, Ping An Insurance, Bank of Communications and Industrial Bank, all raised new capital in 2007 in the A share market in Shanghai in which HSBC, as a foreign investor, was unable to participate. The dilution of the Groups interests was considerably less than its share of the new monies, resulting in gains of US$1.1 billion which should be regarded as exceptional.

Net interest income rose by 30 per cent. Continued expansion of the branch network, particularly in the populous markets of mainland

China, Indonesia and India, together with increased marketing expenditure and greater brand awareness, accelerated customer acquisition and growth in loans and deposits.

In the Middle East, the significant increase in net interest income was driven by balance sheet growth across all customer groups and augmented by improved spreads. The growth was underpinned by strong local economies, higher oil prices and demand for credit for infrastructure investment and trade.

In Global Banking and Markets, the rise in net interest income was driven by the recovery in Balance Sheet Management revenues and, as trade and investment flows increased, by higher transactional balances in the payments and cash management businesses.

In Personal Financial Services, net interest income rose by 23 per cent, driven by higher personal lending, credit cards and deposit balances. Growth was broad-based across the region. Commercial Banking net interest income grew by 29 per cent due to volume growth in both loans and deposits following an increase in customer numbers.

Fee income increased by 34 per cent. Buoyant stock markets stimulated customer appetite for unit trusts and other investment products. Strong investment sales were recorded in India, Philippines, South Korea, Singapore and mainland China. Security services increased, driven by a sustained level of transaction volumes and investment flows. In the Middle East, increases were registered in cards,

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global custody, credit facilities and insurance. Increased trade services income in the region reflected higher intra-regional trade flows, which were driven by the favourable economic conditions.

Strong *trading income* growth was delivered, led by foreign exchange trading, where higher volumes were driven by increased volatility which, in turn, increased customer demand for risk management products.

Net earned insurance premiums rose by 24 per cent to US$226 million. This growth was mainly generated in Malaysia by the HSBC Amanah Takaful business which was launched in late 2006, offering *shariah*-compliant insurance products.

Other operating income decreased by 2 per cent, partly because gains on disposals of certain businesses in Australia were recorded in 2006. Similarly, profits from the disposal of assets held for sale decreased due to the non-recurrence of profits on sale of properties in Japan and India.

Net insurance claims incurred and movement in liabilities to policyholders rose by 25 per cent to US$253 million, in line with the increase in premiums, mainly in Malaysia.

Loan impairment charges rose by 17 per cent to US$616 million as corporate loan impairment charges increased in several countries. In addition, loan impairment charges in India rose due to balance sheet growth and higher loss rates on credit cards. Partly offsetting these factors, loan impairment charges were significantly lower in Taiwan due to the non-recurrence of impairment charges in 2006 which resulted from regulatory intervention in the card market and the imposition of a government debt negotiation scheme. In Indonesia, performance improved on 2006 when loan impairment charges

were affected by the introduction of minimum repayment terms.

Operating expenses increased by 28 per cent in line with the rise in net operating income before loan impairment charges. Business expansion continued throughout the region. Staff costs in India, mainland China and the Middle East rose on increases in volume-driven headcount and performance-related bonuses, the latter due to higher revenue generation. Business expansion initiatives were taken in mainland China, where an additional 27 new branches or sub-branches were opened. In India, the branch network and the consumer finance and credit card businesses were all expanded. Marketing, technology and infrastructure costs were incurred in support of business expansion.

Share of profit in associates and joint ventures in the region rose by 51 per cent, mainly due to increased contributions from HSBC's strategic investments in mainland China, Bank of Communications, Ping An Insurance and Industrial Bank. HSBC's share of profit from Ping An Insurance rose by 101 per cent to US$518 million as a result of robust growth, notably from life insurance products, and the realisation of synergistic gains across Ping An Insurance's other business offerings. Profit from the Bank of Communications rose by 64 per cent to US$445 million as a result of improved performance across the associate's various product offerings. Increased income from credit and treasury products and significant growth in fee income contributed to the rise in profits. HSBC's share of profits from the Saudi British Bank decreased by 22 per cent to US$216 million. This was largely due to the effects of a significant correction to the local stock market in the second half of 2006.

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

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

Analysis by customer group and global business

Profit before tax

	2008						
Rest of Asia-Pacific (including the Middle East)	**Personal Financial Services**	**Commercial Banking**	**Global Banking & Markets**	**Private Banking**	**Other**	**Inter-segment elimination[21]**	**Total**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**
Net interest income	**2,360**	**1,444**	**1,886**	**106**	**185**	**(488)**	**5,493**
Net fee income	**819**	**597**	**1,048**	**77**	**17**	–	**2,558**
Trading income/(expense) excluding net interest income	**112**	**187**	**1,477**	**77**	**(30)**	–	**1,823**
Net interest income/(expense)on trading activities	**(5)**	–	**143**	–	**(5)**	**488**	**621**
Net trading income/(expense)[16]	**107**	**187**	**1,620**	**77**	**(35)**	**488**	**2,444**
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	**1**	–	**1**
Net income/(expense) from other financial instruments designated at fair value	**(172)**	–	**(4)**	–	**4**	–	**(172)**
Net income/(expense) from financial instruments designated at fair value	**(172)**	–	**(4)**	–	**5**	–	**(171)**

Gains less losses from financial investments	**29**	**3**	–	–	–	–	**32**
Dividend income	–	–	**4**	–	–	–	**4**
Net earned insurance premiums	**172**	**25**	–	–	–	–	**197**
Other operating income	**79**	**84**	**90**	**2**	**1,096**	**(287)**	**1,064**
Total operating income	**3,394**	**2,340**	**4,644**	**262**	**1,268**	**(287)**	**11,621**
Net insurance claims[17]	**42**	**(14)**	–	–	–	–	**28**
Net operating income[5]	**3,436**	**2,326**	**4,644**	**262**	**1,268**	**(287)**	**11,649**
Loan impairment charges and other credit risk provisions	**(863)**	**(182)**	**(85)**	**(1)**	–	–	**(1,131)**
Net operating income	**2,573**	**2,144**	**4,559**	**261**	**1,268**	**(287)**	**10,518**
Total operating expenses	**(2,527)**	**(953)**	**(1,298)**	**(148)**	**(1,024)**	**287**	**(5,663)**
Operating profit	**46**	**1,191**	**3,261**	**113**	**244**	–	**4,855**
Share of profit in associates and joint ventures	**454**	**602**	**525**	–	**32**	–	**1,613**
Profit before tax	**500**	**1,793**	**3,786**	**113**	**276**	–	**6,468**
	%	**%**	**%**	**%**	**%**		**%**
Share of HSBC's profit before tax	**5.4**	**19.3**	**40.7**	**1.2**	**2.9**		**69.5**
Cost efficiency ratio	**73.5**	**41.0**	**28.0**	**56.5**	**80.8**		**48.6**
Balance sheet data[15]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**34,860**	**35,188**	**34,590**	**2,989**	**329**		**107,956**
Total assets	**44,478**	**43,702**	**172,049**	**12,486**	**702**	**(11,112)**	**262,305**
Customer accounts	**56,531**	**36,350**	**50,605**	**14,475**	**1,398**		**159,359**

For footnotes, see page 143.

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	2007						
Rest of Asia-Pacific (including the Middle East)	Personal Financial Services	Commercial Banking	Global Banking & Markets	Private Banking	Other	Inter-segment elimination[21]	Total
	US$m	US$m	US$m	US$m	US$m	US$m	US$m
Net interest income	1,965	1,131	1,295	60	153	(461)	4,143
Net fee income	766	429	952	85	14	–	2,246
Trading income/(expense) excluding net interest income	72	129	1,000	71	(70)	–	1,202
Net interest income/(expense) on trading activities	(2)	–	(22)	–	4	461	441
Net trading income/(expense)[16]	70	129	978	71	(66)	461	1,643
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	1	–	1
Net income/(expense) from other financial instruments designated at fair value	73	4	(3)	(1)	37	–	110
Net income/(expense) from financial instruments designated at fair value	73	4	(3)	(1)	38	–	111
Gains less losses from financial investments	5	4	28	–	1	–	38
Gains arising from dilution of interests in associates	–	–	–	–	1,081	–	1,081
Dividend income	–	–	2	–	6	–	8
Net earned insurance premiums	209	16	–	–	1	–	226
Other operating income	40	15	53	2	849	(161)	798
Total operating income	3,128	1,728	3,305	217	2,077	(161)	10,294
Net insurance claims[17]	(246)	(7)	–	–	–	–	(253)
	2,882	1,721	3,305	217	2,077	(161)	10,041

Net operating income[5]							
Loan impairment charges and other credit risk provisions	(552)	(61)	(3)	—	—	—	(616)
Net operating income	2,330	1,660	3,302	217	2,077	(161)	9,425
Total operating expenses	(2,131)	(739)	(1,140)	(125)	(790)	161	(4,764)
Operating profit	199	921	2,162	92	1,287	—	4,661
Share of profit in associates and joint ventures	561	429	302	—	56	—	1,348
Profit before tax	760	1,350	2,464	92	1,343	—	6,009
	%	%	%	%	%		%
Share of HSBC's profit before tax	3.1	5.6	10.2	0.4	5.5		24.8
Cost efficiency ratio	73.9	42.9	34.5	57.6	38.0		47.4
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	34,486	32,159	32,106	2,955	146		101,852
Total assets	42,337	39,743	155,106	9,294	4,756	(8,031)	243,205
Customer accounts	49,703	34,891	54,120	11,116	403		150,233

For footnotes, see page 143.

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Analysis by customer group and global business *(continued)*

Profit before tax

	2006						
Rest of Asia-Pacific (including the Middle East)	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income	1,520	848	802	35	61	(219)	3,047
Net fee income	524	330	688	68	12	–	1,622
Trading income/(expense) excluding net interest income	61	86	717	74	(3)	–	935
Net interest income on trading activities	–	–	–	–	27	219	246
Net trading income[16]	61	86	717	74	24	219	1,181
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	–	–	–
Net income from other financial instruments designated at fair value	59	4	4	–	12	–	79
Net income from financial instruments designated at fair value	59	4	4	–	12	–	79
Gains less losses from financial investments	2	2	38	(1)	–	–	41
Dividend income	–	–	1	–	4	–	5
Net earned insurance premiums	148	26	–	–	–	–	174

Other operating income	108	20	61	—	667	(91)	765
Total operating income	2,422	1,316	2,311	176	780	(91)	6,914
Net insurance claims[17]	(180)	(11)	—	—	(1)	—	(192)
Net operating income[5]	2,242	1,305	2,311	176	779	(91)	6,722
Loan impairment (charges)/recoveries and other credit risk provisions	(545)	29	5	—	(1)	—	(512)
Net operating income	1,697	1,334	2,316	176	778	(91)	6,210
Total operating expenses	(1,593)	(554)	(869)	(96)	(527)	91	(3,548)
Operating profit	104	780	1,447	80	251	—	2,662
Share of profit in associates and joint ventures	373	254	202	—	36	—	865
Profit before tax	477	1,034	1,649	80	287	—	3,527
	%	%	%	%	%		%
Share of HSBC’s profit before tax	2.2	4.7	7.5	0.4	1.2		16.0
Cost efficiency ratio	71.1	42.5	37.6	54.5	67.7		52.8
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	28,911	21,912	24,311	2,313	127		77,574
Total assets	35,794	26,757	109,535	7,882	—	(4,958)	175,010
Customer accounts	38,557	24,228	36,623	8,929	658		108,995

For footnotes, see page 143.

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North America

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

	Personal Financial Services US$m	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Total US$m**
2008						
United States[23]	**(17,364)**	**226**	**(2,899)**	**67**	**3,427**	**(16,543)**
Canada	**106**	**380**	**252**	**5**	**96**	**839**
Bermuda	**31**	**51**	**72**	**11**	**9**	**174**
Other	**(1)**	**1**	**–**	**–**	**2**	**2**
	(17,228)	**658**	**(2,575)**	**83**	**3,534**	**(15,528)**
2007						
United States	(1,824)	377	(1,243)	156	1,468	(1,066)
Canada	265	466	239	8	5	983
Bermuda	13	77	39	10	34	173
Other	–	–	–	–	1	1
	(1,546)	920	(965)	174	1,508	91
2006						
United States	3,128	442	199	107	(264)	3,612
Canada	253	437	189	–	17	896
Bermuda	10	78	31	7	29	155
Other	–	–	4	–	1	5
	3,391	957	423	114	(217)	4,668

For footnote, see page 143.

Loans and advances to customers (net) by country

	At 31 December		
	2008 US$m	2007 US$m	2006 US$m
United States	**208,834**	233,706	236,188
Canada	**44,866**	53,891	39,584
Bermuda	**2,514**	2,263	2,215
	256,214	289,860	277,987

Customer accounts by country

	At 31 December		
	2008	2007	2006
	US$m	US$m	US$m
United States	**101,963**	100,034	84,560
Canada	**33,905**	37,061	28,668
Bermuda	**7,664**	8,078	7,694
	143,532	145,173	120,922

2008 compared with 2007

Economic briefing

Economic conditions proved very difficult in the **US** during 2008 as the economy entered a period of recession. Overall GDP growth slowed to just 1.1 per cent for the year, down from 2 per cent in 2007. In common with many other economies, much of this weakness was concentrated in the final months of 2008 as fourth quarter GDP registered the largest quarterly decline for 26 years. Economic

weakness proved broad-based across most areas of the economy, with the notable exception of net exports. Housing sales and residential construction activity both declined from already depressed levels, with house prices continuing to fall in most regions and mortgage delinquencies continuing to rise. Labour market conditions weakened throughout the course of the year as the unemployment rate rose from 4.9 per cent in January to a 15-year high of 7.2 per cent in December 2008. The annual rate of

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Profit/(loss) before tax

North America	**2008 US$m**	2007 US$m	2006 US$m
Net interest income	**15,218**	14,847	14,268
Net fee income	**5,227**	5,810	4,766
Net trading income/(expense)	**(3,135)**	(542)	1,358
Changes in fair value of long-term debt issued and related derivatives	**3,736**	1,750	(63)
Net income from other financial instruments designated at fair value	**1**	–	–
Net income/(expense) from financial instruments designated at fair value	**3,737**	1,750	(63)
Gains less losses from financial investments	**(120)**	245	58
Dividend income	**77**	105	85
Net earned insurance premiums	**390**	449	492
Other operating income	**23**	360	922
Total operating income	**21,417**	23,024	21,886
Net insurance claims incurred and movement in liabilities to policyholders	**(238)**	(241)	(259)
Net operating income before loan impairment charges and other credit risk provisions	**21,179**	22,783	21,627
Loan impairment charges and other credit risk provisions	**(16,795)**	(12,156)	(6,796)
Net operating income	**4,384**	10,627	14,831
Operating expenses (excluding goodwill impairment)	**(9,359)**	(10,556)	(10,193)
Goodwill impairment	**(10,564)**	–	–
Operating profit/(loss)	**(15,539)**	71	4,638
Share of profit in associates and joint ventures	**11**	20	30
Profit/(loss) before tax	**(15,528)**	91	4,668
	%	%	%
Share of HSBC's profit before tax	**(166.8)**	0.4	21.1
Cost efficiency ratio	**94.1**	46.3	47.1
Year-end staff numbers (full-time equivalent)	**44,725**	52,722	55,642

Balance sheet data[15]

At 31 December

	2008 US$m	2007 US$m	2006 US$m
Loans and advances to customers (net)	**256,214**	289,860	277,987
Loans and advances to banks (net)	**11,458**	16,566	17,865
Trading assets, financial assets designated at fair value, and financial investments[20]	**119,634**	133,998	145,700
Total assets	**552,612**	549,285	505,638
Deposits by banks	**18,181**	16,618	11,484
Customer accounts	**143,532**	145,173	120,922

For footnotes, see page 143.
All commentaries on North America are on an underlying basis unless stated otherwise.

consumer price inflation reached a 17-year high of 5.6 per cent in July 2008 before moderating sharply to stand at just 0.1 per cent by the year-end. A combination of falling asset values and weak employment conditions undermined consumer confidence and household spending growth turned negative during the second half of 2008. The Standard & Poor's S&P 500 stock market index fell by 38 per cent during the year. Faced with this deterioration in economic activity and financial

conditions, the Federal Reserve lowered short-term interest rates by 425 basis points during the course of 2008, leaving the Funds' target rate within a narrow range of between zero and 25 basis points, while a number of liquidity initiatives were also introduced.

Canadian GDP increased by 0.4 per cent during the first eleven months of 2008 compared with the equivalent period of 2007, with growth slowing markedly during the second half of the year, due predominantly to weaker external demand. Labour

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market conditions deteriorated as the unemployment rate rose from a historical low of 5.8 per cent in January 2008 to finish the year at 6.6 per cent. After rising to a level of 3.5 per cent in August 2008, the headline rate of consumer price inflation slowed to 1.2 per cent by the year-end. The core rate of

inflation remained below 2.0 per cent throughout the year. Responding to the deteriorating economic outlook, the Bank of Canada cut its overnight interest rate from 4.25 per cent at the end of 2007 to 1.5 per cent in December 2008.

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

	2008 compared with 2007							
North America	**2007 as reported US$m**	**2007 acquisitions, disposals & dilution gains[1] US$m**	**Currency translation[2] US$m**	**2007 at 2008 exchange rates[3] US$m**	**2008 acquisitions and disposals[1] US$m**	**Under-lying change US$m**	**2008 as reported US$m**	**Re-ported change %**
Net interest income	**14,847**	**1**	**7**	**14,855**	**–**	**363**	**15,218**	**2**
Net fee income	**5,810**	**(105)**	**1**	**5,706**	**–**	**(479)**	**5,227**	**(10)**
Other income[4]	**2,126**	**(18)**	**(1)**	**2,107**	**–**	**(1,373)**	**734**	**(65)**
Net operating income[5]	**22,783**	**(122)**	**7**	**22,668**	**–**	**(1,489)**	**21,179**	**(7)**
Loan impairment charges and other credit risk provisions	**(12,156)**	**–**	**12**	**(12,144)**	**–**	**(4,651)**	**(16,795)**	**(38)**
Net operating income	**10,627**	**(122)**	**19**	**10,524**	**–**	**(6,140)**	**4,384**	**(59)**
Operating expenses (excluding goodwill impairment)	**(10,556)**	**98**	**(6)**	**(10,464)**	**–**	**1,105**	**(9,359)**	**11**
Goodwill impairment	**–**	**–**	**–**	**–**	**–**	**(10,564)**	**(10,564)**	**n/a**
Operating profit/(loss)	**71**	**(24)**	**13**	**60**	**–**	**(15,599)**	**(15,539)**	**(21,986)**

Income from associates	**20**			**20**		**(9)**	**11**	**(45)**
Profit/(loss) before tax	**91**	**(24)**	**13**	**80**		**(15,608)**	**(15,528)**	**(17,164)**

For footnotes, see page 143.

Review of business performance

HSBCs operations in North America reported a pre-tax loss of US$15.5 billion in 2008, compared with a pre-tax profit of US$91 million in 2007.

Net interest income in North America increased by 2 per cent to US$15.2 billion, driven by Balance Sheet Management activities in Global Banking and Markets which more than offset the decline in Personal Financial Services as lending reduced.

The significant increase in net interest income in the Balance Sheet Management business resulted from correct positioning in anticipation of lower interest rates. Net interest income was also boosted by higher balances within certain loan portfolios in Global Banking and Markets.

Net interest income fell in Personal Financial Services as asset balances declined and deposit spreads narrowed. Deposit spread compression was driven by the competitive environment for retail deposits in which HSBC refrained from passing on the full effects of interest rate cuts to customers.

Asset spreads widened, particularly in vehicle finance and credit cards and, to a lesser extent, the real estate secured portfolios as yields declined by less than funding costs in the lower interest rate environment, and the credit card portfolio benefited from APR floors. This was partly offset by a rise in non-performing loans, lower loan prepayments, increased volumes of loan modifications, and lower fees from reduced loan origination volumes. Funding costs declined as a result of lower base rates during the year.

Lending balances declined as the mortgage services portfolio continued to run-off, originations ceased during the year within the dealer and direct-to-consumer channels in vehicle finance, and tighter underwriting criteria in consumer lending constrained customer eligibility for finance. In addition, US$8.2 billion of mortgages were sold from the US real estate secured portfolios during the year. These factors were partly offset by a change in mix towards higher-yielding credit card loans and reduced levels of prepayments that resulted in loans remaining on the balance sheet longer. At the end of

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February 2009, HSBC authorised the discontinuation as soon as practicable of all new receivable originations of all products by the branch-based consumer lending business of HSBC Finance in North America (see page 70).

Net fee income declined by 8 per cent, driven by reductions in US credit card fees following changes in fee practices implemented since the fourth quarter of 2007 and lower cash advance and interchange fees as a result of reduced volumes. Partly offsetting the decline were increased income from enhancement services due to higher customer acceptance rates of Account Secure Plus and Identity Protection Plan, a rise in syndication, credit and service fees in Commercial Banking and increased fees from asset management.

Trading losses were dominated by write-downs in Global Banking and Markets on legacy exposures as continuing turmoil in credit markets adversely affected valuations of credit and structured credit trading positions, monoline exposures and leveraged and acquisition finance loans. Continued deterioration in the fair value of the run-off portfolio of sub-prime residential mortgage loans held for sale also contributed to the loss. US$3.6 billion in leveraged loans, high yield notes and securities held for balance sheet management were reclassified in 2008 under revised IFRS rules from trading assets to loans and receivables and available for sale, preventing any further mark-to-market trading losses on these assets. If these reclassifications had not been made, the loss before tax would have been US$0.9 billion higher.

The losses on legacy assets were partly offset by strong performances in other trading areas as foreign exchange trading benefited from pronounced market volatility, Rates trading correctly anticipated central bank rate cuts and gains were generated on credit default swaps in Global Banking. Revenues from emerging markets trading and precious metals trading also rose as a result of ongoing market volatility and increased transaction volumes as prices of gold and platinum rose during 2008. Losses on non-qualifying hedge positions in interest rate swaps generated further trading losses. In 2007, the Decision One business, which was closed that year, recorded trading losses of US$263 million.

Net income from financial instruments designated at fair value rose by US$2.0 billion to US$3.7 billion, primarily on HSBC's fixed-rate long-term debt as credit spreads widened significantly in the second half of 2008 in the ongoing market turmoil. These gains, together with

those booked in previous years, will fully reverse over the life of the debt.

Gains less losses from financial investments declined, mainly due to losses on US government agency securities in 2008 and the non-recurrence of the sale of MasterCard shares, partly offset by gains from the Visa IPO in 2008.

Net earned insurance premiums decreased by 13 per cent to US$390 million, driven by lower credit related premiums in HSBC Finance due to declining loan volumes.

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

Net insurance claims incurred and movement in liabilities to policyholders were broadly in line with 2007 at US$238 million.

Loan impairment charges and other credit risk provisions rose sharply, by 38 per cent to US$16.8 billion, reflecting substantially higher impairment charges in HSBC Finance across all portfolios and, in HSBC USA, the deterioration of credit quality in prime residential mortgages, second lien portfolios and private label cards. The main factors driving this deterioration were the continued weakening of the US economy, which led to rising levels of unemployment and personal bankruptcy filings: higher early-stage delinquency and increased roll rates in consumer lending: the ageing of portfolios: and further declines in house prices which increased loss severity and reduced customers ability to refinance and access equity in their homes. Partly offsetting these factors was a reduction in overall lending as HSBC continued to actively reduce its balance sheet and lower its risk profile in the US.

In the Mortgage Services business, loan impairment charges rose by 14 per cent to US$3.5 billion as the 2005 and 2006 vintages continued to season and experience rising delinquency. Run-off of the portfolio slowed in light of continued house price depreciation which, along with the constrained credit environment, restricted refinancing options for personal customers. In consumer lending, loan impairment charges rose by 39 per cent to US$5.7 billion. In the second half of 2008, delinquency rates began to accelerate particularly in the first lien portfolios in the parts of the country most affected by house price depreciation and rising unemployment rates. In

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HSBC USA, loan impairment charges rose by 76 per cent to US$2.6 billion driven by credit quality deterioration across the Home Equity line of credit, Home Equity loan, prime first lien residential mortgage and private label card portfolios.

Loan impairment charges in US card and retail services rose, driven by portfolio seasoning and rising unemployment, particularly in the second half of 2008, higher levels of personal bankruptcy filings and lower recovery rates. As with mortgages, this was most notable in parts of the country most affected by house price falls and unemployment. Vehicle finance loan impairment charges rose as delinquencies rose and lower prices resulted in lower recoveries when repossessed vehicles were sold at auction.

Loan impairment charges in Commercial Banking grew to US$449 million from a low base, primarily driven by higher impairment losses due to deterioration across the middle market, commercial real estate and corporate banking portfolios in the US and among firms in the manufacturing, export and commercial real estate sectors in Canada. Higher loan impairment charges and other credit risk provisions in Global Banking and Markets reflected weaker credit fundamentals in the US in 2008.

Operating expenses increased by 90 per cent, driven by US$10.6 billion of impairment charge recognised in respect of North America Personal Financial Services in 2008 to fully write off goodwill. Excluding the goodwill impairment charge, expenses were US$1.1 billion or 11 per cent lower. Staff costs declined, primarily in HSBC Finance, following decisions taken in 2007 to close the acquisition channels for new business in Mortgage Services and a number of consumer lending branches, and integrate the operations of the card businesses. HSBC USA made the decision to close its wholesale and third-party correspondent mortgage business in November 2008, while HSBC Finance took the decision to cease originations in the dealer and direct-to-consumer channels in the vehicle finance business in July 2008. Staff costs in Global Banking and Markets also fell as performance-related compensation and staff numbers both declined.

Other administrative costs decreased as origination activity declined, marketing costs in card and retail services reduced and branch costs in consumer lending fell as tightened underwriting criteria curtailed business and led to branch closures. This was partly offset by higher marketing and occupancy costs in the retail bank reflecting a continued expansion of the branch network,

increased community investment activities and higher deposit insurance, collection, payments and cash management and asset management costs in support of business growth.

2007 compared with 2006

Economic briefing

In the **US**, GDP growth in 2007 was 2.2 per cent, 0.7 percentage points less than that recorded in 2006 as the housing-led downturn gathered pace. Consumer spending in 2007 grew by 2.9 per cent, the weakest annual expansion since 2003. Housing activity continued to weaken in 2007, with residential investment falling by 17 per cent during the year. Both new and existing home sales also declined to new lows in 2007. The unemployment rate averaged 4.6 per cent in 2007, with the average in the second half of the year slightly higher at 4.8 per cent. The trade deficit narrowed in 2007 as export growth strengthened. Consumer price inflation averaged around 4 per cent in the final quarter of 2007. This was largely due to higher energy prices; excluding food and energy, consumer price inflation averaged 2.3 per cent in the fourth quarter. The Federal Reserve lowered short-term interest rates by 100 basis points in the second half of 2007, from 5.25 per cent to 4.25 per cent, as policymakers attempted to mitigate the worst effects of the sub-prime related credit squeeze upon economic activity. 10-year note yields reached a high of 5.3 per cent in June 2007, before falling to 4 per cent by the year-end. Declines in the final months of 2007 left the S&P 500 stock market index practically unchanged compared with the end of 2006.

Canadian GDP increased by 2.4 per cent during the first eleven months of 2007 compared with the equivalent period of 2006. Domestic demand remained strong despite tighter credit conditions in the latter part of the year, supported by the robust labour market. The unemployment rate averaged 6 per cent for the year, reaching a historical low of 5.8 per cent in October. After hitting a high of 2.5 per cent in April, core consumer price inflation slowed to 1.5 per cent by the end of 2007. The Canadian dollar appreciated during the year, particularly in the second half. In July, the Bank of Canada raised its overnight interest rate from 4.25 per cent to 4.5 per cent before reversing this move in the final weeks of 2007.

Review of business performance

HSBC's operations in North America experienced a significant fall in pre-tax profits of 98 per cent in 2007, on both reported and underlying bases.

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Reconciliation of reported and underlying profit before tax

	2007 compared with 2006								
North America	2006 as reported US$m	2006 acquisitions and disposals[1] US$m	Currency translation[2] US$m	2006 at 2007 exchange rates[6] US$m	2007 acquisitions, disposals & dilution gains[1] US$m	Under-lying change US$m	2007 as reported US$m	Re-ported change %	Under-lying change %
Net interest income	14,268	—	65	14,333	—	514	14,847	4	4
Net fee income	4,766	—	26	4,792	—	1,018	5,810	22	21
Other income[4]	2,593	—	10	2,603	20	(497)	2,126	(18)	(19)
Net operating income[5]	21,627	—	101	21,728	20	1,035	22,783	5	5
Loan impairment charges and other credit risk provisions	(6,796)	—	(3)	(6,799)	—	(5,357)	(12,156)	(79)	(79)
Net operating income	14,831	—	98	14,929	20	(4,322)	10,627	(28)	(29)
Operating expenses	(10,193)	—	(47)	(10,240)	(26)	(290)	(10,556)	(4)	(3)
Operating profit	4,638	—	51	4,689	(6)	(4,612)	71	(98)	(98)
Income from associates	30	—	1	31	—	(11)	20	(33)	(35)
Profit before tax	4,668	—	52	4,720	(6)	(4,623)	91	(98)	(98)

For footnotes, see page 143.

The US economy began to slow in the fourth quarter of 2007 and, increasingly, evidence suggested that some parts of the country were already in recession. As the housing market slump affected the real economy, the deterioration in credit quality that began in the mortgage services business extended to include other consumer finance businesses in the US. In HSBC, this was reflected in a 79 per cent rise in loan impairment charges and a loss before tax of US$1.5 billion in Personal Financial Services. In response to this, management took actions to manage exposure and realign the business, including stopping new mortgage purchases in mortgage services, tightening underwriting criteria, restricting the product range in consumer lending, decreasing credit lines and reducing the volume of balance transfers in credit cards, and restructuring the consumer lending branch network by closing some 400 branches of HSBC Finance to reflect expected lower demand. A loss of US$965 million in Global Banking and Markets arose from credit-related and liquidity event write-downs as asset-backed securities markets became illiquid and credit spreads widened markedly.

Net interest income rose by 4 per cent, as higher revenues from payments and cash management, commercial lending and cards were offset by lower mortgage balances, spread compression and higher non-performing balances.

Overall, average lending balances were 5 per cent higher, as growth in credit and private label cards and vehicle finance offset lower mortgage

balances. The benefits of higher volumes were largely offset as asset spreads narrowed due to higher funding costs. Also, although deposit balances rose, spreads reduced as the product mix shifted to higher yielding products. Business expansion and higher customer volumes drove growth in loans and deposits in Commercial Banking. A 43 per cent increase in revenue from payments and cash management was due to higher customer balances.

Net fee income rose as a result of higher personal card balances attracting late and over-limit fees. Fees from card services also rose, due to enhancement services on cards such as debt protection and identity protection. The Intellicheck service, which allows customers to pay their credit card balances over the telephone for a fee, proved popular with customers. Payments and cash management fees also increased on higher volumes generated. In the fourth quarter of 2007, HSBC changed fee practices on credit cards to ensure they fully reflected HSBCs brand principles. This reduced income by US$55 million in 2007.

HSBC incurred a *trading loss* following write-downs in credit and structured derivatives, including US$282 million relating to monoline exposures, and in leveraged and acquisition finance, driven by deterioration in the credit market in the second half of the year. The write-downs were compounded by trading losses on purchased loans in the mortgage services wholesale business, in response to which HSBC closed the Decision One business. By

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contrast, foreign exchange trading performance was strong, supported by activity generated by a weakening dollar and volatile markets.

Net income from financial instruments designated at fair value rose to US$1.8 billion, driven by significant fair value movements on HSBCs own debt as a result of the widening of credit spreads and related derivatives in the second half of the year.

Gains less losses from financial investments of US$245 million were primarily attributable to the sale of shares in MasterCard.

Net earned insurance premiums decreased by 9 per cent to US$449 million, as the decline in loan volumes led to a fall in credit insurance sales and HSBC stopped reinsuring credit insurance for other lenders.

Other operating income decreased significantly, as higher losses were recorded on foreclosed properties due to the combined effect of an increase in the stock of such properties and a reduction in their value due to falling prices. In addition, there were lower gains on the sale of investments, mainly due to a significant one-off gain in the latter part of 2006.

Net insurance claims incurred and movement in liabilities to policyholders decreased by 7 per cent to US$241 million, in line with the change in net earned insurance premiums.

Loan impairment charges posted a steep rise, increasing by 79 per cent to US$12.2 billion, reflecting substantially higher charges in the US consumer finance loan book, primarily in mortgage lending but also in the credit cards portfolio in the final part of the year. The main factor driving this deterioration was the effect of the weaker housing market on both economic activity and the ability of borrowers to extend or refinance debt. In addition, seasoning and mix change within the credit cards portfolio and increases in bankruptcy filings after the exceptionally low levels seen in 2006, following changes in legislation, added to loan impairment charges.

The real estate secured portfolios experienced continuing deterioration in credit quality as a lack of demand for securitised sub-prime mortgages and falls in house prices severely restricted refinancing options for many customers. Loan impairment charges rose by 41 per cent to US$3.1 billion and by 139 per cent to US$4.1 billion in the mortgage services business and consumer lending,

respectively. Delinquency rates exceeded recent historical trends, particularly for those loans originated in 2005 and 2006. Performance was weakest in housing markets which had previously experienced the steepest home price appreciation, second lien products and stated income products.

US card services experienced a rise in loan impairment charges from a combination of factors, primarily a growth in balances, higher losses in the final part of the year as the economy slowed, a rise in bankruptcy rates to levels approaching those seen historically, and a shift in portfolio mix towards non-prime loans.

Loan impairment charges in Commercial Banking rose by 151 per cent to US$191 million, reflecting growth in the loan book, the increasing probability of default among commercial real estate loans in the US and a change in methodology for determining loan impairment allowances on a portfolio of revolving loans to small businesses. In addition, in Canada, loan impairment charges increased due to exposure to certain sectors affected by the strength of the Canadian dollar and an impairment charge for non-bank asset-backed commercial paper was also taken.

Operating expenses increased by 3 per cent, compared with growth in net operating income before loan impairment charges of 5 per cent. The retail bank branch network was extended both within and beyond the Groups traditional spheres of operation to support the expansion of the Personal Financial Services and Commercial Banking businesses in the US and Canada. Premises and equipment expenses rose as a consequence. The consumer finance business incurred restructuring charges from the discontinuation of the wholesale and correspondent channels in mortgage services and the closing of branch offices in consumer lending. There were corresponding benefits in origination costs. The Canadian consumer finance business was also restructured in a similar fashion to the US. The business incurred US$70 million of one-off costs arising from the indemnification agreement with Visa ahead of Visas planned IPO. In the cards and consumer lending businesses, communication expenses increased due to higher mailing volumes on cards and consumer lending as credit collection policies were tightened. In the third quarter, however, expenditure on card marketing declined in line with a decision to slow lending growth.

Share of profit in associates and joint ventures declined to US$20 million.

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

Geographical regions > North America > Profit/loss before tax by customer group

Analysis by customer group and global business

Profit/(loss) before tax

	2008						
North America	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Intersegment elimination[21] US$m**	**Total US$m**
Net interest income	**12,632**	**1,480**	**1,064**	**224**	**22**	**(204)**	**15,218**
Net fee income/(expense)	**3,896**	**391**	**818**	**181**	**(59)**	**–**	**5,227**
Trading income/(expense) excluding net interest income	**(250)**	**5**	**(3,516)**	**10**	**(128)**	**–**	**(3,879)**
Net interest income/(expense) on trading activities	**66**	**–**	**584**	**–**	**(110)**	**204**	**744**
Net trading income/(expense)[16]	**(184)**	**5**	**(2,932)**	**10**	**(238)**	**204**	**(3,135)**
Changes in fair value of long-term debt issued and related derivatives	**–**	**–**	**–**	**–**	**3,736**	**–**	**3,736**
Net income/(expense) from other financial instruments designated at fair value	**(2)**	**–**	**(1)**	**–**	**4**	**–**	**1**
Net income/(expense) from financial instruments designated at fair value	**(2)**	**–**	**(1)**	**–**	**3,740**	**–**	**3,737**
Gains less losses from financial investments	**65**	**5**	**(209)**	**–**	**19**	**–**	**(120)**
Dividend income	**36**	**11**	**27**	**3**	**–**	**–**	**77**
Net earned insurance premiums	**390**	**–**	**–**	**–**	**–**	**–**	**390**
	(426)	**140**	**240**	**20**	**1,419**	**(1,370)**	**23**

Other operating income/ (expense)							
Total operating income/(expense)	**16,407**	**2,032**	**(993)**	**438**	**4,903**	**(1,370)**	**21,417**
Net insurance claims[17]	**(238)**	—	—	—	—	—	**(238)**
Net operating income/ (expense)[5]	**16,169**	**2,032**	**(993)**	**438**	**4,903**	**(1,370)**	**21,179**
Loan impairment charges and other credit risk provisions	**(16,132)**	**(449)**	**(198)**	**(16)**	—	—	**(16,795)**
Net operating income/ (expense)	**37**	**1,583**	**(1,191)**	**422**	**4,903**	**(1,370)**	**4,384**
Operating expenses (excluding goodwill impairment)	**(6,701)**	**(937)**	**(1,384)**	**(339)**	**(1,368)**	**1,370**	**(9,359)**
Goodwill impairment	**(10,564)**	—	—	—	—	—	**(10,564)**
Operating profit/(loss)	**(17,228)**	**646**	**(2,575)**	**83**	**3,535**	—	**(15,539)**
Share of profit/(loss) in associates and joint ventures	—	**12**	—	—	**(1)**	—	**11**
Profit/(loss) before tax	**(17,228)**	**658**	**(2,575)**	**83**	**3,534**	—	**(15,528)**
	%	**%**	**%**	**%**	**%**		**%**
Share of HSBC's profit before tax	**(185.1)**	**7.1**	**(27.7)**	**0.9**	**38.0**		**(166.8)**
Cost efficiency ratio	**106.8**	**46.1**	**(139.4)**	**77.4**	**27.9**		**94.1**
Balance sheet data[15]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**179,663**	**35,725**	**35,583**	**5,243**	—		**256,214**
Total assets	**192,240**	**42,211**	**318,139**	**7,054**	**3,323**	**(10,355)**	**552,612**
Customer accounts	**65,830**	**39,105**	**23,844**	**14,657**	**96**		**143,532**

For footnotes, see page 143.

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	2007						
North America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income/(expense)	13,175	1,558	378	273	(17)	(520)	14,847
Net fee income/(expense)	4,571	338	701	279	(79)	—	5,810
Trading income/(expense) excluding net interest income	(349)	(2)	(871)	11	(78)	—	(1,289)
Net interest income/(expense) on trading activities	134	—	137	—	(44)	520	747
Net trading income/(expense)[16]	(215)	(2)	(734)	11	(122)	520	(542)
Changes in fair value of long-term debt issued and related derivatives	—	—	—	—	1,750	—	1,750
Net income/(expense) from other financial instruments designated at fair value	—	—	11	—	(11)	—	—
Net income from financial instruments designated at fair value	—	—	11	—	1,739	—	1,750
Gains less losses from financial investments	176	(1)	65	2	3	—	245
Dividend income	47	1	57	—	—	—	105
Net earned insurance premiums	449	—	—	—	—	—	449
Other operating income/(expense)	(5)	88	167	34	1,480	(1,404)	360
Total operating income	18,198	1,982	645	599	3,004	(1,404)	23,024
Net insurance claims[17]	(241)	—	—	—	—	—	(241)
Net operating income[5]	17,957	1,982	645	599	3,004	(1,404)	22,783
Loan impairment charges and other credit risk provisions	(11,909)	(191)	(46)	(10)	—	—	(12,156)
	6,048	1,791	599	589	3,004	(1,404)	10,627

Net operating income							
Total operating expenses	(7,594)	(893)	(1,562)	(415)	(1,496)	1,404	(10,556)
Operating profit/(loss)	(1,546)	898	(963)	174	1,508	–	71
Share of profit/(loss) in associates and joint ventures	–	22	(2)	–	–	–	20
Profit/(loss) before tax	(1,546)	920	(965)	174	1,508	–	91
	%	%	%	%	%		%
Share of HSBC’s profit before tax	(6.4)	3.8	(4.0)	0.7	6.3		0.4
Cost efficiency ratio	42.3	45.1	242.2	69.3	49.8		46.3
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	218,676	38,930	26,186	6,068	–		289,860
Total assets	237,475	46,247	252,804	20,073	1,095	(8,409)	549,285
Customer accounts	61,824	36,306	30,732	16,187	124		145,173

For footnotes, see page 143.

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

Analysis by customer group and global business *(continued)*

Profit/(loss) before tax

	2006						
North America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income/(expense)	12,964	1,362	266	212	(52)	(484)	14,268
Net fee income/(expense)	3,675	329	656	240	(134)	–	4,766
Trading income/(expense) excluding net interest income	66	13	746	12	(220)	–	617
Net interest income/(expense) on trading activities	208	–	72	–	(23)	484	741
Net trading income/(expense)[16]	274	13	818	12	(243)	484	1,358
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	(63)	–	(63)
Net income/(expense) from other financial instruments designated at fair value	–	–	(11)	–	11	–	–
Net expense from financial instruments designated at fair value	–	–	(11)	–	(52)	–	(63)
Gains less losses from financial investments	14	19	12	9	4	–	58
Dividend income	23	1	61	–	–	–	85
Net earned insurance premiums	492	–	–	–	–	–	492
	270	87	269	31	1,536	(1,271)	922

Other operating income							
Total operating income	17,712	1,811	2,071	504	1,059	(1,271)	21,886
Net insurance claims[17]	(259)	—	—	—	—	—	(259)
Net operating income[5]	17,453	1,811	2,071	504	1,059	(1,271)	21,627
Loan impairment charges and other credit risk provisions	(6,683)	(74)	(3)	(35)	(1)	—	(6,796)
Net operating income	10,770	1,737	2,068	469	1,058	(1,271)	14,831
Total operating expenses	(7,379)	(814)	(1,641)	(355)	(1,275)	1,271	(10,193)
Operating profit/(loss)	3,391	923	427	114	(217)	—	4,638
Share of profit/(loss) in associates and joint ventures	—	34	(4)	—	—	—	30
Profit/(loss) before tax	3,391	957	423	114	(217)	—	4,668
	%	%	%	%	%		%
Share of HSBC's profit before tax	15.4	4.3	1.9	0.5	(1.0)		21.1
Cost efficiency ratio	42.3	44.9	79.2	70.4	120.4		47.1
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	220,517	34,651	17,215	5,604	—		277,987
Total assets	252,725	43,665	203,639	7,334	1,898	(3,623)	505,638
Customer accounts	54,099	31,066	23,711	11,938	108		120,922

For footnotes, see page 143.

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Latin America

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

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Total US$m
2008						
Argentina	**–**	**111**	**113**	**–**	**–**	**224**
Brazil	**250**	**348**	**298**	**8**	**6**	**910**
Mexico	**360**	**157**	**190**	**7**	**–**	**714**
Panama	**51**	**37**	**33**	**–**	**–**	**121**
Other	**7**	**53**	**7**	**1**	**–**	**68**
	668	**706**	**641**	**16**	**6**	**2,037**
2007						
Argentina	36	75	90	–	–	201
Brazil	293	286	297	9	(6)	879
Mexico	514	333	113	11	9	980
Panama	45	18	16	7	–	86
Other	5	28	1	(2)	–	32
	893	740	517	25	3	2,178
2006						
Argentina	35	51	68	–	3	157
Brazil	121	185	218	6	(4)	526
Mexico	628	197	177	7	–	1,009
Panama	16	13	10	–	–	39
Other	–	5	2	1	(4)	4
	800	451	475	14	(5)	1,735

Loans and advances to customers (net) by country

	At 31 December		
	2008 US$m	2007 US$m	2006 US$m
Argentina	**2,356**	2,485	1,912
Brazil	**18,255**	18,491	11,469
Mexico	**12,211**	18,059	14,294
Panama	**4,538**	4,158	4,178
Other	**4,927**	4,730	3,938
	42,287	47,923	35,791

Customer accounts by country

	At 31 December		
	2008	2007	2006

	US$m	US$m	US$m
Argentina	**2,988**	2,779	2,470
Brazil	**27,857**	26,231	19,946
Mexico	**17,652**	22,307	19,775
Panama	**5,185**	5,062	5,031
Other	**5,761**	4,913	3,639
	59,443	61,292	50,861

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

Profit before tax

Latin America	**2008 US$m**	2007 US$m	2006 US$m
Net interest income	**6,458**	5,576	4,197
Net fee income	**2,167**	2,153	1,630
Net trading income	**701**	548	537
Changes in fair value of long-term debt issued and related derivatives	**–**	–	–
Net income from other financial instruments designated at fair value	**364**	320	237
Net income from financial instruments designated at fair value	**364**	320	237
Gains less losses from financial investments	**176**	253	84
Gains arising from dilution of interests in associates	**–**	11	–
Dividend income	**20**	9	6
Net earned insurance premiums	**1,717**	1,594	1,076
Other operating income	**300**	228	91
Total operating income	**11,903**	10,692	7,858
Net insurance claims incurred and movement in liabilities to policyholders	**(1,390)**	(1,427)	(1,023)
Net operating income before loan impairment charges and other credit risk provisions	**10,513**	9,265	6,835
Loan impairment charges and other credit risk provisions	**(2,492)**	(1,697)	(938)
Net operating income	**8,021**	7,568	5,897
Total operating expenses	**(5,990)**	(5,402)	(4,166)
Operating profit	**2,031**	2,166	1,731
Share of profit in associates and joint ventures	**6**	12	4
Profit before tax	**2,037**	2,178	1,735
	%	%	%
Share of HSBC's profit before tax	**21.9**	9.0	7.9
Cost efficiency ratio	**57.0**	58.3	61.0
Year-end staff numbers (full-time equivalent)	**58,559**	64,404	64,900

Balance sheet data[15]

	At 31 December	
2008	2007	2006

	US$m	US$m	US$m
Loans and advances to customers (net)	**42,287**	47,923	35,791
Loans and advances to banks (net)	**14,572**	12,675	12,634
Trading assets, financial assets designated at fair value, and financial investments	**18,753**	24,715	20,497
Total assets	**97,944**	101,088	82,169
Deposits by banks	**5,598**	4,092	5,267
Customer accounts	**59,443**	61,292	50,861

For footnote, see page 143.

All commentaries on Latin America are on an underlying basis unless stated otherwise.

2008 compared with 2007

Economic briefing

Inflationary pressures developed in **Mexico** during the course of 2008, mostly due to rising commodity prices, as consumer price inflation accelerated from 3.7 per cent in January to 6.5 per cent by the year-end. In response, the Bank of Mexico raised its overnight interest rate by 75 basis points to 8.25 per cent by the end of the year, although a variety of

economic indicators pointed to a sharp loss of momentum during the final quarter as global growth slowed.

The **Brazilian** economy performed strongly during the first half of 2008, driven by domestic demand, with the annual rate of consumer price inflation rising from 4.6 per cent in January to 6.4 per cent in July, towards the upper limit of the central banks tolerance range. Conditions within the labour market improved, with the rate of

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unemployment well below levels observed a year earlier. In line with many other economies within the region, however, conditions weakened markedly towards the end of 2008, with industrial production falling by close to 20 per cent during the fourth quarter.

In **Argentina**, economic activity held at a reasonably robust level for much of the year, although measures of industrial production growth slowed noticeably during the final months of 2008.

Declines in commodity prices during the second half of 2008 and the reduced value of exports raised concerns over the level of capital outflow from the country, while domestic currency interest rates increased sharply. The official headline rate of consumer price inflation rose during the first half of 2008, reaching 9.3 per cent in June 2008 before slowing to 7.2 per cent in December, although methodological changes make comparisons over year difficult.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007							
Latin America	**2007 as reported**	**2007 acquisitions, disposals & dilution gains[1]**	**Currency translation[2]**	**2007 at 2008 exchange rates[3]**	**2008 acquisitions and disposals[1]**	**Under-lying change**	**2008 as reported**	**Reported change**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**%**
Net interest income	**5,576**	–	**155**	**5,731**	–	**727**	**6,458**	**16**
Net fee income	**2,153**	–	**58**	**2,211**	–	**(44)**	**2,167**	**1**
Other income[4]	**1,536**	**(11)**	**23**	**1,548**	**71**	**269**	**1,888**	**23**
Net operating income[5]	**9,265**	**(11)**	**236**	**9,490**	**71**	**952**	**10,513**	**13**
Loan impairment charges and other credit risk provisions	**(1,697)**	–	**(64)**	**(1,761)**	–	**(731)**	**(2,492)**	**(47)**
Net operating income	**7,568**	**(11)**	**172**	**7,729**	**71**	**221**	**8,021**	**6**
Operating expenses	**(5,402)**	–	**(190)**	**(5,592)**	–	**(398)**	**(5,990)**	**(11)**
Operating profit	**2,166**	**(11)**	**(18)**	**2,137**	**71**	**(177)**	**2,031**	**(6)**

Income from associates	**12**			**12**		**(6)**	**6**	**(50)**
Profit before tax	**2,178**	**(11)**	**(18)**	**2,149**	**71**	**(183)**	**2,037**	**(6)**

For footnotes, see page 143.

Review of business performance

In Latin America, HSBC reported a pre-tax profit of US$2.0 billion compared with US$2.2 billion in 2007, a decrease of 6 per cent. On an underlying basis, pre-tax profits decreased by 9 per cent as increased revenues were offset by higher loan impairment charges, largely in Mexico and Brazil, and increased operating costs across the region.

Net interest income increased by 13 per cent. Growth in average personal lending volumes was mainly driven by vehicle finance and payroll loans in Brazil, and credit cards and personal loans in Mexico. Average credit card balances increased as a result of significant organic growth in 2007 which was not repeated in 2008. Commercial loan volume growth was driven by increased lending for working capital and trade finance loans in Brazil, and medium-sized businesses and the real estate sector in Mexico. Increased income on customer liabilities, which was driven by volume growth, particularly in time deposits, was largely offset by a contraction in deposit spreads, primarily on US dollar denominated accounts. Active repricing strategies were deployed to mitigate spread compression in the region and to better reflect the credit risk on the loan portfolio. Lower overall spreads on lending products were partly offset by increases in cards in the region, small business loans in Mexico and overdrafts in Brazil. In Argentina, spreads on most products widened.

Net fee income decreased by 2 per cent following a ruling by the Brazilian Central Bank reducing or eliminating certain fees such as charges on early loan repayments and returned cheques. Lower transaction volumes in Personal Financial Services in Brazil also reduced fee income. These were partly offset by product repricing, the introduction of new fees and volume growth, particularly in cards, personal loans, packaged deposit products and payments and cash management.

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Trading income rose by 22 per cent largely reflecting favourable positioning against foreign exchange movements and increased foreign exchange sales volumes. Trading losses were registered on certain transactions where an offsetting benefit is reported in *net income from financial instruments designated at fair value*. Losses from defaults on derivative contracts were registered, primarily in Mexico.

Gains less losses from financial investments declined by 24 per cent as gains on the redemption of VISA shares, following its global IPO, and the sale of shares in both Brazil and Mexico were lower than the gains achieved on the sale of shares in a number of companies in Brazil in 2007.

Net earned insurance premiums rose, driven by higher prices and increased sales in the general insurance business, primarily in Argentina. Sales of life assurance products remained strong.

Increased *net insurance claims incurred and movements in liabilities to policyholders* in Argentina were more than offset by a decrease in liabilities to policyholders in Brazil following a decline in the equity market where the investment losses were passed on to unit-linked policyholders. This was compensated for by a similar decrease in *net income from financial instruments designated at fair value.*

Other operating income was broadly in line with 2007. A refinement of the income recognition methodology used in respect of long-term insurance contracts in Brazil in 2008 was offset by a similar adjustment in Mexico in 2007.

Loan impairment charges and other credit risk provisions rose by 42 per cent, mainly relating to credit cards, as organically grown portfolios in Mexico seasoned following market share growth and credit quality deteriorated in Mexico and Brazil. The personal unsecured, vehicle finance and small and medium-sized commercial loan portfolios in Brazil also experienced increased levels of loan impairment. Specific focus was placed on improving the quality of new business, based on underwriting experience and relationship management, and steps were taken to improve collection strategies.

Operating expenses increased by 7 per cent. An increase in staff costs was primarily driven by higher salaries following union-agreed pay rises and redundancy payments following reductions in staff numbers, partly offset by cost savings from the reduced headcount. Administrative expenses rose following an increase in the use of a credit card cashback promotional facility in Mexico which was terminated at the end of 2008. Costs also grew in support of improved operational processes in the region. HSBC benefited in 2008 from the recognition of a tax credit following a court ruling in Brazil granting the right to recover excess taxes paid on insurance transactions and changes in transactional tax legislation. As economic conditions weakened towards the second half of 2008, strategic cost saving measures were implemented throughout the region.

2007 compared with 2006

Economic briefing

In response to fluctuations in export demand from the US, economic growth in **Mexico** moderated during the course of 2007, with GDP rising an estimated 3.1 per cent during the year, compared with 4.8 per cent in 2006. Inflationary pressures remained significant throughout 2007, with consumer price inflation averaging 4 per cent, driven by increases in international prices of commodities, which affected domestic food prices in the core index. As a result, the Bank of Mexico raised its overnight interest rate by a total of 50 basis points, and has maintained its restrictive monetary policy despite reductions in interest rates by the US Federal Reserve.

The **Brazilian** economy expanded strongly in 2007, with GDP expected to have grown by 5.4 per cent compared with 3.7 per cent in 2006. As in 2006, growth was driven by domestic demand, with private consumption rising considerably. As a consequence, the average unemployment rate fell to 9.3 per cent in 2007 from 10 per cent in 2006. After declining to 3.1 per cent at the end of 2006, the annual rate of consumer price inflation climbed to 4.5 per cent by December 2007, mainly from higher food prices. The cycle of monetary easing which began in the third quarter of 2005 paused in October 2007 with the overnight rate at 11.25 per cent, the lowest level in several decades. After nine years of steady expansion, the trade balance surplus fell slightly in 2007, and is expected to decrease further in 2008. Balance of payments fundamentals, however, remained robust and, as a result, the Brazilian economy seemed less vulnerable to external shocks than in previous years.

The **Argentine** economy also performed strongly in 2007, with GDP expected to have risen by 8.7 per cent. This strength was a consequence of several factors such as a competitive exchange rate, spare capacity in the economy and a generally

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favourable external environment, which helped Argentina extend its fiscal and external surpluses into a fourth successive year. Less encouraging was the fact that inflation accelerated to about 13 per cent, up from 10 per cent in 2006. Although food inflation was part of the explanation, rapid demand growth was also a factor. 2007 was an election year, and as a result the rate of growth of fiscal spending doubled to 45 per cent on an annual basis. As a consequence, the primary surplus fell by around 1.2 per cent of GDP.

Throughout the region as a whole, GDP growth roughly matched that of 2006. The slowdown in Mexico provided a contrast to better performances elsewhere in Central and Southern America. Central America grew by an estimated 6.3 per cent, up from 5.9 per cent in 2006 while, in South America, growth was an estimated 5.8 per cent, up from 5.3 per cent in 2006. The most dynamic economies in Central America were Panama (10.0 per cent growth in GDP) and the Dominican Republic (8.0 per cent), followed by Costa Rica (6.2 per cent) and Honduras (6.2 per cent). In South America, the fastest growing countries after Argentina were Peru (7.2 per cent growth in GDP), Venezuela (7.0 per cent) and Colombia (6.5 per cent). In general, inflation appears to be under control in Latin America, averaging around 5 per cent over the past three years. Only Venezuela and Argentina have experienced double-digit inflation, while the US dollar-based economies of Panama, Ecuador and El Salvador have better inflationary records.

Reconciliation of reported and underlying profit before tax

	2007 compared with 2006								
Latin America	2006 as reported	2006 acquisitions and disposals [1]	Currency translation[2]	2006 at 2007 exchange rates[6]	2007 acquisitions, disposals & dilution gains[1]	Under-lying change	2007 as reported	Re-ported change	Under-lying change
	US$m	US$m	US$m	US$m	US$m	US$m	US$m	%	%
Net interest income	4,197	–	261	4,458	375	743	5,576	33	17
Net fee income	1,630	–	86	1,716	86	351	2,153	32	20
Other income[4]	1,008	–	60	1,068	102	366	1,536	52	34
Net operating income[5]	6,835	–	407	7,242	563	1,460	9,265	36	20
Loan impairment charges and other credit risk provisions	(938)	–	(81)	(1,019)	(133)	(545)	(1,697)	(81)	(53)
Net operating income	5,897	–	326	6,223	430	915	7,568	28	15

Operating expenses	(4,166)			(258)	(4,424)	(320)	(658)	(5,402)	(30)	(15)
Operating profit	1,731			68	1,799	110	257	2,166	25	14
Income from associates	4				4	9	(1)	12	200	(25)
Profit before tax	1,735			68	1,803	119	256	2,178	26	14

For footnotes, see page 143.

Review of business performance

HSBCs operations in Latin America reported a pre-tax profit of US$2.2 billion compared with US$1.7 billion in 2006, representing an increase of 26 per cent. The Groups acquisitions of HSBC Bank Panama and Banca Nazionale in 2006 strengthened the existing business platform and geographical representation. On an underlying basis, pre-tax profits rose by 14 per cent as increased revenues were partly offset by higher loan impairment charges, largely from Mexico, and a rise in operating costs.

Notable contributions to Commercial Bankings pre-tax profits, which were 64 per cent higher than in 2006, arose in Brazil from small and mid-market

enterprises and in Mexico from larger corporates. In Personal Financial Services, profit before tax increased by 12 per cent as strong growth in revenues was partly offset by increased loan impairment charges in Mexico. Profit before tax in Global Banking and Markets increased as strong growth in net fee and net interest income was partly offset by a decrease in trading income and higher costs related to business expansion.

Notwithstanding continuing investment and integration costs throughout the region, the cost efficiency ratio improved by 2.7 percentage points to 58.3 per cent.

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Net interest income increased by 17 per cent. Growth was strong across the region, with net interest income rising by 22 per cent and 11 per cent in Mexico and Brazil, respectively.

In Mexico, net interest income rose despite a fall in balance sheet management revenues due to growth in both assets and liabilities. In particular, credit card balances increased, driven by marketing and portfolio management initiatives designed to improve customer retention and card usage. Volume growth was achieved in mortgages, commercial real estate lending, trade and factoring. Customer relationship management campaigns resulted in new customer acquisitions and increased cross-selling. Net interest income in Brazil increased as the sound economic outlook and falling interest rates resulted in strong demand for credit.

Fee income rose by 20 per cent, primarily driven by robust business growth across the region. In Mexico, the use of debit and credit cards grew, in part because of the growing ATM network and the number of cards in force, which drove commissions from ATM cash withdrawals and point of sale billing. Stricter guidelines on the imposition of late payment fees also led to higher income.

A strategy to migrate more transactions to internet-based services resulted in higher payment and cash management transactions as the number of active customers rose.

Current account income increased as a result of a re-pricing exercise and a rise in volumes. Fees from loans and funds under management also grew on higher volumes. Strong growth in customer accounts delivered higher transactional fees and the continuing success of the Tu Cuenta product in Mexico led to increased take-up with higher product fees charged to customers.

Net income from trading activities decreased by 4 per cent, mainly due to reduced trading opportunities in Credit and Rates. This was partly offset by income growth from foreign exchange trading, driven by continuing market volatility.

Net gains from financial investments rose significantly following a gain on sale of shares held in a credit bureau, a stock exchange and a derivatives exchange in Brazil.

The continued growth of insurance operations in the region, achieved by increasing HSBC's product offerings and expanding its distribution channels, along with targeted sales initiatives, led to higher *net insurance claims incurred and movements in liabilities to policyholders.*

A 97 per cent increase in *other operating income* reflected the recognition of the embedded value calculation on the PVIF life assurance business in Mexico. The improvement on 2006 was also aided by the non-recurrence of a loss on sale of a portfolio of assets during that year and sundry gains on foreclosed assets in 2007.

Loan impairment charges rose sharply, by 53 per cent to US$1.7 billion, mainly driven by portfolio growth, normal seasoning and higher delinquency rates on credit cards in Mexico, following a targeted expansion in market share. Loan impairment charges for small and medium-sized businesses lending and delinquencies on loans to the self-employed also increased in Mexico. Partly offsetting these developments was an improvement in personal and commercial delinquency rates in Brazil.

Continuing investment and business expansion resulted in an increase in *operating expenses* of 15 per cent. This compared favourably with growth in net operating income before loan impairment charges of 20 per cent. Staff costs rose, primarily on higher salaries and bonuses in the region, driven by the need to support business growth, union-agreed pay rises and one-off costs incurred in Brazil to improve operational efficiencies. These were partially offset by a curtailment and settlement gain in Mexico from staff transferring from the Group’s defined benefit healthcare scheme to a new defined contribution scheme.

Increases in non-staff costs included higher marketing expenditure in support of growth in credit card operations, continued investment in infrastructure to support business growth and a rise in telecommunication costs and transactional taxes. Four additional months of Banca Nazionale expenses also increased costs.

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Analysis by customer group and global business

Profit/(loss) before tax

	2008						
Latin America	**Personal Financial Services**	**Commercial Banking**	**Global Banking & Markets**	**Private Banking**	**Other**	**Inter-segment elimination[21]**	**Total**
	US$m	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**	**US$m**
Net interest income	**4,582**	**1,637**	**579**	**22**	**(35)**	**(327)**	**6,458**
Net fee income	**1,339**	**536**	**248**	**35**	**9**	**–**	**2,167**
Trading income excluding net interest income	**123**	**27**	**200**	**3**	**4**	**–**	**356**
Net interest income/(expense) on trading activities	**7**	**4**	**8**	**–**	**(2)**	**327**	**345**
Net trading income[16]	**130**	**31**	**208**	**3**	**2**	**327**	**701**
Changes in fair value of long-term debt issued and related derivatives	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Net income from other financial instruments designated at fair value	**187**	**–**	**139**	**–**	**38**	**–**	**364**
Net income from financial instruments designated at fair value	**187**	**–**	**139**	**–**	**38**	**–**	**364**
Gains less losses from financial investments	**132**	**21**	**21**	**2**	**–**	**–**	**176**
	16	**1**	**3**	**–**	**–**	**–**	**20**

Dividend income							
Net earned insurance premiums	**1,547**	**82**	**88**	****	****	****	**1,717**
Other operating income	**244**	**57**	**39**	**3**	**8**	**(51)**	**300**
Total operating income	**8,177**	**2,365**	**1,325**	**65**	**22**	**(51)**	**11,903**
Net insurance claims[17]	**(1,281)**	**(42)**	**(68)**	****	**1**	****	**(1,390)**
Net operating income[5]	**6,896**	**2,323**	**1,257**	**65**	**23**	**(51)**	**10,513**
Loan impairment charges and other credit risk provisions	**(2,120)**	**(340)**	**(29)**	****	**(3)**	****	**(2,492)**
Net operating income	**4,776**	**1,983**	**1,228**	**65**	**20**	**(51)**	**8,021**
Total operating expenses	**(4,114)**	**(1,277)**	**(587)**	**(49)**	**(14)**	**51**	**(5,990)**
Operating profit	**662**	**706**	**641**	**16**	**6**	****	**2,031**
Share of profit in associates and joint ventures	**6**	****	****	****	****	****	**6**
Profit before tax	**668**	**706**	**641**	**16**	**6**	****	**2,037**
	%	**%**	**%**	**%**	**%**		**%**
Share of HSBCs profit before tax	**7.2**	**7.6**	**6.9**	**0.2**	****		**21.9**
Cost efficiency ratio	**59.7**	**55.0**	**46.7**	**75.4**	**60.9**		**57.0**
Balance sheet data[15]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to	**18,523**	**15,460**	**8,273**	**31**	****		**42,287**

customers (net)							
Total assets	**30,320**	**19,382**	**48,868**	**391**	**361**	**(1,378)**	**97,944**
Customer accounts	**27,564**	**14,367**	**15,384**	**2,128**	–		**59,443**

For footnotes, see page 143.

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

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

Analysis by customer group and global business *(continued)*

Profit/(loss) before tax

	2007						
Latin America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	**Total US$m**
Net interest income	3,983	1,407	410	20	3	(247)	5,576
Net fee income	1,372	485	250	40	6	–	2,153
Trading income excluding net interest income	67	39	164	2	–	–	272
Net interest income on trading activities	10	1	18	–	–	247	276
Net trading income[16]	77	40	182	2	–	247	548
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	–	–	–
Net income from other financial instruments designated							

at fair value	314	–	6	–	–	–	320
Net income from financial instruments designated at fair value	314	–	6	–	–	–	320
Gains less losses from financial investments	120	51	82	1	(1)	–	253
Gains arising from dilution of interests in associates	–	–	–	–	11	–	11
Dividend income	5	2	2	–	–	–	9
Net earned insurance premiums	1,448	66	80	–	–	–	1,594
Other operating income	145	69	31	8	12	(37)	228
Total operating income	7,464	2,120	1,043	71	31	(37)	10,692
Net insurance claims[17]	(1,330)	(37)	(60)	–	–	–	(1,427)
Net operating income[5]	6,134	2,083	983	71	31	(37)	9,265
Loan impairment (charges)/ recoveries and other credit risk provisions	(1,492)	(212)	13	–	(6)	–	(1,697)
Net operating income	4,642	1,871	996	71	25	(37)	7,568
Total operating expenses	(3,758)	(1,132)	(481)	(46)	(22)	37	(5,402)
Operating profit	884	739	515	25	3	–	2,166

Share of profit in associates and joint ventures	9	1	2	—	—	—	12
Profit before tax	893	740	517	25	3	—	2,178
	%	%	%	%	%		%
Share of HSBC’s profit before tax	3.7	3.1	2.1	0.1	—		9.0
Cost efficiency ratio	61.3	54.3	48.9	64.8	71.0		58.3
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	21,680	16,243	9,935	65	—		47,923
Total assets	35,181	21,049	45,045	302	261	(750)	101,088
Customer accounts	30,628	15,524	13,950	1,190	—		61,292

For footnotes, see page 143.

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	2006						
Latin America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[21] US$m	Total US$m
Net interest income/(expense)	3,057	1,037	325	13	(2)	(233)	4,197
Net fee income	1,053	387	167	23	–	–	1,630
Trading income excluding net interest income	61	21	218	1	–	–	301
Net interest income/(expense) on trading activities	14	5	(16)	–	–	233	236
Net trading income[16]	75	26	202	1	–	233	537
Changes in fair value of long-term debt issued and related derivatives	–	–	–	–	–	–	–
Net income from other financial instruments designated at fair value	227	–	11	–	(1)	–	237
Net income/(expense) from financial instruments designated at fair value	227	–	11	–	(1)	–	237
Gains less losses from financial investments	11	1	72	–	–	–	84
Dividend income	5	1	–	–	–	–	6
Net earned insurance premiums	992	27	59	–	(2)	–	1,076
Other operating income	74	7	10	4	14	(18)	91
Total operating income	5,494	1,486	846	41	9	(18)	7,858
Net insurance claims[17]	(957)	(16)	(51)	–	1	–	(1,023)

Net operating income[5]	4,537	1,470	795	41	10	(18)	6,835
Loan impairment (charges)/ recoveries and other credit risk provisions	(764)	(197)	26	—	(3)	—	(938)
Net operating income	3,773	1,273	821	41	7	(18)	5,897
Total operating expenses	(2,977)	(822)	(346)	(27)	(12)	18	(4,166)
Operating profit/(loss)	796	451	475	14	(5)	—	1,731
Share of profit in associates and joint ventures	4	—	—	—	—	—	4
Profit/(loss) before tax	800	451	475	14	(5)	—	1,735
	%	%	%	%	%		%
Share of HSBC's profit before tax	3.6	2.0	2.2	0.1	—		7.9
Cost efficiency ratio	65.6	55.9	43.5	65.9	120.0		61.0
Balance sheet data[15]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	16,165	11,463	8,147	16	—		35,791
Total assets	28,237	16,599	37,564	90	344	(665)	82,169
Customer accounts	25,200	13,754	11,685	222	—		50,861

For footnotes, see page 143.

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Products and services

Personal Financial Services

Personal Financial Services provides over 105 million individual and self-employed customers with financial services in 62 countries. The selection of products and services offered in each case is determined by HSBC's participation strategy in the respective markets.

In markets where HSBC already has scale or, in emerging markets where scale can be built over time, HSBC offers a full range of personal financial products and services. Typically, products provided include personal banking products (current and savings accounts, mortgages and personal loans, credit cards, and local and international payment services), together with consumer finance and wealth management services.

In other markets, HSBC participates more selectively, targeting only those customer segments which have strong international connectivity or where HSBC's global scale is crucial.

HSBC Premier, the Group's premium banking service, provides personalised relationship management, a single online view of all international accounts, free international funds transfer between HSBC accounts, 24-hour priority telephone access, global travel assistance and wealth management services. There are now over 2.6 million HSBC Premier customers, who can use more than 300 specially designated Premier branches and centres in 41 countries and territories.

Wealth management (insurance and investment products and financial planning services) plays an important part in meeting the needs of customers. Insurance products distributed by HSBC through its direct channels and branch networks include loan protection, life, property and health insurance and pensions. HSBC also makes available a wide range of investment products. A choice of third-party and proprietary funds provides customers with the ability to diversify their investments across a range of best-in-class fund managers chosen after a rigorous and objective selection process. Comprehensive financial planning services covering customers' investment, retirement, personal and asset protection needs are offered through qualified financial planning managers.

Personal customers prefer to conduct their financial business at times convenient to them, using the sales and service channels of their choice. This demand for flexibility is met through the increased provision of direct channels such as the internet and self-service terminals, in addition to traditional and automated branches and service centres accessed by telephone.

HSBC is a major global credit card issuer with over 100 million credit cards in force in 49 countries. In addition to HSBC branded cards, HSBC Finance in the US offers Household Bank and Orchard Bank branded cards and affiliation programmes such as the GM card and the AFL-CIO Union Plus card. HSBC is also a provider of third-party private label credit cards (or store cards) through merchant relationships.

HSBC Finance's operations in the US, the UK and Canada also make credit available to customers not well catered for by traditional banking operations and facilitate point-of-sale credit in support of retail purchases. At the end of February 2009, HSBC authorised the discontinuation as soon as practicable of all new receivable originations of all products by the branch-based consumer lending business of HSBC Finance in North America (see page 70).

High net worth individuals and their families who choose the differentiated services offered within Private Banking are not included in this customer group.

Commercial Banking

HSBC is one of the world's leading and most international banks, with over 2.9 million Commercial Banking customers in 63 countries, including sole proprietors, partnerships, clubs and associations, incorporated businesses and publicly quoted companies. At 31 December 2008, HSBC had total commercial customer account balances of US$236 billion and total commercial customer loans and advances, net of loan impairment allowances, of US$204 billion.

HSBC segments its Commercial Banking business into corporate, mid-market, small and micro businesses, allowing the development of tailored customer propositions while adopting a broader view of the entire Commercial Banking sector, from sole traders to top-end mid-market corporations. This allows HSBC to provide continuous support to companies as they grow in size both domestically and internationally, and ensures a clear focus on the small and micro business sectors, which are typically the key to innovation and growth in market economies.

HSBC places particular emphasis on geographical collaboration to meet its business customers' needs and aims to be recognised as the leading international business bank and the best bank

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for small business in target markets. The range of products and services includes:

Financing: HSBC provides a range of short and longer-term financing options for Commercial Banking customers, both domestically and cross-border, including overdrafts, receivables finance, term loans and property finance. The Group offers forms of asset finance in selected sites and has established specialised divisions providing leasing and instalment finance for vehicles, plant and equipment.

Payments and cash management: HSBC is a leading provider of domestic and cross-border payments, collections, liquidity management and account services worldwide. The Groups extensive network of offices and direct access to numerous local clearing systems enhances its customers ability to manage their cash efficiently on a global basis. Deposits are attracted through both current accounts and savings products, in local and foreign currencies.

International trade: HSBC finances and facilitates significant volumes of international trade, under both open account terms and traditional trade finance instruments. HSBC also provides international factoring, commodity and insured export finance, and forfaiting services. The Group utilises its extensive international network to build customer relationships at both ends of trade flows, and maximises efficiency through expertise in documentary checking and processing, and highly automated systems.

Treasury and capital markets: Commercial Banking customers are volume users of the Groups foreign exchange capabilities, including sophisticated currency and interest rate options.

Commercial cards: HSBC offers commercial card services covering both issuing and acquiring. Commercial card issuing provides its customers with services which enhance cash management, improve cost control and streamline purchasing processes. HSBC offers card acquiring services, either directly or as part of a joint venture, enabling merchants to accept credit and debit card payments either in person/on the premises or when the cardholder is not present (eg over the internet or on the telephone).

Insurance: HSBC offers insurance services covering a full range of commercial insurance products designed to meet the needs of businesses and their employees, including employee benefit, pension and healthcare programmes, and a variety of commercial risks such as buildings, marine, cargo, keyman and credit protection. These products are provided by HSBC either as an intermediary (broker,

agent or consultant) or as a supplier of in-house or third-party offerings. HSBC also provides insurance due diligence reviews, and actuarial and employee benefit consultancy services.

Wealth management services: These include advice and products related to savings and investments provided to Commercial Banking customers and their employees through HSBCs worldwide network, with clients being referred to Private Banking where appropriate.

Investment banking: A small number of Commercial Banking customers need corporate finance and advisory support. These requirements are serviced by the Group on a client-specific basis.

Delivery channels: HSBC deploys a full range of delivery channels, including specific online and direct banking offerings such as HSBCnet and Business Internet Banking.

Global Banking and Markets

Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients worldwide. Managed as a global business, Global Banking and Markets operates a long-term relationship management approach to build a full understanding of clients financial requirements. Sectoral client service teams comprising relationship managers and product specialists develop financial solutions to meet individual client needs. With dedicated offices in over 66 countries and access to HSBCs worldwide presence and capabilities, this business serves subsidiaries and offices of its clients on a global basis.

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

Global Markets

HSBC's operations in Global Markets consist of treasury and capital markets services for supranationals, central banks, corporations, institutional and private investors, financial institutions and other market participants. Products include:

- foreign exchange;
- currency, interest rate, bond, credit, equity and other derivatives;

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- government and non-government fixed income and money market instruments;
- precious metals and exchange traded futures;
- equity services, including research, sales and trading for institutional, corporate and private clients and asset management services;
- distribution of capital markets instruments, including debt, equity and structured products, utilising HSBCs global network; and
- securities services, where HSBC is one of the worlds leading custodians providing custody and clearing services and funds administration to both domestic and cross-border investors.

Global Banking

HSBCs operations in Global Banking consist of financing, advisory and transaction services for corporations, institutional and private investors, financial institutions, and governments and their agencies. Products include:

- financing and capital markets, which comprises capital raising, including debt and equity capital, corporate finance and advisory services, bilateral and syndicated lending, leveraged and acquisition finance, structured and project finance, lease finance, and non-retail deposit- taking;
- international, regional and domestic payments and cash management services; and
- other transaction services, including trade services, factoring and banknotes.

Global Asset Management

HSBCs operations in asset management consist of products and services for institutional investors, intermediaries and individual investors and their advisers.

Principal Investments

This includes private equity, which comprises HSBCs captive private equity funds, strategic relationships with third-party private equity managers and other investments.

Private Banking

HSBCs presence in all the major wealth-creating regions has enabled it to build one of the worlds leading private banking groups, providing private banking and trustee services to high net worth individuals and their families from over 90 locations

in 43 countries and territories, with client assets of US$352 billion at 31 December 2008.

HSBC Private Bank is the principal marketing name of the HSBC Groups international private banking business and utilising the most suitable products from the marketplace, HSBC Private Bank works with its clients to offer both traditional and innovative ways to manage and preserve wealth while optimising returns. Products and services offered include:

Private Banking Services: These comprise multi-currency deposit accounts and fiduciary deposits, credit and specialist lending, treasury trading services, cash management, securities custody and clearing. In addition, HSBC Private Bank works to ensure its clients have full access to other products and services available throughout HSBC, such as credit cards, internet banking, corporate banking, and investment banking.

Private Wealth Management: These comprise both advisory and discretionary investment services. A wide range of investment vehicles is covered, including bonds, equities, derivatives, options, futures, structured products, mutual funds and alternatives (hedge funds, private equity and real estate). By accessing regional expertise located within six major advisory centres in Hong Kong, Singapore, Geneva, New York, Paris and London, Private Banking seeks to find the most suitable investments for clients needs and investment strategies. Corporate Finance Solutions helps provide clients with cross-border solutions for their companies working with Global Banking & Markets.

Private Wealth Solutions: These comprise inheritance planning, trustee and other fiduciary services designed to protect existing wealth and create tailored structures to preserve wealth for future generations. Areas of expertise include trusts, foundation and company administration, charitable trusts and foundations, insurance, family office advisory and philanthropy. These are tailored to meet the individual needs of each family.

Other information

Funds under management

	2008	2007
	US$bn	US$bn
Funds under management		
At 1 January	**844**	695
Net new money	**(1)**	36
Value change	**(159)**	53
Exchange and other	**51**	60
At 31 December	**735**	844

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	At 31 December	
	2008	2007
	US$bn	US$bn
Funds under management by business		
Global Asset Management	**370**	380
Private Banking	**219**	275
Affiliates	**2**	3
Other	**144**	186
	735	844

Funds under management at 31 December 2008 were US$735 billion, a decrease of 13 per cent compared with 31 December 2007. Both Global Asset Management and Private Banking funds decreased due to the fall in equity markets.

Global Asset Management funds under management amounted to US$370 billion, a decrease of 3 per cent compared with 31 December 2007. Excluding an internal transfer of US$67 billion, Global Asset Management funds decreased by 20 per cent to US$303 billion.

Net outflows were predominantly driven by clients redeeming long-term funds as a consequence of the downturn in the global economic environment, although this was reduced by net new money into money market funds as clients sought to reduce risk. Additionally, the total value of funds under management was affected by a weaker investment performance resulting from turbulent markets and by foreign exchange movements.

Notwithstanding a decrease in emerging markets funds during the year, Global Asset Management remained one of the world's largest emerging market asset managers, with US$52 billion of funds under management.

Private Banking's funds under management decreased by 20 per cent to US$219 billion, driven by equity market performance. Net new money, while positive, amounted to only US$2 billion as positive flows in Europe, were offset by outflows of funds in other regions as clients reduced risk by transferring funds to cash deposits, many with HSBC in response to its perceived strength.

Other funds under management, of which the main element is a corporate trust business in Asia, decreased to US$144 billion.

Assets held in custody and under administration

Custody is the safekeeping and servicing of securities and other financial assets on behalf of clients. At 31 December 2008, assets held by HSBC as custodian amounted to US$3.6 trillion, 33 per cent lower than the US$5.4 trillion held at 31 December 2007. This was mainly driven by

adverse market movements affecting the value of assets held.

HSBC's assets under administration business, which includes the provision of various support function activities including the valuation of portfolios of securities and other financial assets on behalf of clients, complements the custody business. At 31 December 2008, the value of assets held under administration by the Group amounted to US$3.3 trillion, in line with 31 December 2007.

Property

During 2008, HSBC recognised a gain of US$416 million in other operating income in respect of the purchase of the subsidiary of Metrovacesa which owned the property and long leasehold land comprising 8 Canada Square, London. See Note 23 on the Financial Statements for further details.

At 31 December 2008, HSBC operated from some 9,870 operational properties worldwide, of which approximately 2,770 were located in Europe, 1,090 in Hong Kong and Rest of Asia-Pacific, 1,640 in North America, 4,200 in Latin America and 170 in the Middle East. These properties had an area of approximately 73.6 million square feet (2007: 69.8