

HSBC HOLDINGS PLC  
Form 20-F  
February 26, 2015  
Table of Contents

As filed with the Securities and Exchange Commission on February 26, 2015.

**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

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

For the fiscal year ended December 31, 2014

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: 001-14930

**HSBC Holdings plc**

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

(Exact name of Registrant as specified in its charter)

<p><b>N/A</b> (Translation of Registrant's name into English)</p>	<p><b>United Kingdom</b> (Jurisdiction of incorporation or organisation)</p>
	<p>8 Canada Square London E14 5HQ United Kingdom</p>
	<p>(Address of principal executive offices)</p> <p>Russell C Picot 8 Canada Square London E14 5HQ United Kingdom</p> <p>Tel +44 (0) 20 7991 8888 Fax +44 (0) 20 7992 4880</p>
	<p>(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)</p>

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 Depositary Shares, each representing 5	New York Stock Exchange
Ordinary Shares of nominal value US\$0.50 each. 6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange*
American Depositary Shares evidenced by American Depositary receipts, each representing one- fortieth of a Share of 6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange
5.10% Senior Unsecured Notes Due 2021	New York Stock Exchange
4.00% Senior Unsecured Notes Due 2022	New York Stock Exchange
4.875% Senior Unsecured Notes Due 2022	New York Stock Exchange
7.625% Subordinated Notes due 2032	New York Stock Exchange
7.35% Subordinated Notes due 2032	New York Stock Exchange
6.5% Subordinated Notes 2036	New York Stock Exchange

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

6.5% Subordinated Notes 2037	New York Stock Exchange
6.8% Subordinated Notes Due 2038	New York Stock Exchange
6.100% Senior Unsecured Notes due 2042	New York Stock Exchange
8.125% Perpetual Subordinated Capital Securities	New York Stock Exchange

Exchangeable at the Issuer's Option into Non-

Cumulative Dollar Preference Shares	
8.00% Perpetual Subordinated Capital Securities	New York Stock Exchange

Exchangeable at the Issuer's Option into Non-

Cumulative Dollar Preference Shares, Series 2	
4.250% Subordinated Notes due 2024	New York Stock Exchange
5.250% Subordinated Notes due 2044	New York Stock Exchange

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

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

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

Ordinary Shares, nominal value US\$0.50 each	19,217,874,260
--	----------------

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>
--	--	--

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

U.S. GAAP <input type="checkbox"/>	International Financial Reporting Standards as issued by the International Accounting Standards Board <input type="checkbox"/>	Other <input type="checkbox"/>
------------------------------------	--	--------------------------------

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

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.

**Table of Contents****HSBC HOLDINGS PLC ANNUAL REPORT AND ACCOUNTS 2014****Strategic Report**

1	<u>Overview</u>
2	<u>Cautionary statement regarding forward-looking statements</u>
3	<u>Highlights</u>
4	<u>Group Chairman's Statement</u>
7	<u>Group Chief Executive's Review</u>
9	<u>Strategic objectives</u>
12	<u>Business model</u>
26	<u>Strategic priorities</u>
28	<u>Outcomes</u>

**Report of the Directors****Financial Review**

40	<u>Financial summary</u>
63	<u>Global businesses</u>
78	<u>Geographical regions</u>
105aa	<u>Reconciliation of reported to constant currency, underlying and adjusted items for 2013</u>
105b	<u>Reconciliation of reported and adjusted items for 2014</u>
105s	<u>2013 compared with 2012</u>
106	<u>Other information</u>
110b	<u>Regulation and supervision</u>
111	<u>Risk</u>
238	<u>Capital</u>

**Corporate Governance**

263	<u>Corporate Governance Report</u>
264	<u>Biographies of Directors and senior management</u>
270	<u>Board of Directors</u>
276	<u>Board committees</u>
288	<u>Internal control</u>
290	<u>Going concern</u>
291	<u>Employees</u>

**Directors' Remuneration Report**

300	<u>Directors' Remuneration Report</u>
-----	---------------------------------------

**Financial Statements**

329	<u>Report of Independent Registered Public Accounting Firm</u>
334	<u>Financial Statements</u>
345	<u>Notes on the Financial Statements</u>

**Shareholder Information**

458	<a href="#">Shareholder information</a>
466	<a href="#">Abbreviations</a>
470	<a href="#">Glossary</a>
478	<a href="#">Index</a>

**Certain defined terms**

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

**Financial statements**

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). EU endorsed IFRSs could differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs were not to be endorsed by the EU. At 31 December 2014, there were no unendorsed standards effective for the year ended 31 December 2014 affecting these consolidated and separate financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to HSBC. Accordingly, HSBC's financial statements for the year ended 31 December 2014 are prepared in accordance with IFRSs as issued by the IASB.

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

When reference to adjusted is made in tables or commentaries, the comparative information has been expressed at constant currency (see page 40), the impact of fair value movements in respect of credit spread charges on HSBC's own debt has been eliminated and the effects of other significant items have been adjusted as reconciled on page 44. Adjusted return on risk-weighted assets is defined and reconciled on page 62.

**Table of Contents**

**Strategic Report**

**Who we are**

**HSBC is one of the largest  
banking and financial  
services organisations  
in the world.**

Customers:

51m

Served by:

266,000

employees (257,600 FTE)

Through four global businesses:

Retail Banking and Wealth Management

Commercial Banking

Global Banking and Markets

Global Private Banking

Located in:

Table of Contents

73

countries and territories

Across five geographical regions:

Europe

Asia

Middle East and North Africa

North America

Latin America

Offices:

Over 6,100

Global headquarters:

London

Market capitalisation:

US\$182bn

Listed on stock exchanges in:

London

Hong Kong

New York

Paris

Bermuda

Shareholders:



216,000 in 127

countries and territories

HSBC HOLDINGS PLC

1

**Table of Contents**

**Strategic Report** (continued)

**Cautionary statement regarding forward-looking statements**

The *Annual Report and Accounts 2014* contains certain forward-looking statements with respect to HSBC's financial condition, results of operations, capital position and business.

Statements that are not historical facts, including statements about HSBC's beliefs and expectations, are forward-looking statements. Words such as expects, anticipates, intends, plans, believes, seeks, estimates, 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. HSBC makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statements.

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

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

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

changes in government policy and regulation, including the monetary, interest rate and other policies of central banks and other regulatory authorities; initiatives to change the size, scope of activities and interconnectedness of financial institutions in connection with the implementation of stricter regulation of financial institutions in key markets worldwide; revised capital and liquidity benchmarks which could serve to deleverage bank balance sheets and lower returns available from the current business model and portfolio mix; imposition of levies or taxes designed to change business mix and risk appetite; the practices, pricing or responsibilities of financial institutions serving their consumer markets; expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; changes in bankruptcy legislation in the principal markets in which we operate and the consequences thereof; general changes in government policy that may significantly influence investor decisions; extraordinary government actions as a result of current market

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

factors specific to HSBC, including discretionary RWA growth and our success in adequately identifying the risks we face, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, our ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and our success in addressing operational, legal and regulatory, and litigation challenges, notably compliance with the DPA.

HSBC HOLDINGS PLC

**Table of Contents****Strategic Report** (continued)**Highlights**

**Profit before tax was down 17% to US\$18.7bn on a reported basis.** Adjusted profit before tax, excluding the effect of significant items and currency translation, was broadly unchanged at US\$22.8bn.

**Reinforced HSBC's capital strength.** Our CRD IV transitional common equity tier 1 ratio was 10.9% compared with 10.8% at the end of 2013.

**Dividends to shareholders increased to US\$9.6bn** as capital strength created capacity for organic growth and allowed us to increase the dividends paid.

**Profit before taxation**

(reported basis)

**US\$18.7bn**

£11.3bn

HK\$145bn

**Capital strength**(CRD IV common equity tier 1 ratio transitional)<sup>1</sup>**10.9%**

At 31 December

**Dividends per ordinary share**(in respect of year)<sup>3</sup>**US\$0.50****Cost efficiency ratio**(reported basis)<sup>2</sup>

67.3%

**Return on average ordinary****shareholders' equity**

7.3%

**Share price**

(at 31 December)

£6.09

HK\$74.00  
US\$47.23 American

Depository Share

*For a description of the difference between reported and adjusted performance, see page 40.*

*For footnotes, see page 39.*

HSBC HOLDINGS PLC

**Table of Contents**

**Strategic Report** (continued)

**Group Chairman's Statement**

**HSBC's performance in 2014 reflected another year of consolidation in the reshaping and strengthening of the Group against a backdrop of geopolitical and economic headwinds, many of which could not have been foreseen at the outset of the year.**

As economic activity in much of the world failed to reach the levels required to rebuild sustainable consumer confidence and prompt renewed investment expenditure, governments most impacted expanded their stimulus measures and the major central banks maintained interest rates at their unprecedented low levels. Concerns over deflationary trends, particularly in the eurozone, grew. Although China delivered growth which comfortably surpassed all other major economies, expectations of slower growth in the future weighed heavily on market sentiment and contributed to significant commodity price falls and further curtailment of global investment spending.

Unsurprisingly in this environment, revenue growth opportunities were strongest in our Asian businesses, with expansion in lending and debt capital financing. Cost progression continued globally in large part to implement regulatory change and enhance risk controls, notably around financial system integrity and conduct. Streamlining initiatives could only partly offset this cost expansion. Further customer redress costs and regulatory penalties around past failings reinforced the Board's continuing commitment to prioritise whatever further investment in systems and controls is necessary to mitigate future repetition.

It is clear now that societal, regulatory and public policy expectations of our industry are changing its long-term cost structure. Technological advancements around data analytics, including big data, are providing much more sophisticated tools to enhance our capabilities to protect the financial system from bad actors. Also, as more and more customers choose to transact online and through mobile devices, we are making the necessary investment to protect ourselves and our customers from cyber threats. Building the required analytical capabilities entails considerable investment in systems and in maintaining customer data which is accurate and up to date. Reconfiguring customer and transactional data to the digital age is no small endeavour given legacy systems and a multiplicity of historical data standards globally. The benefits, however, of enhanced customer due diligence capabilities and greater systems security essentially go to the core of our systemic role and allow us to be more proactive in fulfilling that role as a key gatekeeper to the financial system.

As our industry reshapes in response to public policy and regulatory directives, we now need to demonstrate, through clarity of our business model, the value to society of our scale and diversification. We must

never forget that investors have choices where to invest and individuals have choices where to make their careers. Thus it is essential that we can demonstrate a positive contribution to the societies we serve in order to bolster the business friendly environment that all agree is essential for economic growth and prosperity.

For 150 years HSBC has been following trade and investment flows to serve customers as they fulfil their financial ambitions. In a world which has moved from being interconnected to being interdependent, our business model is increasingly relevant to companies of all sizes and to individuals whose financial future is linked to economic activity in multiple countries.

This can be seen most markedly in our Commercial Banking business, which delivered a record year buoyed by the expansion of supply chain management solutions and increasing cross-border payment flows. Our network coverage of the countries which originate more than 85% of the world's payment activity drives this key element of our business model. On the investment side, throughout our network we saw corporate flows continuing to target the higher growth emerging markets. At the same time, growth in outward investment from mainland China accelerated as its major companies sought diversification and access to both skill bases and markets. These trends played to HSBC's scale and presence in the key financial centres, allowing us to support customers with debt and equity financing solutions, offering tailored liquidity and transactional banking support and providing risk management solutions primarily against our clients' interest rate and foreign exchange exposures. Success was evidenced by growing recognition in industry awards, the most important of which are referred to in the Group Chief Executive's Review. Finally, our Retail Banking and Wealth Management business continued its journey to build a sustainable customer focused business model, completing the removal of formulaic links between product sales and performance-related pay of our staff, and expanding our digital and mobile offerings.

HSBC HOLDINGS PLC



## **Table of Contents**

### **Strategic Report (continued)**

#### **Performance in 2014**

Profit before tax of US\$18.7bn on a reported basis was US\$3.9bn or 17% lower than that achieved in 2013. This primarily reflected lower business disposal and reclassification gains and the negative effect, on both revenue and costs, of significant items including fines, settlements, UK customer redress and associated provisions. On the adjusted basis that is one of the key metrics used to assess current year management and business performance, profit before tax was US\$22.8bn, broadly in line with 2013 on a comparable basis.

Earnings per share were US\$0.69, against US\$0.84 in 2013. The Group's capital position remained strong with the transitional common equity tier 1 ratio standing at 10.9% at the end of the year, compared with 10.8% 12 months earlier, and our end point ratio at 11.1% compared with 10.9%. Based on this capital strength and the Group's capital generating capabilities, the Board approved a fourth interim dividend in respect of 2014 of US\$0.20 per share, taking the total dividends in respect of the year to US\$0.50 per share (US\$9.6bn, US\$0.4bn higher than in respect of 2013).

Taking into account this financial performance, together with the further progress made in reshaping the Group, responding to regulatory change and implementing Global Standards, the Board considered executive management to have made good progress during 2014 towards strengthening HSBC's long-term competitive position.

The Group Chief Executive's Review analyses in detail the important benchmarks and highlights of 2014.

#### **Regulatory landscape becomes clearer but still much to do**

A great deal of progress was made during 2014 to finalise the framework under which globally systemic banks like HSBC will be required to operate when it is fully implemented. This clarity is essential if we are to be able to position our global businesses to meet the return expectations of those who invest in us within an acceptable risk appetite.

In particular, major progress was made in addressing the challenge of 'too big to fail', largely through finalising proposals to augment existing loss absorbing capacity with 'bail-inable' debt and through greater definition of how resolution frameworks

would operate in practice. In both cases, this involved the critical issue of how to address cross-border implications and home and host country regulatory responsibilities.

There is, however, still much to complete. The regulatory reform agenda for 2015 is very full with pending public policy decisions, regulatory consultations and impact studies in areas of far reaching influence to the structure of our industry. These include the conclusion of structural separation deliberations in Europe, further work on so called 'shadow banking' including identifying non-bank systemically important institutions, addressing the resolution framework for central counterparties, finalising the calibration of the leverage ratio, calibrating the quantum of total loss absorbing capacity to be raised and settling the disposition of that capacity within global groups.

**Restoration of trust in our industry remains a significant challenge as further misdeeds are uncovered but it is a challenge we must meet successfully.**

In addition, further work will be undertaken on utilising standardised risk weights to overcome regulatory loss of confidence in internally modelled capital measures and a fundamental review of the trading book is also underway within the regulatory community to look again at capital support for this activity. These measures, which in aggregate are designed to make the industry structurally more stable, will take the next five or so years to implement, an indication of the scale of the transformation to be completed.

During 2014, the UK government also confirmed the permanence of the UK bank levy. This was introduced in 2010, in part to address the burden borne by taxpayers from failures during the global financial crisis; in 2014, the cost to HSBC of the levy was US\$1.1bn, an increase of US\$0.2bn over 2013. 58% of the levy we pay does not relate to our UK banking activity.

### **Rebuilding trust**

Restoration of trust in our industry remains a significant challenge as further misdeeds are uncovered but it is a challenge we must meet successfully. We owe this not just to

society but to our staff to ensure they can be rightly proud of the organisation to which they have committed their careers. When commentators extrapolate instances of control failure or individual misconduct to question the culture of the firm it strikes painfully at the heart of our identity.

### **Swiss Private Bank**

The recent disclosures around unacceptable historical practices and behaviour within the Swiss private bank remind us of how much there still is to do and how far society's expectations have changed in terms of banks' responsibilities. They are also a reminder of the need for constant vigilance over the effectiveness of our controls and the imperative to embed a robust and ethical compliance culture.

We deeply regret and apologise for the conduct and compliance failures highlighted which were in contravention of our own policies as well as expectations of us.

In response to, and in parallel with, the tax investigations prompted by the data theft more than eight years ago, we have been completely overhauling our private banking business, putting the entire customer base through enhanced due diligence and tax transparency filters. Our Swiss Private Bank customer base and the countries we serve are now both about one-third of the size they were in 2007. In addition, HSBC is already working to implement the OECD's Common Reporting Standard and other measures to foster greater transparency. We cannot change the past. But, looking to the future, we can and must reinforce controls and provide demonstrable evidence of their effectiveness. This forms part of our commitment to Global Standards, to ensure that we will never knowingly do business with counterparties seeking to evade taxes or use the financial system to commit financial crime.

### **Banking standards**

More broadly, following the publication in 2013 of the Parliamentary Commission on Banking Standards, considerable progress has been made in giving effect to its recommendations. The Financial Services (Banking Reform) Act of 2013 provided greater clarity on the accountabilities and responsibilities of management and the Board. We welcome the appointment of Dame Colette Bowe to lead the Banking Standards Review Council and have committed to support her fully in its work. The current Fair and Effective Markets



## **Table of Contents**

### **Strategic Report** (continued)

Review being conducted by the Bank of England, Her Majesty's Treasury and the Financial Conduct Authority is an extremely timely and important exercise to re-establish the integrity of wholesale financial markets.

In terms of our own governance of these areas, the Conduct & Values Committee of the Board that we created at the beginning of 2014 to focus on behavioural issues has established itself firmly as the central support to the Board in these important areas.

### **Board changes**

Since we reported at the interim stage we have taken further steps to augment the skills and experience within the Board and to address succession to key roles.

On 1 January 2015, Phillip Ameen joined the Board and the Group Audit Committee as an independent non-executive Director. Phil was formerly Vice President, Comptroller and Principal Accounting Officer of General Electric Corp. He brings with him extensive financial and accounting experience gained in one of the world's leading international companies as well as a depth of technical knowledge from his long service in the accounting standard setting world. As a serving Director on HSBC's US businesses he also brings further detailed insight to Group Board discussions and enhances the strong links that already exist between the Group Board and its major subsidiaries.

Sir Simon Robertson had previously indicated his intention to retire from the Board at the upcoming AGM. I am delighted to report that Simon has agreed to stay on for at least a further

year as Deputy Chairman. He has been a considerable support to me and to Stuart Gulliver, in addition to his role leading the non-executives, and we are all delighted that we shall continue to benefit from his wisdom and experience.

### **150th anniversary**

2015 marks the 150th anniversary of our founding back in Hong Kong and Shanghai as a small regional bank focused on trade and investment. All of us within HSBC owe a huge debt of gratitude and respect to our forebears who charted the course that has taken HSBC to one of the most important institutions serving the financial needs of this inter-dependent world.

### **Outlook**

It is impossible not to reflect on the very broad range of uncertainties and challenges to be addressed in 2015 and beyond, most of which are outside our control, particularly against a backdrop of patchy economic recovery and limited policy ammunition. Unexpected outcomes arising from current geopolitical tensions, eurozone membership uncertainties, political changes, currency and commodity price realignments, interest rate moves and the effectiveness of central banks' unconventional policies, to name but a few, all could materially affect economic conditions and confidence around investment and consumption decisions. One economic uncertainty stands out for a major financial institution headquartered in the UK, that of continuing UK membership of the EU. Today, we publish a major research study which concludes that working to complete the Single Market in

services and reforming the EU to make it more competitive are far less risky than going it alone, given the importance of EU markets to British trade.

There are also many underlying positive trends that shape our thinking about the coming year. We are very encouraged by the trends in outward investment from China, the potential for further liberalisation and internationalisation of the renminbi and the reshaping of the Chinese economy from export dependence to domestic consumption. We are positive on the opportunities that will arise from Capital Markets Union within Europe and the declared focus of the incoming Commission on growth and jobs. The strength of the US economy and the benefits of lower oil prices should be positive drivers of growth. There is much to be gained from successful negotiation of the Transatlantic Trade and Investment Partnership and the Trans-Pacific Partnership. Current attention on funding infrastructure investment globally is potentially of huge significance.

Finally, on behalf of the Board, I want again to express our thanks and gratitude to our 266,000 colleagues around the world who worked determinedly in 2014 to build an HSBC fit for the next 150 years.

**D J Flint**

Group Chairman

23 February 2015

HSBC HOLDINGS PLC

**Table of Contents**

**Strategic Report** (continued)

**Group Chief Executive's Review**

**2014 was a challenging year in which we continued to work hard to improve business performance while managing the impact of a higher operating cost environment.**

Profits disappointed, although a tough fourth quarter masked some of the progress made over the preceding three quarters. Many of the challenging aspects of the fourth quarter results were common to the industry as a whole. In spite of this, there were a number of encouraging signs, particularly in Commercial Banking, Payments & Cash Management and renminbi products and services. We were also able to continue to grow the dividend.

Reported profit before tax in 2014 was US\$18.7bn, US\$3.9bn lower than in the previous year. This reflected lower gains from disposals and reclassifications, and the negative effect of other significant items, including fines, settlements, UK customer redress and associated provisions, totalling US\$3.7bn.

Adjusted profit before tax, which excludes the year-on-year effects of currency translation differences and significant items, was US\$22.8bn, broadly unchanged on 2013.

Asia continued to provide a strong contribution to Group profits. Middle East and North Africa reported a record profit before tax in 2014. Together, Asia and MENA generated more than 70% of adjusted Group profit before tax.

Commercial Banking also delivered a record reported profit, which is evidence of the successful execution of our strategy. Revenue in CMB continued to grow,

notably in our two home markets of Hong Kong and the UK.

Global Banking and Markets performed relatively well for the first three quarters of the year, but, like much of the rest of the industry, suffered a poor fourth quarter. Revenue was lower in 2014, particularly in our Markets businesses, but all other client-facing businesses delivered year-on-year growth.

Revenue was also lower in Retail Banking and Wealth Management, due primarily to the continuing repositioning of the business. However, in our Global Asset Management business we continued our strategy of strengthening collaboration across our global businesses, which helped to attract net new money of US\$29bn.

Global Private Banking continues to undergo a comprehensive overhaul which was accelerated from 2011. As part of this overhaul, we are implementing tough financial crime, regulatory compliance and tax transparency measures. In order to achieve our desired business model and informed by our six filters process, we have also sold a number of businesses and customer portfolios, including assets in Japan, Panama and Luxembourg. The number of customer accounts in our Swiss Private Bank is now nearly 70% lower than at its peak. We continued to remodel the Private Bank in 2014, which included the sale of a customer portfolio in Switzerland to LGT Bank. One consequence of this

remodelling was a reduction in revenue. We have also

grown the parts of the business that fit our new model, attracting US\$14bn of net new money in 2014, mostly through clients of Global Banking & Markets and Commercial Banking.

Loan impairment charges were lower, reflecting the current economic environment and the changes we have made to our portfolio since 2011.

Operating expenses were higher due to increased regulatory and compliance costs, inflationary pressures and investment in strategic initiatives to support growth, primarily in Commercial Banking in Asia and Europe. Significant items, which include restructuring costs, were also higher than last year.

We agreed settlements in respect of inquiries by the UK Financial Conduct Authority and the US Commodity Futures Trading Commission into the foreign exchange market in 2014. HSBC was badly let down by a few individuals whose actions do not reflect the vast majority of employees who uphold the values and standards expected of the bank. This matter is now rightly in the hands of the Serious Fraud Office.

Our balance sheet remained strong, with a ratio of customer advances to customer accounts of 72%. Excluding the effects of currency translation, customer loans and advances grew by US\$28bn during 2014.

The common equity tier 1 ratio on a transitional basis was 10.9% and on a CRD IV end point basis was 11.1% at 31 December 2014.

### **Connecting customers to opportunities**

2015 is HSBC's 150th anniversary. Founded in Hong Kong in 1865 to finance local and international trade, the bank expanded rapidly to capture the increasing flow of commerce between Asia, Europe and North America. Our ability to connect customers across the world remains central to the bank's strategy today and in 2014 we continued to develop and grow the product areas that rely on international connectivity.

Our market-leading Global Trade and Receivables Finance business remains strong and we were voted best global trade finance bank and best trade finance bank in MENA in the *Global Trade Review* Leaders In Trade Awards.

HSBC HOLDINGS PLC

## Table of Contents

### **Strategic Report** (continued)

In Payments and Cash Management, we increased customer mandates and improved client coverage. We were recognised as the best global cash management bank for the third successive year in the 2014 *Euromoney* Cash Management Survey.

Our share of the capital financing market continued to improve and we were ranked number one for debt capital markets in our home markets of the UK and Hong Kong, and number one for Equity Capital Markets in Hong Kong by *Dealogic*. HSBC was also named global bond house of the year, global derivatives house of the year and Asian bond house of the year in the *International Financing Review* Awards 2014.

We consolidated our leadership of the rapidly growing renminbi market in 2014. According to SWIFT, the renminbi is now the fifth most widely used payment currency in the world, up from 13th just two years ago. We increased revenue from renminbi products and retained our ranking as number one issuer of offshore renminbi bonds worldwide over the last twelve months. HSBC was also recognised as the best overall provider for products and services in *Asiamoney*'s Offshore Renminbi Services Survey in 2014, and renminbi house of the year in the 2014 Asia Risk Awards.

### **Operating a global business**

It is already clear that the regulatory costs of operating a global business model have increased since we announced our strategy for HSBC in 2011.

As the Group Chairman's Statement explains, the regulatory environment continues to evolve.

Our commitment to be the world's leading international bank means that improving our regulatory and compliance abilities and implementing Global Standards must remain priorities for HSBC. Our Compliance staff headcount has more than doubled since 2011 and there is more work still to do to strengthen the Group's compliance capability.

At the same time, the level of capital that we hold has increased by over 60% since before the financial crisis. Specifically, we have further strengthened our capital levels in response to increasing capital

requirements from the UK Prudential Regulation Authority.

Whilst we expected an increase in the amount of capital we were required to hold when setting targets for the Group in 2011, we could not have foreseen the full extent of the additional costs and capital commitment that would subsequently be asked of us. The pace of change has been exceptional. As a consequence, some of the targets that we set for the Group in 2011 are no longer realistic.

In recognition of that fact, we have set new medium-term targets that better reflect the ongoing operating environment.

We are setting a revised return on equity target of more than 10%. This target is modelled using a common equity tier 1 capital ratio on a CRD IV end point basis in the range of 12% to 13%.

Our cost target will be to grow our revenue faster than costs ( positive jaws ) on an adjusted basis.



We are also restating our commitment to grow the dividend. To be clear, the progression of dividends should be consistent with the growth of the overall profitability of the Group and is predicated on our ability to meet regulatory capital requirements in a timely manner.

These targets offer a realistic reflection of the capabilities of HSBC in the prevailing operating environment.

### **Our employees**

I am grateful for the hard work, dedication and professionalism of all of our employees in 2014.

Extensive work was required to prepare HSBC for stress tests in a number of jurisdictions throughout the year, the results of which confirmed the capital strength of the Group. HSBC will face additional stress testing in 2015.

We all have to work continuously to make sure that the Group remains compliant with anti-money laundering and sanctions legislation and this effort continued in 2014.

Management and staff across the Group continued to work very closely with the Monitor to deliver our commitments under the terms of our December 2012

settlement agreements with the US authorities and the UK Financial Conduct Authority. We have now received the second annual report from the Monitor. Whilst it confirmed that we continue to comply with the obligations we undertook in the Deferred Prosecution Agreement with the US Department of Justice, as we expected we still have substantial work to do.

### **Summary and outlook**

The business remains in a good position structurally to capitalise on broader market trends and the macroeconomic backdrop remains favourable, notwithstanding the continuing low interest rate environment. There are still a number of historical issues left to resolve and we will make further progress on these in 2015. We will also continue the work we started in 2011 to simplify the Group to make it easier to manage and control.

Our 2014 results show a business powered by our continued strength in Hong Kong, with significant additional contributions from the rest of Asia and the Middle East and North Africa. The continuing success of Commercial Banking and the resilience of our differentiated Global Banking & Markets business illustrate the effectiveness of our strategy to bridge global trade and capital flows. Retail Banking & Wealth Management remains a work in progress, but we took considerable further steps to de-risk the business in 2014. Global Private Banking continues to attract net new money from clients in our other global businesses. We maintain a sharp focus on generating net savings to offset increased costs arising from inflation, and the cost of implementing global standards.

Our early 2015 performance has been satisfactory.

We continue to focus on the execution of our strategy and on delivering value to shareholders.

**S T Gulliver**

Group Chief Executive

23 February 2015

HSBC HOLDINGS PLC

8

---

**Table of Contents**

**Strategic Report** (continued)

**Strategic objectives**

**Value creation**

**and long-term sustainability**

**We continue to follow the vision for HSBC we first outlined in 2011 along with the clear strategy that will help us achieve it. Our strategy guides where and how we seek to compete. We constantly assess our progress against this strategy and provide regular updates to stakeholders.**

Through our principal activities – making payments, holding savings, enabling trade, providing finance and managing risks – we play a central role in society and in the economic system. Our target is to build and maintain a business which is sustainable in the long term.

**How we create value**

Banks, and the individuals within them, play a crucial role in the economic and social system, creating value for many parties in different ways.

We provide a facility for customers to securely and conveniently deposit their savings. We allow funds to flow from savers and investors to borrowers, either directly or through the capital markets. The borrowers use these loans or other forms of credit to buy goods or invest in businesses. By these means, we help the economy to convert savings which may be individually short-term into financing which is, in aggregate, longer term. We bring together investors and people looking for investment funding. We develop new financial products. We also facilitate personal and commercial transactions by acting as payment agent both within countries and internationally. Through these activities, we take on risks which we then manage and reflect in our prices.

Our direct lending includes residential and commercial mortgages and overdrafts, and term loan facilities. We finance importers and exporters engaged in international trade and provide advances to companies secured on amounts owed to them by their customers.

We also offer additional financial products and services including broking, asset management, financial advisory services, life insurance, corporate finance, securities services and alternative investments. We make markets in financial assets so that investors have confidence in efficient pricing and the availability of buyers and sellers. We provide these products for clients ranging from governments to large and mid-market corporates, small and medium-sized enterprises, high net worth individuals and retail customers. We help customers raise financing from external investors in debt and equity capital markets. We create liquidity and price transparency in these securities allowing investors to buy and sell them on the secondary market. We exchange national currencies, helping

international trade.

We offer products that help a wide range of customers to manage their risks and exposures through, for example, life insurance and pension products for retail customers and receivables finance or

documentary trade instruments for companies. Corporate customers also ask us to help with managing the financial risks arising in their businesses by employing our expertise and market access.

An important way of managing risks arising from changes in asset and liability values and movements in rates is provided by derivative products such as forwards, futures, swaps and options. In this connection, we are an active market-maker and derivative counterparty. Customers use derivatives to manage their risks, for example, by:

using forward foreign currency contracts to hedge their income from export sales or costs of imported materials;

using an inflation swap to hedge future inflation-linked liabilities, for example, for pension payments;

transforming variable payments of debt interest into fixed rate payments, or vice versa; or

providing investors with hedges against movements in markets or particular stocks.

HSBC HOLDINGS PLC

## **Table of Contents**

### **Strategic Report** (continued)

We charge customers a spread, representing the difference between the price charged to the customer and the theoretical cost of executing an offsetting hedge in the market. We retain that spread at maturity of the transaction if the risk management of the position has been effective.

We then use derivatives along with other financial instruments to constrain the risks arising from customer business within risk limits. Normally, our customers both buy and sell relevant instruments, in which case our focus is on managing any residual risks through transactions with other dealers or professional counterparties. Where we do not fully hedge the residual risks we may gain or lose money as market movements affect the net value of the portfolio.

Stress tests and other risk management techniques are also used to ensure that potential losses remain within our risk appetite under a wide range of potential market scenarios.

In addition, we manage risks within HSBC, including those which arise from the business we do with customers.

*For further information on our risks, see page 21, and on how we manage them, see page 24.*

### **Long-term sustainability**

At HSBC, we understand that the continuing financial success of our business is closely connected to the economic, environmental and social landscape in which we operate. For us, sustainability means building our business for the long term by balancing social, environmental and economic considerations in the decisions we make. This enables us to help businesses thrive, reward shareholders and employees, pay taxes and duties in

the countries in which we operate and contribute to the health and growth of communities. Achieving a sustainable return on equity and long-term profit growth is built on this foundation.

How we do business is as important as what we do: our responsibilities to our customers, employees and shareholders as well as to wider society go far beyond simply being profitable. These include our consistent implementation of the highest standards everywhere we operate to detect, deter and protect against financial crime.

Sustainability underpins our strategic priorities and enables us to fulfil our purpose. Our ability to identify and address environmental, social and ethical developments which present risks or opportunities for the business contributes to our financial success. Sustainable decision-making shapes our reputation, drives employee engagement and affects the risk profile of the business and can help reduce costs and secure new revenue streams.

Our international presence and the long-established position of many of our businesses in HSBC's home and priority growth markets, when combined with our wide-ranging portfolio of products and services, differentiate HSBC from our competitors and give our business and operating models an inherent resilience. This has enabled the Group to remain profitable through the most turbulent of times for our industry, and we are confident that the models will continue to stand us in good stead in the future and will underpin the achievement of our strategic priorities.

*Our business and operating models are described in more detail on page 12. For further information about sustainability at HSBC, see page 36.*

## HSBC Values

**Embedding HSBC Values in every decision and every interaction with customers and with each other is a top priority for the Group and is shaping the way we do business.**

The role of HSBC Values in daily operating practice is fundamental to our culture, and is particularly important in light of developments in regulatory policy, investor confidence and society's expectations of banks. HSBC Values are integral to the selection, assessment, recognition, remuneration and training of our employees. We expect our executives and employees to act with courageous integrity in the execution of their duties in the following ways:

### HSBC Values

Be dependable and do the right thing

stand firm for what is right, deliver on commitments, be resilient and trustworthy;

take personal accountability, be decisive, use judgement and common sense, empower others.

Be open to different ideas and cultures

communicate openly, honestly and transparently, value challenge, learn from mistakes;

listen, treat people fairly, be inclusive, value different perspectives.

Be connected with our customers, communities, regulators and each other

build connections, be externally focused, collaborate across boundaries;

care about individuals and their progress, show respect, be supportive and responsive.

HSBC HOLDINGS PLC

**Table of Contents**

**Strategic Report** (continued)

**Our strategy**



Our strategy is aligned to two long-term trends:

The world economy is becoming ever more interconnected, with growth in world trade and cross-border capital flows continuing to outstrip growth in average gross domestic product. Over the next decade we expect growth in trade and capital flows to outstrip GDP growth and 35 markets to generate 85% of world trade growth with a similar degree of concentration in cross-border capital flows.

Of the world's top 30 economies, we expect those of Asia, Latin America, the Middle East and Africa to have increased by around four-fold in size by 2050, benefiting from demographics and urbanisation. By this time they will be larger than those of Europe and North America combined. By 2050, we expect 18 of the 30 largest economies will be from Asia, Latin America or the Middle East and Africa.

What matters in this environment is:

having an international network and global product capabilities to capture international trade and movements in capital; and

being able to take advantage of organic investment opportunities in the most attractive growth markets and maintaining the capacity to invest.

HSBC's competitive advantages come from:

our meaningful presence in and long-term commitment to our key strategic markets;

our business network, which covers over 85% of global trade

Responding to these long-term trends, we have developed a two-pronged approach that reflects our competitive advantages:

A network of businesses connecting the world. HSBC is well positioned to capture growing international trade and capital flows. Our global reach and range of services place us in a strong position to serve clients as they grow from small enterprises into large multi-nationals through our Commercial Banking and Global Banking & Markets businesses.

Wealth management and retail with local scale. We aim to capture opportunities arising from social mobility and wealth creation in our priority growth markets across Asia, Latin America and the Middle East, through our Premier proposition and Global Private Banking business. We expect to invest in

and capital flows;

full scale retail businesses only in markets where we can achieve profitable scale.

our balanced business portfolio centred on our global client franchise;

our strong ability to add to our capital base while also providing competitive rewards to our staff and good returns to our shareholders;

our stable funding base, with about US\$1.4 trillion of customer accounts of which 72% has been advanced to customers; and

our local balance sheet strength and trading capabilities in the most relevant financial hubs.

HSBC HOLDINGS PLC



---

**Table of Contents**

**Strategic Report** (continued)

**Business model**

**Market presence**

**Our business model is based on an international network connecting and serving a cohesive portfolio of markets.**

Our comprehensive range of banking and related financial services is provided by operating subsidiaries and associates. Services are primarily delivered by domestic banks, typically with local deposit bases.

The UK and Hong Kong are our home markets, and a further 19 countries form our priority growth markets (see below). These 21 markets accounted for over 90% of our profit before tax in 2014, and are the primary focus of capital deployment. Network markets are markets with strong international relevance which serve to complement our international presence, operating mainly through Commercial Banking and Global Banking and Markets. Our combination of home, priority growth and network markets covers around 85% of all international trade and financial flows.

The final category, small markets, includes those where our operations are of sufficient scale to operate profitably, or markets where we maintain representative offices.

Our legal entities are regulated by their local regulators and on a Group-wide basis we are regulated from the UK by the Prudential Regulation Authority ( PRA ) for prudential matters (safety and soundness) and by the Financial Conduct Authority ( FCA ) for conduct (consumer and market protection).

*HSBC's markets*

**Investment criteria**

We use six filters to guide our decisions about when and where to invest. The first two – international connectivity and economic development – determine whether the business is strategically relevant. The next three – profitability, efficiency and liquidity – determine whether the financial position of the business is attractive. The sixth filter – the risk of financial crime – governs our activities in high risk jurisdictions, and is applied to protect us by restricting the scope of our business where appropriate.

Decisions over where to invest additional resources have three components:

Strategic: we will only invest in businesses aligned to our strategy, mostly in our home and priority growth markets and in target businesses and clients;

Financial: the investment must be value accretive for the Group, and must meet minimum returns, revenue and cost hurdles; and

Risk: the investment must be consistent with our risk appetite.

We conduct an annual geographic and business portfolio review following the six filter approach to update our market and business priorities.

*Using the six filters in decision-making*

HSBC HOLDINGS PLC

## **Table of Contents**

### **Strategic Report** (continued)

#### **Organisation**

**Our operating model is based on a matrix management structure comprising global businesses, geographical regions and global functions.**

The matrix is overlaid on a legal entity structure headed by HSBC Holdings plc.

#### **Holding company**

HSBC Holdings, the holding company of the Group, is the primary source of equity capital for its subsidiaries and provides non-equity capital to them when necessary.

Under authority delegated by the Board of HSBC Holdings, the Group Management Board ( GMB ) is responsible for the management and day-to-day running of the Group, within the risk appetite set by the Board. GMB works to ensure that there are sufficient cash resources to pay dividends to shareholders, interest to bondholders, expenses and taxes.

HSBC Holdings does not provide core funding to any banking subsidiary, nor is it a lender of last resort and does not carry out any banking business in its own right. Subsidiaries operate as separately capitalised entities implementing the Group strategy.

#### **Global management structure**

The following table lists our four global businesses, five geographical regions and 11 global functions, and summarises their responsibilities under HSBC s management structure.

*For details of our principal subsidiaries see Note 22 on the Financial Statements. A simplified Group structure chart is provided on page 462.*

#### *Global management structure*

HSBC HOLDINGS PLC

## **Table of Contents**

### **Strategic Report** (continued)

#### **Structural Reform**

**Banking structural reform and recovery and resolution planning** Globally there have been a number of developments relating to banking structural reform and the introduction of recovery and resolution regimes.

As recovery and resolution planning has developed, some regulators and national authorities have also required changes to the corporate structures of banks. These include requiring the local incorporation of banks or ring-fencing of certain businesses. In the UK, ring-fencing legislation has been enacted requiring the separation of retail and small and medium-sized enterprise ( SME ) deposits from trading activity (see below). Similar requirements have been introduced or are in the process of being introduced in other jurisdictions.

#### **Policy background to recovery and resolution**

Following the financial crisis, G20 leaders requested that the Financial Stability Board ( FSB ) establish more effective arrangements for the recovery and resolution of 28 (now 30) designated Global Systemically Important Banks ( G-SIBs ), resulting in a series of policy recommendations in relation to recovery and resolution planning, cross-border co-operation agreements and measures to mitigate obstacles to resolution.

In December 2013, the PRA set out rules for the recovery and resolution of UK banks and international banks operating in the UK. These rules were modified as part of the implementation of the EU Bank Recovery and Resolution Directive from January 2015.

#### **HSBC resolution strategy and corporate structure changes**

We have been working with the Bank of England, the PRA and our other primary regulators to develop and agree a resolution strategy for HSBC. It is our view that a resolution strategy whereby the Group breaks up at a subsidiary bank level at the point of resolution (referred to as a Multiple Point of Entry strategy) rather than being kept together as a Group at the point of resolution (referred to as a Single Point of Entry strategy) is the optimal approach as it

is aligned to our existing legal and business structure.

In common with all G-SIBs, we are working with our regulators to understand inter-dependencies between different businesses and subsidiary banking entities in the Group in order to enhance resolvability.

We have initiated plans to mitigate or remove critical inter-dependencies to further facilitate the resolution of the Group. In particular, in order to remove operational dependencies (where one subsidiary bank provides critical services to another), we have determined to transfer such critical services from the subsidiary banks to a separately incorporated group of service companies ( ServCo group ). The ServCo group will be separately capitalised and funded to ensure continuity of services in resolution. A significant portion of the ServCo group already exists and therefore this initiative involves transferring the remaining critical services still held by subsidiary banks into the ServCo group. The services will then be provided to the subsidiary banks by the ServCo group.

#### **UK ring-fencing**

In December 2013, the UK's Financial Services (Banking Reform) Act 2013 ( Banking Reform Act ) received Royal Assent. It implements most of the recommendations of the Independent Commission on Banking ( ICB ), which *inter alia* require large banking groups to ring-fence UK retail banking activity in a separately incorporated banking subsidiary (a ring-fenced bank ) that is prohibited from engaging in significant trading activity. For these purposes, the UK excludes the Crown Dependencies. Ring-fencing is to be completed by 1 January 2019.

In July 2014, secondary legislation was finalised. This included provisions further detailing the applicable individual customers to be transferred to the ring-fenced bank by reference to gross worth and enterprises to be transferred based on turnover, assets and number of employees. In addition, the secondary legislation places restrictions on the activities and geographical scope of ring-fenced banks.

In October 2014, the PRA published a consultation paper on ring-fencing rules in

relation to legal structure, governance, and continuity of services and facilities. The PRA intends to undertake further consultations and finalise ring-fencing rules in due course. The PRA also published a discussion paper concerning operational continuity in resolution.

As required by the PRA's consultation paper, a provisional ring-fencing project plan was presented to the UK regulators in November 2014. This plan provided for ring-fencing of the activities prescribed in the legislation, broadly the retail and SME services that are currently part of HSBC Bank plc ( HSBC Bank ), in a separate subsidiary.

In addition, the plan reflected the operational continuity expectations of each of the PRA's consultation and discussion papers by providing for the proposed enhancement of the ServCo group. The plan remains subject to further planning and approvals internally and is ultimately subject to the approval of the PRA, FCA and other applicable regulators.

### European banking structural reform

In January 2014, the European Commission published legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors, at their discretion, to require certain trading activities to be undertaken in a separate subsidiary from deposit taking activities.

The ring-fenced deposit taking entity would be subject to separation from the trading entity including requirements for separate capital and management structures, issuance of own debt and arms-length transactions between entities.

The draft proposals contain a provision which would permit derogation by member states that have implemented their own structural reform legislation, subject to meeting certain conditions. This derogation may benefit the UK in view of the Banking Reform Act.

The proposals are currently subject to discussion in the European Parliament and the Council. The implementation date for any separation under the final rules would depend upon the date on which the final legislation (if any) is agreed.



**Table of Contents**

**Strategic Report** (continued)

**Governance**

**The Board is committed to establishing and maintaining the highest standards of corporate governance wherever we operate. Good corporate governance is critical to HSBC's long-term success and sustainability.**

We believe that a robust and transparent corporate governance framework is vital to the sustainable success of HSBC. Strengthening our corporate governance framework to support the successful implementation of our Global Standards programme is a continuing focus for the Board.

**Role of the Board and Committees**

The strategy and risk appetite for HSBC is set by the Board, which delegates the day-to-day

running of the business to the GMB. Risk Management Meetings of the GMB are held in addition to regular GMB meetings.

The key roles of the non-executive committees established by the Board are described in the chart below. The terms of reference of the principal non-executive Board committees are available at [www.hsbc.com/boardcommittees](http://www.hsbc.com/boardcommittees).

*For further details on Group corporate governance, see page 263.*

*The committee structure and governance framework of the HSBC Holdings Board*

HSBC HOLDINGS PLC

## **Table of Contents**

### **Strategic Report** (continued)

#### **Global businesses**

Our four global businesses are Retail Banking and Wealth Management ( RBWM ), Commercial Banking ( CMB ), Global Banking and Markets ( GB&M ) and Global Private Banking ( GPB ). They are responsible for

developing, implementing and managing their business propositions consistently across the Group, focusing on profitability and efficiency. They set their strategies within the parameters of the Group strategy in liaison with the geographical regions; are responsible for issuing planning guidance

regarding their businesses; are accountable for their profit and loss performance; and manage their headcount.

*The main business activities of our global business and their products and services are summarised below.*

#### *Main business activities by global business in 2014*

*For footnotes, see page 39.*

#### **Retail Banking and Wealth Management**

##### **Products and services**

RBWM takes deposits and provides transactional banking services to enable customers to manage their day-to-day finances and save for the future. We offer credit facilities to assist them in their short or longer-term borrowing requirements and we provide financial advisory, broking, insurance and investment services to help them to manage and protect their financial futures.

We develop products designed to meet the needs of specific customer segments, which may include a range of different services and delivery channels.

**RBWM offers four main types of service:**



**HSBC Premier:** we provide a dedicated relationship manager to our mass affluent customers and their immediate families, offering specialist and tailored advice. Customers can access emergency travel assistance, priority telephone banking and an online global view of their Premier accounts around the world.

**HSBC Advance:** we offer our emerging affluent customers control over their day-to-day finances and access to a range of preferential products, rates and terms. HSBC Advance is also the start of a relationship where we give customers support and guidance to help them to realise their ambitions.

**Wealth Solutions & Financial Planning:** a financial planning process designed around individual customer needs to help our clients to protect, grow and manage their wealth. We offer investment and wealth insurance products manufactured by Global Asset Management, Markets and HSBC Insurance and by selected third-party providers.

**Personal Banking:** we provide globally standardised but locally delivered, reliable, easy to understand, good-value banking products and services using global product platforms and globally set service standards.

RBWM delivers services through four principal channels: branches, self-service terminals, telephone service centres and digital (internet and mobile).

## Customers

RBWM serves nearly 50 million customers. We are committed to building lifelong relationships with our customers as they move from one stage of their lives to the next, offering tailored products and services

appropriate to their diverse goals, aspirations and ambitions. We recognise that some of our customers face financial challenges and, in these cases, we aim to be tolerant, fair and understanding and to support them during difficult times.

We put the customer at the heart of everything we do. We constantly carry out research and invest resources to make sure that customers can access our services conveniently, securely and reliably. We have conducted work to ensure that we sell products that meet their needs and at a price that represents a fair exchange of value between customers and shareholders, and have introduced new incentive programmes that have no formulaic links to sales volumes but are focused on assessing how well we are meeting our customers' needs.

We measure customer satisfaction through an independent market research survey of retail banking customers in selected countries and calculate a Customer Recommendation Index to measure performance. This is benchmarked against average scores of a peer group of banks in each market and we set targets for our business relative to our competitor set of banks. We expect continuous improvements across markets in which we operate. We aim

HSBC HOLDINGS PLC

---

**Table of Contents**

**Strategic Report** (continued)

to handle customer complaints promptly and fairly, monitoring trends to further improve our services.

**Commercial Banking**

**Products and services**

CMB provides a broad range of banking and financial services to enable customers to manage and grow their businesses domestically and internationally. We aim to be recognised as the leading international trade and business bank by connecting customers to markets and by enhancing collaboration within the Group, both geographically and between global businesses. A global operating model increases transparency, enables consistency, improves efficiency and ensures the right outcomes for our customers.

**CMB customer offerings typically include:**

**Credit and Lending:** we offer a broad range of domestic and cross-border financing, including overdrafts, corporate cards, term loans and syndicated, leveraged, acquisition and project finance. Asset finance is also offered in selected countries.

**Global Trade and Receivables Finance:** we support customers' access to the world's trade flows and provide unrivalled experience in addressing today's most complex trade challenges. Our comprehensive suite of products and services, letters of credit, collections, guarantees, receivables finance, supply chain solutions, commodity and structured finance and risk distribution, can be combined into global solutions that make it easier for businesses to manage risk, process transactions and fund activities throughout the trade cycle.

**Payments and Cash Management:** we are strategically located where most of the world's payments and capital flows originate. We provide local, regional and global transaction banking services including payments, collections, account services, e-commerce and liquidity management via e-enabled platforms to address the needs of our customers.

**Insurance and Investments:** we offer business and financial protection, trade insurance, employee benefits, corporate wealth management and a variety of other commercial risk insurance products in selected countries.

**Collaboration:** our CMB franchise represents a key client base for products and services provided by GB&M, RBWM and GPB, including foreign exchange, interest rate, capital markets and advisory services, payroll and personal accounts services and wealth management and wealth transition services.

HSBC is leading the development of the renminbi as a trade currency, with renminbi capabilities in more than 50 markets.

Our range of products, services and delivery channels is tailored to meet the needs of specific customer segments.

## Customers

We have organised ourselves around our customers' needs and their degree of complexity by developing three distinct segments within CMB: Business Banking, Mid-Market and Large Corporates.

Business Banking now has two distinct needs-based servicing models: relationship managers focused on customers with more complex needs; and portfolio management for customers requiring simpler, more routine products and services.

We have brought increased focus to our Mid-Market customers and are re-configuring our organisation and resources across our home and priority growth markets to provide enhanced relationship management.

For our Large Corporate customers, who typically have complex and multi-country needs, we provide globally managed senior coverage teams, who are also able to coordinate with other global businesses.

To ensure that our customers remain at the heart of our business, we continue to place the utmost value on customer feedback and customer engagement. We are now in the 6th year of our Client Engagement Programme, a global survey of 15 markets designed to deepen our understanding of our customers and reinforce our relationship with them. This initiative, combined with other insight programmes, helps us to identify customers' critical business issues so that we can tailor solutions and services offered to better meet their needs.

Building long-term relationships with reputable customers is core to our growth strategy and organisational values.

## Global Banking and Markets

### Products and services

GB&M provides wholesale capital markets and transaction banking services organised across eight client-facing businesses.

**GB&M products and services include:**

Sales and trading services in the secondary market are provided in **Markets**, which includes four businesses organised by asset class:

**Credit and Rates** sell, trade and distribute fixed income securities to clients including corporates, financial institutions, sovereigns, agencies and public sector issuers. They assist clients in managing risk via interest rate and credit derivatives, and facilitate client financing via repurchase (repo) agreements.

**Foreign Exchange** provides spot and derivative products to meet the investment demands of institutional investors, the hedging needs of small and medium-sized enterprises (SMEs), middle-market enterprises (MMEs) and large corporates in GB&M and CMB, and the needs of RBWM and GPB customers in our branches. Foreign Exchange trades on behalf of clients in over 90 currencies.

**Equities** provides sales and trading services for clients, including direct market access and financing and hedging solutions.

**Capital Financing** offers strategic financing and advisory services focusing on a client's capital structure. Products include debt and equity capital raising in the primary market, transformative merger and acquisition advisory and execution, and corporate lending and specialised structured financing solutions such as leveraged and acquisition finance, asset and structured finance, real estate, infrastructure and project finance, and export credit.

**Payments and Cash Management** helps clients move, control, access and invest their cash. Products include non-retail deposit taking and international, regional and domestic payments and cash management services.

**Securities Services** provides custody and clearing services to corporate and institutional clients and funds administration to both domestic and cross-border investors.

**Global Trade and Receivables Finance** provides trade services on behalf of GB&M clients to support them throughout their trade cycle.

In addition to the above, Balance Sheet Management is responsible for the management of liquidity and funding for the Group. It also manages structural interest rate positions within the Markets limit structure.



---

## **Table of Contents**

### **Strategic Report** (continued)

#### **Customers**

GB&M provides tailored financial solutions to major governmental, corporate and institutional clients worldwide. Managed as a global business with regional oversight, GB&M operates a long-term relationship management approach to build a full understanding of clients' financial requirements and strategic goals.

Client coverage is centralised in Banking, which contains relationship managers organised by sector, region and country who work to understand client needs and provide holistic solutions by bringing together our broad array of product capabilities and utilising our extensive global network.

Our goal is to be a Top 5 bank to our priority clients. We strive to achieve this goal by assembling client coverage teams across our geographical network who work alongside product specialists in developing individually tailored solutions to meet client needs. Our client coverage and product teams are supported by a unique customer relationship management platform and comprehensive client planning process. Our teams utilise these platforms to better serve global client relationships, which facilitates our ability to connect clients to international growth opportunities.

#### **Global Private Banking**

##### **Products and services**

Drawing on the strength of HSBC and the most suitable products from the marketplace, we work with our clients to provide solutions to grow, manage and preserve wealth for today and for the future. Our products and services include Private Banking, Investment Management and Private Wealth Solutions.

##### **GPB products and services include:**

**Private Banking** services comprise multicurrency and fiduciary deposits, account services, and credit and specialist lending. GPB also accesses HSBC's universal banking capabilities to offer products and services such as credit cards, internet banking and corporate and investment banking solutions.

**Investment Management** comprises advisory and discretionary investment services and brokerage across asset classes. This includes a complete range of investment vehicles, portfolio management, securities services and alternatives.

**Private Wealth Solutions** comprise trusts and estate planning, designed to protect wealth and preserve it for future generations.

##### **Customers**

GPB serves the needs of high net worth and ultra-high net worth individuals and their families in our home and priority growth markets.

Within these broad segments, GPB has teams dedicated to serving HSBC's global priority clients, which include our most significant Group relationships, and other clients who benefit from our private banking proposition and services offered by CMB and GB&M. Our aim is to build and grow connectivity with these customers Group-wide, establishing strong relationships across all global businesses to meet clients' needs. We aim to build on HSBC's commercial banking heritage to be the leading private bank for high net worth business owners.

Relationship managers are the dedicated points of contact for our clients, tailoring services to meet their individual needs. They develop a thorough understanding of their clients' including their family, business, lifestyle and ambitions and introduce them to specialists equipped to help build the best financial strategy. Specialists include:

investment advisers, who discuss investment ideas in line with a client's investment and risk profile;

credit advisers, who provide expertise in complex liquidity and lending requirements; and

wealth planners, who have the knowledge and expertise to manage wealth now and for future generations.

The use of digital platforms continues to grow in line with strong demand from self-directed clients. These platforms enable clients to access account information, investment research and online transactional capabilities directly. We continue to invest in digital systems to better meet clients' evolving expectations and needs.

## Employees

**Successfully enhancing a values-led high performance culture in HSBC is critical to implementing Global Standards sustainably. We continue to focus on embedding HSBC Values in every decision and interaction between colleagues and with customers.**

We aim to attract, retain and motivate the very best people, and our remuneration policy supports this endeavour.

We actively manage succession planning by defining the capabilities we need and complement this by identifying talented individuals and ensuring they are provided with appropriate career and development opportunities to fulfil their potential in HSBC.

We provide training and development opportunities to enable employees to acquire the technical and leadership skills needed to enhance their careers.

We are committed to a diverse and inclusive culture reflective of our customer base.

We encourage employees to engage in the local communities in which they work.

At the end of 2014 we had a total workforce of 266,000 full-time and part-time employees compared with 263,000 at the end of 2013 and 270,000 at the end of 2012. Our main centres of employment were as follows (approximate numbers):

HSBC HOLDINGS PLC



## **Table of Contents**

### **Strategic Report** (continued)

#### **Profile of leadership**

At the date of this Report, the Executive Management of HSBC consists of four Executive Directors, 11 Group Managing Directors and 60 Group General Managers. Of these, 13 (17%) are female. This leadership team is based in 17 different countries and comprises 13 different nationalities. 71% have served with HSBC for more than 10 years and the total average tenure is 20 years.

HSBC has 13 non-executive Directors.

#### **Employment proposition**

##### **HSBC Values**

In 2014, education on HSBC Values continued for all levels of employees through induction and other training programmes that covered relevant technical, management and leadership skills. We require a high behavioural standard from all our employees, and our focus on values and courageous integrity continues to be instilled at every level in the Group. For example, our employee induction programme has been refreshed to further reinforce courageous integrity and meeting the needs of our customers. Also, an assessment of adherence to our values and supporting behaviours has been formalised as part of our performance appraisal process for all employees. In 2014, some 145,000 employees received values training in addition to 135,000 employees in 2013. A further 100,000 employees are expected to receive this training in 2015. A number of employees left the Group for breaching our values.

##### **Employee development**

The development of employees is essential if our businesses and operations are to strengthen and prosper. We take a systematic approach to identifying, developing and deploying talented employees to ensure we have a robust supply of high calibre individuals with the values, skills and experience for current and future senior management positions.

We keep our approach to training current and under constant review in order to improve the quality of our curricula and ensure employees are equipped with the technical and leadership skills to operate in a global organisation. We are standardising our training to help employees provide a consistently high quality experience for customers in all our markets and support the mitigation of current and emerging risks and the Global Standards programme.

##### **Employee engagement**

Strong employee engagement leads to positive commercial outcomes and underpins improved business performance, increased customer satisfaction, higher productivity, talent retention and reduced absenteeism.

We assess our employees' engagement through our Global People Surveys, which were held annually from 2007 to 2011 and biennially thereafter. The latest Survey, in 2013, focused on supporting a values-led high performance culture by assessing if our employees were engaged in the Group's purpose and felt able to deliver on our ambition to become the world's leading international bank.

Our employees' engagement continues to be positive when compared with the financial services industry and sector best-in-class benchmark. The overall engagement score in 2013 was 68%, which was four percentage points ahead of the financial services industry norm and eight points behind the best-in-class benchmark. Strong scores were registered in risk awareness (81% and nine points above best-in-class benchmark), leadership capability (67%) and living the HSBC Values (77%). Employee development significantly improved from six points below best-in-class in 2011 to three points above in 2013. Aspects that required attention included pride and advocacy, which were 12 and 13 points, respectively, below best in class norms and had fallen from 2011 levels. The next Global People Survey will be conducted in 2015.

HSBC also conducts a regular survey, Snapshot, which is sent to one quarter of our employees every three months. Insights from Snapshot provide a timely indication of employee sentiment towards the organisation, including signifiers of engagement. As at the end of September 2014, the favourable responses to selected questions were: support for HSBC's strategy, 81%; intend to still be working at HSBC in three years' time, 74%; pride in working for HSBC, 79%; and willingness to recommend HSBC to other senior professionals as a great place to further their career, 68%. Aspects for further attention include helping employees see the positive effects of HSBC's strategic priorities, 62%.

### Succession planning

Our talent strategy aims to ensure that high-quality candidates are available to fill key positions and meet business needs across all areas of the Group. We directly align succession planning with talent management, individual development and career planning. The succession plan defines the number, distribution, types of roles and capabilities needed by HSBC, and talented individuals are then aligned to these roles. This approach in turn defines the individual's career path and development plan. In 2014, we assessed 104 senior employees with the potential to become leaders and determined their career development needs. Potential successors must demonstrate an understanding of our Global Standards and exemplify HSBC Values.

Our talent strategy supports our aspirations in emerging markets, where in 2014 the representation of those defined as talent was 34%. We closely monitor local nationals identified as short-term and medium-term successors to key leadership roles so as to improve the proportion of local nationals in senior management over the medium term.

### Diversity and inclusion

HSBC is committed to a diverse and inclusive culture where employees can be confident their views are encouraged, their concerns are attended to, they work in an environment where bias, discrimination and harassment on any matter (including gender, age, ethnicity, religion, sexuality and disability) are not tolerated, and advancement is based on merit. Our diversity helps us support our increasingly diverse customer base and acquire, develop and retain a secure supply of skilled and committed employees.

Oversight of our diversity and inclusion agenda resides with senior executives on the Group Diversity Committee, complemented by a number of subsidiary People/Diversity Committees. We have over 55 employee network groups representing gender, ethnicity, age, sexuality, disability, religion, culture, working parents, health and community volunteering. These groups are instrumental in driving an inclusive culture and maintaining effective dialogue between management and employees.



**Table of Contents****Strategic Report** (continued)**Gender balance**

An area of continued focus is gender representation, particularly at senior levels of our organisation. We are addressing bias in hiring, promotions and talent identification, expanding mentoring and sponsorship, introducing better support for returning parents and increasing flexible working opportunities.

The gender balance for HSBC Directors and employees at 31 December 2014 was as follows:

*Gender balance*

	Headcount		
	Male	Female	Total
Executive Directors	4		4
Non-executive Directors	6	6	12
Directors	10	6	16
Senior employees	6,719	2,076	8,795
Other employees	120,496	136,966	257,462
<b>Total</b>	<b>127,225</b>	<b>139,048</b>	<b>266,273</b>
	%		
	Male	Female	Total
Executive Directors	100		100
Non-executive Directors	50.0	50.0	100
Directors	62.5	37.5	100
Senior employees	76.4	23.6	100
Other employees	46.8	53.2	100
<b>Total</b>	<b>47.8</b>	<b>52.2</b>	<b>100</b>

Overall, Group-wide female representation was 52.2% at 31 December 2014, largely unchanged on 2013. Female representation at senior levels rose from 22.7% in 2013 to 23.6% in 2014, and our target is to improve this to 25% by 2015. The proportion of females in our talent pipeline improved from 32.2% in 2013 to 34.0% in December 2014 and female representation on the GMB was 20% (three out of fifteen) in December 2014.

The average age of our employees was 36.2 years and average tenure was 8.5 years.

**Unconscious bias**

It is recognised that social behaviour may be driven by stereotypes that operate automatically and therefore unconsciously. These stereotypes can lead to a less inclusive environment. We are addressing this by incorporating inclusive behaviours in our processes and continue to deliver unconscious bias training to 8,700 managers and 18,500 employees in 2014 (8,300 managers and 50,000 employees in 2013).

In 2015, our diversity and inclusion priorities will continue to address unconscious bias through targeted education, encourage the career development of diverse talent with a continued emphasis on gender and local nationals and extend inclusion to cover wider aspects of diversity, for example, sexual orientation, ethnicity and disability. We continue to enhance a bias-free approach to performance management and improve internal and external candidate lists, connecting and utilising our Employee Resource Network Groups globally and maintaining a consistent global framework of governance and sponsorship to drive a diverse and inclusive culture throughout the Group.

### **Health, welfare and safety**

We regard the physical and psychological health, welfare and safety of our people as being of the utmost importance. We recently introduced a global occupational health framework which requires the proactive management of employee welfare and encourages the sharing of best practice across the Group. Between August 2012 and the end of 2014, 96% of assigned HSBC employees carried out our bi-annual online health and safety training.

We run a number of employee assistance programmes tailored to local requirements. Skilled professional counsellors are available on free phone lines 24 hours a day and seven days a week to help employees manage personal or work-related problems that create stress and affect their work. Free face-to-face counselling is also provided, as is support for partners and dependents. Programmes are offered in the UK, Hong Kong, North America and India.

### **Whistleblowing**

HSBC operates a global Compliance disclosure line (telephone and email) which is available to allow employees to make disclosures when the normal channels for airing grievances or concerns are unavailable or inappropriate. The Compliance disclosure line is available to capture employee concerns on a number of matters, including breaches of law or regulation, allegations of bribery and corruption, failure to comply with Group policies, suspicions of money laundering, breaches of internal controls and fraud or deliberate error in the financial records of any Group company. Global Regulatory Compliance is responsible for the operation of the Compliance disclosure line and the handling of disclosure cases. Cases are reviewed and referred for appropriate investigation. Whistleblowing cases may also be raised directly with senior executives, line managers, Human Resources and Security and Fraud.

Additional local whistleblowing lines are in place in several countries, operated by Security and Fraud, Human Resources and Regulatory Compliance. Disclosures made on the local whistleblowing lines are escalated to Global Regulatory Compliance or Financial Crime Compliance. Global Regulatory Compliance also monitors an external email address for complaints regarding accounting and internal financial controls or auditing matters ([accountingdisclosures@hsbc.com](mailto:accountingdisclosures@hsbc.com) highlighted under Investor Relations and Governance on [www.hsbc.com](http://www.hsbc.com)). Cases received are escalated to the Group Chief Accounting Officer, Group Finance Director or Group Chief Executive as appropriate.

HSBC's policies and procedures for capturing and responding to whistleblowing disclosures relating to accounting or auditing matters are overseen by the Group Audit Committee. Those relating to other whistleblowing disclosures are overseen by the Conduct & Values Committee.

Disclosures and actions taken are reported on a periodic basis to the Conduct & Values Committee, Group Audit Committee and the Financial System Vulnerabilities Committee in respect of matters relating to financial crime compliance.



## **Table of Contents**

### **Strategic Report** (continued)

#### **Risk overview**

#### **All our activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks.**

As a provider of banking and financial services, we actively manage risk as a core part of our day-to-day activities. We employ a risk management framework at all levels of the organisation, underpinned by a strong risk culture and reinforced by HSBC Values and our Global Standards. It ensures that our risk profile remains conservative and aligned to our risk appetite, which describes the type and quantum of risk we are willing to accept in achieving our strategic objectives.

#### **Risk and our strategic priorities**

The Group's three strategic priorities are reflected in our management of risk.

**Grow the business and dividends** we ensure risk is maintained at an acceptable and appropriate level while creating value and generating profits.

**Implement Global Standards** we are transforming how we detect, deter and protect against financial crime through the deployment of Global Standards, which govern how we do business and with whom.

**Streamline processes and procedures** our disposal programme has made HSBC easier to manage and control. By focusing on streamlining our processes and procedures, we are making HSBC less complex and

complicated to operate, creating capacity for growth.

*Our business and operating models are described on page 12. For further information on Global Standards, see page 26.*

#### **Risk in 2014**

Concerns remained during 2014 over the sustainability of economic growth in both developed and emerging markets, while geopolitical tensions rose or remained high in many parts of the world.

We continued to sustain a conservative risk profile based on our core philosophy of maintaining balance sheet, liquidity and capital strength by reducing exposure to the most likely areas of stress:

we managed selectively our exposures to sovereign debt and bank counterparties to ensure that the overall quality of the portfolio remained strong;

we regularly assessed higher risk countries and sectors and adjusted our risk appetite, limits and exposures accordingly;

we use stress testing, both internal and regulatory programmes, to assess vulnerabilities and proactively adjust our portfolios, where required;

we continued to reposition and exit certain portfolios through our six filters process (see page 12) and our focus on certain products or customer segments;

we made our client selection filters more robust in managing the risk of financial crime; and

we mitigated risks, for example reputational and operational, when they were forecast to exceed our risk appetite. The diversification of our lending portfolio across global businesses and geographical regions, together with our broad range of products, ensured that we were not overly dependent on a limited number of countries or markets to generate income and growth.

We monitored a range of key risk metrics in 2014 as part of our risk appetite process, supported by a limit and control framework.

*Risk appetite is discussed on page 25.*

*Our approach to stress testing is discussed on page 117 and regulatory stress testing programmes on page 125.*

#### **Risks incurred in our business activities**

Our principal banking risks are credit risk, liquidity and funding risks, market risk, operational risk, compliance risk, fiduciary risk, reputational risk, pension risk and sustainability risk. We also incur insurance risk.

The chart overleaf provides a high level guide to how our business activities are reflected in our risk measures and in the Group's balance sheet. The third-party assets and liabilities indicate the contribution each business makes to the balance sheet, while RWAs illustrate the relative size of the risks incurred in respect of each business.

*For a description of our principal risks, see page 114.*

HSBC HOLDINGS PLC



## **Table of Contents**

### **Strategic Report** (continued)

*Exposure to risks arising from the business activities of global businesses*

*For footnote, see page 39.*

*For further information on credit risk, see page 127; capital and risk-weighted assets, see page 238; market risk, including value at risk, see page 175; and operational risk see page 186.*

### **Top and emerging risks**

Identifying and monitoring top and emerging risks are integral to our approach to risk management.

We define a **top risk** as being a current, emerged risk which has arisen across any of our risk categories, global businesses or regions and has the potential to have a material impact on our financial results or our reputation and the sustainability of our long-term business model, and which may form and crystallise within a one-year time horizon. We consider an **emerging risk** to be one with potentially significant but uncertain outcomes which may form and crystallise beyond a year, in the event of which it could have a material effect on our ability to achieve our long-term strategy.

Our top and emerging risk framework enables us to identify and manage current and forward-looking risks to ensure our risk appetite remains appropriate. The ongoing

assessment of our top and emerging risks is informed by a comprehensive suite of risk factors which may result in our risk appetite being revised.

During 2014, senior management paid particular attention to a number of top and emerging risks. Our current ones are summarised overleaf.

We made a number of changes to our top and emerging risks during 2014 to reflect our assessment of their effect on HSBC. **Macroeconomic risks arising from an emerging market slowdown** was replaced by **Economic outlook and government intervention** as developed economies demonstrated signs of stress in the second half of 2014. **Third party risk management** was identified as an emerging risk due to the risks associated with the use of third-party service providers, which may be less transparent and more challenging to manage or influence. While **People risk** is inherent

within a number of our top and emerging risks, it has now been disclosed as a standalone risk, as the risks in this area continue to heighten.

When the top and emerging risks listed below resulted in our risk appetite being exceeded, or had the potential to exceed our risk appetite, we took steps to mitigate them, including reducing our exposure to areas of stress. Given the impact on the Group of breaching the US Deferred Prosecution Agreement ( US DPA ), significant senior management attention was given to tracking and monitoring our compliance with its requirements and improving policies, processes and controls to help minimise the risk of a breach.

*For a detailed account of these risks see page 118 and for a summary of our risk factors, see page 113.*

HSBC HOLDINGS PLC

**Table of Contents****Strategic Report** (continued)**Top and emerging risks** /

Risk	Description	Mitigants
<b>Macroeconomic and geopolitical risk</b>		
Economic outlook and government intervention	Weak economic growth in both developed and emerging market countries could adversely affect global trade and capital flows and our profits from operations in those countries.	We closely monitor economic developments in key markets and appropriate action is taken as circumstances evolve.
Increased geopolitical risk	Our operations are exposed to risks arising from political instability and civil unrest in a number of countries, which may have a wider effect on regional stability and regional and global economies.	We monitor the geopolitical and economic outlook, particularly in countries where we have material exposures and/or a physical presence.
<b>Macro-prudential, regulatory and legal risks to our business model</b>		
Regulatory developments affecting our business model and Group profitability	Governments and regulators continue to develop policies which may impose new requirements, particularly in the areas of capital and liquidity management and business structure.	We engage closely with governments and regulators in the countries in which we operate to help ensure that the new requirements are considered properly.
Regulatory investigations, fines, sanctions, commitments	Financial service providers are at risk of regulatory sanctions or fines	Programmes to enhance the management of conduct are

<p>and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand</p>	<p>related to conduct of business and financial crime.</p>	<p>progressing in all global businesses and functions.</p>
<p>Dispute risk</p>	<p>Breach of the US DPA may allow the US authorities to prosecute HSBC with respect to matters covered thereunder.</p> <p>HSBC is party to legal proceedings arising out of its normal business operations which could give rise to potential financial loss and significant reputational damage.</p>	<p>We continue to take steps to address the requirements of the US DPA and other consent orders in consultation with the relevant regulatory agencies.</p> <p>We identify and monitor emerging regulatory and judicial trends.</p> <p>We are enhancing our financial crime and regulatory compliance controls and resources.</p>

**Risks related to our business operations, governance and internal control systems**

<p>Heightened execution risk</p>	<p>The complexity of projects to meet regulatory demands and risks arising from business and portfolio disposals may affect our ability to execute our strategy.</p>	<p>We have strengthened our prioritisation and governance processes for significant projects.</p>
<p>People risk</p>	<p>Significant demands are being placed on the human capital of the Group due to the extent of the regulatory reform agenda.</p>	<p>We have reviewed our remuneration policy to ensure we can remain competitive and retain our key talent and continue to increase the level of specialist resources in key areas.</p>
<p>Third-party risk management</p>	<p>Risks arising from the use of third-party service providers may be less transparent and more challenging to manage or influence.</p>	<p>We are strengthening our risk management processes and procedures in relation to the use and monitoring of third-party service providers.</p>
<p>Internet crime and fraud</p>	<p>HSBC is increasingly exposed to fraudulent and criminal activities as a result of increased usage of internet and mobile channels.</p>	<p>We continually assess these threats as they evolve and adapt our controls and defences to mitigate them.</p>
<p>Information security risk</p>		

	<p>HSBC and other multinational organisations continue to be the targets of cyber attacks.</p>	<p>We have invested significantly in staff training and enhanced multi-layered controls to protect our information and technical infrastructure.</p>
Data management	<p>New regulatory requirements necessitate more frequent and granular data submissions, which must be produced on a consistent, accurate and timely basis.</p>	<p>Our Data Strategy Board is driving consistent data aggregation, reporting and management across the Group.</p>
Model risk	<p>Adverse consequences could result from decisions based on incorrect model outputs or from models that are poorly developed, implemented or used.</p>	<p>Model development, usage and validation are subject to governance and independent review.</p>

HSBC HOLDINGS PLC

**Table of Contents**

**Strategic Report** (continued)

**How we manage risk**

Managing risk effectively is fundamental to the delivery of our strategic priorities.

Our enterprise-wide risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their

interactions. It also ensures that we have a robust and consistent approach to risk management at all levels of the organisation and across all risk types.

This framework is underpinned by a strong risk culture, which is instrumental in aligning the behaviours of individuals with the

Group's attitude to assuming and managing risk and ensuring that our risk profile remains in line with our risk appetite and strategy. It is reinforced by the HSBC Values and our Global Standards.

Our approach to managing risk is summarised below.

*Driving our risk culture*

HSBC HOLDINGS PLC

## Table of Contents

### **Strategic Report** (continued)

#### **Risk appetite**

The Group's risk appetite statement ( RAS ) is a key component in the management of risk. It describes the types and quantum of risks that we are willing to accept in achieving our medium and long-term strategic objectives. The RAS is approved by the Board on the advice of the Group Risk Committee.

Our risk appetite is established and monitored via the Group risk appetite framework, which provides a globally consistent and structured approach to the management, measurement and control of risk in accordance with our core risk principles. The framework outlines the processes, policies, metrics and governance bodies and how to address risk appetite as part of day-to-day business and risk management activities.

The RAS guides the annual planning process by defining the desired forward-looking risk profile of the Group in achieving our strategic objectives and plays an important role in our six filters process. Our risk appetite may be revised in response to our assessment of the top and emerging risks we have identified.

Quantitative and qualitative metrics are assigned to a number of key categories including returns, capital, liquidity and funding, securitisations, cost of risk and intra-Group lending, risk categories such as credit, market and operational risk, risk diversification and concentration, and financial crime compliance. These measures are reviewed annually for continued relevance.

Measurement against the metrics:

guides underlying business activity, ensuring it is aligned to risk appetite statements;

enables the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles;

allows the business decisions needed to mitigate risk to be promptly identified; and

informs risk-adjusted remuneration.

Risk appetite is embedded in day-to-day risk management decisions through the use of risk tolerances and limits for material risk types. This ensures that our risk profile remains aligned with our risk appetite, balancing risk and returns.

Global businesses and geographical regions are required to align their risk appetite statements with the Group's.

Some of the core metrics that were measured, monitored and presented monthly to the Risk Management Meeting of the GMB during 2014 are tabulated below:

#### *Key risk appetite metrics*

	2014	
	target	actual
Common equity tier 1 ratio <sup>1</sup>	≥ 10%	11.1%
Return on equity	Trending upwards to 12-15% by 2016	7.3%
RoRWA <sup>13</sup>	2.2-2.6%	1.5%
Cost efficiency ratio	Mid-50s	67.3%
Advances to customer accounts ratio	Below 90%	72.2%
Cost of risk (loan impairment charges)	Below 15% of operating income	5.4%

For footnotes, see page 39.

In the early part of 2014, we undertook our annual review of our risk appetite statement. It was approved by the Risk Management Meeting of the GMB in January 2014 and the HSBC Holdings Board in February 2014. The core aspects of the RAS were incorporated into the 2014 scorecards for the Executive Directors, as set out on page 405 of the *Annual Report and Accounts 2013*.

We also strengthened the Group's RAS in 2014 by incorporating into it measures related to the core financial crime compliance principles of deterrence, detection and protection.

*Targets for 2015 are discussed on page 32.*

*For details of requirements under CRD IV, see page 239.*

### How risk affects our performance

The management of risk is an integral part of all our activities. Risk measures our exposure to uncertainty and the consequent variability of return.

Credit metrics in our retail portfolio benefited from the continued sale of non-strategic portfolios, an improved economic environment across many markets and growth in Asia and in the core business in the US, while our wholesale portfolios remained broadly stable with an overall favourable change in key impairment metrics. Loan impairment charges fell for reasons outlined on page 29.

Operational losses rose, driven by UK customer redress programme charges and settlements relating to legal and regulatory matters. There are many factors which could affect estimated liabilities with respect to legal and regulatory matters and there remains a high degree of uncertainty as to the eventual cost of fines, penalties and redress for these matters.

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of our normal business operations. Our provisions for legal proceedings and regulatory matters and for customer



remediation at 31 December 2014 totalled US\$4.0bn.

The reported results of HSBC reflect the choice of accounting policies, assumptions and estimates that underlie the preparation of our consolidated financial statements and reflect our assessment of the financial impact of risks affecting the Group.

*For a description of material legal proceedings and regulatory matters, see Note 40 on the Financial Statements on page 446.*

*Provisions for legal proceedings and regulatory matters and for customer remediation are disclosed in Note 29 on the Financial Statements on page 420.*

*For details of operational losses, see page 188.*

*For details of our critical accounting estimates and judgements, see page 62.*

HSBC HOLDINGS PLC

**Table of Contents**

**Strategic Report** (continued)

**We previously defined three interconnected and equally weighted priorities for 2014 to 2016 to help us deliver our strategy:**

grow the business and dividends;

implement Global Standards; and

streamline processes and procedures.

Each priority is complementary and underpinned by initiatives within our day-to-day business. Together, they create value for our customers and shareholders and contribute to the long-term sustainability of HSBC.

In the process, we shall maintain a robust, resilient and environmentally sustainable business in which our customers can have confidence, our employees can take pride and our communities can trust.

**Grow the business and dividends**

**In growing the business and dividends, our targets are to grow risk-weighted assets in line with our organic investment criteria, progressively grow dividends, while reducing the effect of legacy and non-strategic activities on our profit and RWAs.**

Our strategy is to take advantage of the continuing growth of international trade and capital flows, and wealth creation, particularly in Asia, the Middle East and Latin America. We aim to achieve growth by leveraging our international network and client franchise to improve HSBC's market position in products aligned to our strategy.

To facilitate this growth, we recycle RWAs from low into high performing businesses within our risk appetite.

In 2014, we launched a number of investment priorities to capitalise on our global network and accelerate organic growth:

**Global Trade and Receivables Finance:** We are investing in our sales and product capabilities, particularly for high growth products and trade corridors, and expanding in trade hubs as a means of reinforcing HSBC's leading position in trade.

**Payments and Cash Management:** We aim to deliver improved client coverage and products via investments in better sales coverage and customer proposition and mobile enhancements.

**Foreign Exchange:** We aim to improve our services to clients and efficiency by improving our electronic trading platforms and capabilities.

**Renminbi:** Building on our market-leading position, we are investing to roll out our renminbi servicing capabilities internationally, with the aim of capturing a larger share of offshore renminbi foreign exchange and capital markets opportunities.

Industry awards and market share gains have validated our strategy. Our market shares in core international connectivity products such as Payments and Cash Management, Global Trade and Receivables Finance and Foreign Exchange have all improved consistently over the past three years. For three consecutive years, including 2014, HSBC has been voted the top global cash manager for corporate and financial institutions in the *Euromoney* Cash Management survey. In the same survey, HSBC was voted best global cash manager for non-financial institutions for a second consecutive year in 2014. We have also been voted the Best Overall for Products and Services by *Asiamoney* in its Offshore Renminbi Services survey every year since the survey's inception in 2012.

We aim to continue investing in key growth markets and align global resources to city clusters with fast-growing international revenue pools:

**UK and Hong Kong as our home markets:** Our goal is to strengthen and develop our home market position in key products, such as mortgages and personal lending.

**China:** Mainland China continues to be of strategic significance for HSBC and presents a structural long-term growth opportunity. We therefore continue to invest in organic growth, particularly in Guangdong and other economically important regions. We strive to invest and be the first to capture opportunities that may arise from regulatory changes such as the introduction of the Shanghai Free-Trade Zone.

**US and Germany:** We continue to improve our position in the world's largest economy and in Europe's leading trade nation through the expansion of our corporate franchise. In 2014, we broadened our customer base by enhancing our products, widening our geographical coverage and adjusting our risk appetite. International revenues increased through deeper relationships with customers and developing cross-business opportunities. Our universal banking model enables us to generate revenues across global businesses. In 2014, cross-business collaboration revenues grew in all of our identified opportunities, except for Markets revenue from CMB customers primarily due to lower foreign exchange volatility. Approximately half of the total collaboration revenues for the year came from Markets and Capital Financing products provided to CMB customers. In GBP, net new money resulting from cross-business client referrals doubled from 2013.

## Implement Global Standards

**At HSBC, we are adopting the highest or most effective financial crime controls and deploying them everywhere we operate.**

Two new global policies set out these controls for anti-money laundering (AML) and sanctions. They are our Global Standards.

In line with our ambition to be recognised as the world's leading international bank, we aspire to set the industry standard for knowing our customers and detecting, deterring and protecting against financial crime. Delivering on this means introducing a more consistent, comprehensive approach to managing financial crime risk – from understanding

more about our customers, what they do and where and why they do it, to ensuring their banking activity matches what we would expect it to be.

We aim to apply our financial crime risk standards throughout the lifetime of our customer relationships: from selecting and onboarding customers to managing our ongoing relationships and monitoring and assessing the changing risk landscape in the bank.

Our new global AML policy is designed to stop criminals laundering money through HSBC. It sets out global requirements for carrying out customer due diligence, monitoring transactions and escalating concerns about suspicious activity.

HSBC HOLDINGS PLC

## **Table of Contents**

### **Strategic Report** (continued)

Our new global sanctions policy aims to ensure that we comply with local sanctions-related laws and regulations in countries where we operate, as well as with global sanctions imposed by the UN Security Council, European Union, US, UK and Hong Kong governments.

In many cases, our policy extends beyond what we are legally required to do, reflecting the fact that HSBC has no appetite for business with illicit actors.

We expect our Global Standards to underpin our business practices now and in the future, and to provide a source of competitive advantage. Global Standards are expected to allow us to:

strengthen our response to the ongoing threat of financial crime;

make consistent and therefore simplify the ways by which we monitor and enforce high standards at HSBC;

strengthen policies and processes that govern how we do business and with whom; and

ensure that we consistently apply our HSBC Values.

### **Implementing Global Standards**

Each global business and Financial Crime Compliance have identified where and how they need to enhance existing procedures to meet the Global Standards. They are now in the process of deploying the systems, processes, training and support to put the enhanced procedures into practice in each country of operation.

This is being done in two stages:

delivering policy components with limited infrastructure dependency according to an accelerated timeline; and

implementing, in parallel, long-term strategic control enhancements and associated enhancements to infrastructure.

During 2014, we made material progress in a number of areas, including:

global implementation of customer selection policies and governance;

first deployment of enhanced customer due diligence procedures for gathering and verifying customer information;

integration of global sanctions screening lists into our customer and transaction screening tools;

targeted training for the highest risk roles and all-employee campaigns to raise awareness of financial crime risk and encourage escalation;

global roll out of financial intelligence and investigations units to follow up on escalations and alerts, and identify emerging trends and issues; and

the establishment of global procedures and governance to exit business that is outside our financial crime risk appetite.

### **Governance framework**

The global businesses and Financial Crime Compliance, supported by HSBC Technology and Services, are formally accountable for delivering business procedures, controls and the associated operating environment to implement our new policies within each global business and jurisdiction. This accountability is overseen by the Global Standards Execution Committee, which is under the chairmanship of the Group Chief Risk Officer and consists of the Chief Executive Officers of each global business and the Global Head of Financial Crime Compliance.

Correspondingly, and to promote closer integration with business as usual, a report on the implementation of Global Standards is a standing item at the Group's Risk Management Meeting. The Financial System Vulnerabilities Committee and the Board continue to receive regular reports on the Global Standards programme as part of their continued role in providing oversight.

### **Risk appetite**

Financial crime risk controls are a part of our everyday business and they are governed according to our global financial crime risk appetite statement. This aims to ensure sustainability in the long term. Our overarching appetite and approach to financial crime risk is that we will not tolerate operating without the systems and controls in place designed to detect and prevent financial crime and will not conduct business with individuals or entities we believe are engaged in illicit behaviour.

### **Enterprise-wide risk assessment**

We have conducted our second annual enterprise-wide assessment of our risks and controls related to sanctions and AML compliance. The outcome of this assessment has formed the basis for risk management planning, prioritisation and resource allocation for 2015.

### **The Monitor**

Under the agreements entered into with the US Department of Justice ( DoJ ), the UK FCA (formerly the Financial Services Authority ( FSA )) and the US Federal Reserve Board ( FRB ) in 2012, including the five-year Deferred Prosecution Agreement ( US DPA ), an independent compliance monitor ( the Monitor ) was appointed to evaluate our progress in fully implementing our obligations and produce regular assessments of the effectiveness of our Compliance function.

Michael Cherkasky began his work as the Monitor in July 2013, charged with evaluating and reporting upon the effectiveness of the Group's internal controls, policies and procedures as they relate to ongoing compliance with applicable AML, sanctions, terrorist financing and proliferation financing obligations, over a five-year period.

HSBC is continuing to take concerted action to remedy AML and sanctions compliance deficiencies and to implement Global Standards. HSBC is also working to implement the agreed recommendations flowing from the Monitor's 2013 review. We recognise we are only part way through a journey, being two years into our five-year US DPA. We look forward to maintaining a strong, collaborative relationship with the Monitor and his team.

HSBC HOLDINGS PLC

## **Table of Contents**

### **Strategic Report** (continued)

#### **Streamline processes and procedures**

#### **We continue to refine our operational processes, develop our global functions, implement consistent business models and streamline IT.**

Since 2011, we have changed how HSBC is managed by introducing a leaner reporting structure and establishing an operating model with global businesses and functions. These changes together with improvements in software development productivity, process optimisation and our property portfolio realised US\$5.7bn in sustainable savings, equivalent to US\$6.1bn on an annualised (run rate) basis. This exceeded our commitment to deliver US\$2.5–3.5bn of sustainable savings at the outset of the organisational effectiveness programme included in the first phase of our strategy.

Sustainable savings arise from the reduction or elimination of complexity, inefficiencies or unnecessary activities, and release capital that can be reinvested in growing our business as well as increase returns to shareholders.

The reorganisation of the Group into four global businesses and eleven global functions further allows us to run globally consistent operating models. This establishes the foundation for our next stage of streamlining.

Going forward, we aim to fund investments into growth and compliance and offset inflation through efficiency gains. This requires net cost reductions. This programme will be applied to:

improving the end-to-end optimisation of processes and servicing channels;

technology simplification, reducing the number of applications used across the Group; and

enhancing infrastructure, including optimising our real estate utilisation and the location where certain activities are carried out.

Streamlining is expected to be achieved through a combination of simplifying and globalising our processes, products, systems and operations. Simplifying involves identifying inefficiencies or excessive complexity and redesigning or rationalising processes to make them easier to understand and manage and more efficient. Globalising involves developing standard global processes and implementing them around the Group.

#### **Cost efficiency ratio**

Our cost efficiency ratio for 2014 was 67.3%, up from 59.6% in 2013. This change was driven by higher legal, regulatory and conduct settlement costs; inflationary pressures; continued investment in strategic initiatives; and a rise in the bank levy. Cost increases were partly offset by realised sustainable savings of US\$1.3bn.



**Financial performance**

**Performance reflected lower gains on disposals and the negative effect of other significant items.**

*Reported results*

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net interest income	<b>34,705</b>	35,539	37,672
Net fee income	<b>15,957</b>	16,434	16,430
Other income	<b>10,586</b>	12,672	14,228
Net operating income <sup>16</sup>	<b>61,248</b>	64,645	68,330
LICs <sup>15</sup>	<b>(3,851)</b>	(5,849)	(8,311)
Net operating income	<b>57,397</b>	58,796	60,019
Total operating expenses	<b>(41,249)</b>	(38,556)	(42,927)
Operating profit	<b>16,148</b>	20,240	17,092
Income from associates <sup>16</sup>	<b>2,532</b>	2,325	3,557
<b>Profit before tax</b>	<b>18,680</b>	22,565	20,649

*For footnotes, see page 39.*

Profit before tax of US\$18.7bn on a reported basis was US\$3.9bn or 17% lower than that achieved in 2013. This primarily reflected lower business disposal and reclassification gains and the negative effect, on both revenue and costs, of other significant items including fines, settlements, UK customer redress and associated provisions.

Reported net operating income before loan impairment charges and other credit risk provisions ( revenue ) of US\$61bn was US\$3.4bn or 5% lower than in 2013. In 2014 there were lower gains (net of losses) from disposals and reclassifications (2013 included a US\$1.1bn accounting gain arising from the reclassification of Industrial Bank Co. Limited ( Industrial Bank ) as a financial investment following its issue of additional share capital to third parties, and a US\$1.1bn gain on the sale of our operations in Panama). In addition, other significant items included adverse fair value movements on non-qualifying hedges of US\$0.5bn compared with favourable movements of US\$0.5bn in 2013, a US\$0.6bn provision arising from the ongoing review of compliance with the Consumer Credit Act in the UK as well as a net adverse movement on debit valuation adjustments on derivative contracts of US\$0.4bn. These factors were partially offset by favourable fair value

HSBC HOLDINGS PLC

---

**Table of Contents**

**Strategic Report** (continued)

movements of US\$0.4bn on our own debt designated at fair value, which resulted from changes in credit spreads, compared with adverse movements of US\$1.2bn in 2013 together with a US\$0.4bn gain on the sale of our shareholding in Bank of Shanghai in 2014.

Loan impairment charges and other credit risk provisions ( LICs ) of US\$3.9bn were US\$2.0bn or 34% lower than in 2013, notably in North America, Europe and Latin America.

Operating expenses of US\$41bn were US\$2.7bn or 7% higher than in 2013, primarily as a result of significant items which were US\$0.9bn higher than in 2013. These included settlements and provisions in connection with foreign exchange investigations of US\$1.2bn and a charge of US\$0.6bn in the US relating to a settlement agreement with the Federal Housing Finance Agency.

Income from associates of US\$2.5bn was US\$0.2bn or 9% higher than 2013, primarily reflecting the non-recurrence of an impairment charge of US\$106m on the investment in our banking associate in Vietnam in 2013.

The Board approved a 5% increase in the fourth interim dividend in respect of 2014 to US\$0.20 per share, US\$0.01 higher than the fourth interim dividend in respect of 2013. Total dividends in respect of 2014 were US\$9.6bn (US\$0.50 per share), US\$0.4bn higher than in 2013.

The transitional CET1 ratio of 10.9% was up from 10.8% at the end of 2013 and our end point basis of 11.1% was up from 10.9% at the end of 2013, as a result of continued capital generation and management actions offset by RWA growth, foreign exchange movements and regulatory changes.

**Adjusted performance**

*For further information on non-GAAP financial measures, see page 40 for adjusted and [www.hsbc.com](http://www.hsbc.com) for return on tangible equity.*

**From reported results to adjusted performance**

To arrive at adjusted performance:

we adjust for the year-on-year effects of foreign currency translation; and

we adjust for the effect of significant items.

Reconciliations of our reported results to an adjusted basis are set out on page 44.

On an adjusted basis, profit before tax of US\$23bn was broadly unchanged compared with 2013. Lower LICs, notably in North America, Europe and Latin

America, together with a marginal rise in revenue was largely offset by higher operating expenses.

The following commentary is on an adjusted basis.

**Revenue was broadly unchanged. Growth in CMB, notably in our home markets of Hong Kong and the UK, was offset by decreased revenue in RBWM, GB&M and GPB**

Revenue rose by US\$0.1bn to US\$62bn. Revenue increased in CMB following growth in average lending and deposit balances in Hong Kong, together with rising average deposit balances and wider lending spreads in the UK. Revenue also benefited from higher term lending fees in the UK.

These factors were mostly offset by lower revenue in RBWM, GB&M and GPB. In RBWM, it was primarily driven by the run-off of our US Consumer and Mortgage Lending ( CML ) portfolio with revenue in Principal RBWM broadly unchanged. In GB&M, revenue was lower due to the introduction of the funding fair value adjustment ( FFVA ) on certain derivative contracts which resulted in a charge of US\$263m, together with a decrease from our Foreign Exchange business, partly offset by an increase in Capital Financing. In GPB, revenue was down reflecting a managed reduction in client assets as we continued to reposition the business, and reduced market volatility.

**LICs fell in the majority of our regions, notably in North America, Europe and Latin America**

LICs were US\$1.8bn or 31% lower than in 2013, primarily in North America and mainly in RBWM, reflecting reduced levels of delinquency and new impaired loans in the CML portfolio, together with decreased lending balances from the continued portfolio run-off and loan sales. LICs were also lower in Europe, mainly reflecting a fall in individually assessed charges in the UK in CMB and GB&M, and higher net releases of credit risk provisions on available-for-sale asset-backed securities ( ABS s ) in GB&M in the UK. LICs were lower in Latin America too, primarily in Mexico and, to a lesser extent, in Brazil. In Mexico, the decrease in LICs mainly reflected lower individually assessed charges in CMB, while in Brazil LICs were lower in both RBWM and CMB, partly offset by an increase in GB&M.

### **Adjusted profit before tax**

(US\$bn)

### **Reported profit attributable to ordinary shareholders**

(US\$m)

### **Reported earnings per share**

(US\$)

**Return on tangible equity**

(%)

HSBC HOLDINGS PLC

29

## **Table of Contents**

### **Strategic Report** (continued)

**Operating expenses were higher, in part reflecting increases in Regulatory Programmes and Compliance costs and inflation, partly offset by further sustainable cost savings**

Operating expenses were US\$38bn, US\$2.2bn or 6% higher than in 2013. Regulatory Programmes and Compliance costs increased as a result of continued focus on Global Standards and the broader regulatory reform programme being implemented by the industry to build the necessary infrastructure to meet today's enhanced compliance standards.

Operating expenses also increased due to inflationary pressures, including wage inflation, primarily in Asia and Latin America, and an increase in the UK bank levy charge compared with 2013. We continued to invest in strategic initiatives in support of organically growing our business, primarily in CMB. We also increased expenditure on marketing and advertising to support revenue generating initiatives, primarily in RBWM.

These factors were partially offset by further sustainable cost savings in the year of US\$1.3bn, primarily by re-engineering certain of our back office processes.

The number of employees expressed in full-time equivalent numbers ( FTEs ) at the end of 2014 increased by 3,500 or 1%. The average number of FTEs was broadly unchanged as reductions through sustainable savings programmes were offset by the initiatives related to the Regulatory Programmes and Compliance and business growth.

**Income from associates rose, mainly in Asia and the Middle East and North Africa**

Income from associates increased, primarily reflecting higher contributions from Bank of Communications Co, Limited ( BoCom ) and The Saudi British Bank, principally reflecting balance sheet growth.

The effective tax rate was 21.3% compared with 21.1% in 2013.

*For more details of the Group's financial performance, see page 46.*

### **Balance sheet strength**

Total reported assets were US\$2.6 trillion, 1% lower than at 31 December 2013. On a constant currency basis, total assets were US\$85bn or 3% higher. Our balance sheet remained strong with a ratio of customer advances to customer accounts of 72%. This was a consequence of our business model and of our conservative risk appetite, which is based on funding the growth in customer loans with growth in customer accounts.

On a constant currency basis, loans and advances grew by US\$28bn and customer accounts increased by US\$47bn.

*For further information on the Balance Sheet, see page 57, and on the Group's liquidity and funding, see page 163.*

### **Total assets**

(US\$bn)

**Post-tax return on average total assets**

(%)

**Loans and advances to customers<sup>17</sup>**

(US\$bn)

**Customer accounts<sup>17</sup>**

(US\$bn)

**Ratio of customer advances to customer deposits<sup>17</sup>**

(%)

*For footnote, see page 39.*

HSBC HOLDINGS PLC

**Table of Contents****Strategic Report** (continued)**Capital strength**

Our approach to managing Group capital is designed to ensure that we exceed current regulatory requirements and are well placed to meet those expected in the future.

We monitor capital adequacy, *inter alia*, by using capital ratios, which measure capital relative to a regulatory assessment of risks taken, and the leverage ratio, which measures capital relative to exposure.

In June 2013, the European Commission published the final Regulation and Directive, known collectively as CRD IV, to give effect to the Basel III framework in the EU. This came into effect on 1 January 2014.

Under the new regime, common equity tier 1 ( CET1 ) represents the highest form of

eligible regulatory capital against which the capital strength of banks is measured. In 2014 we managed our capital position to meet an internal target ratio on a CET1 end point basis of greater than 10%. This has since been reviewed and, in 2015, we expect to manage Group capital to meet a medium-term target for return on equity of more than 10%. This is modelled on a CET1 ratio on an end point basis in the range of 12% to 13%.

**Leverage ratio**

The following table presents our estimated leverage ratio in accordance with PRA instructions. The numerator is calculated using the CRD IV end point tier 1 capital definition and the exposure measure is

calculated using the EU delegated act published in January 2015 (which is based on the Basel III 2014 revised definition).

*Estimated leverage ratio*

	2014
	US\$bn
<b>At 31 December</b>	
Tier 1 capital under CRD IV (end point)	142
Exposures after regulatory adjustment	2,953
Estimated leverage ratio (end point)	4.8%

*For further details of the leverage ratio, see page 251.*

*For further information on the Group's capital and our risk-weighted assets, see page 239.*

*Capital ratios and risk-weighted assets*

**CRD IV<sup>1</sup>**

<b>Common equity tier 1 ratio (transitional)</b>	<b>Total capital ratio (transitional)</b>	<b>Common equity tier 1 ratio (end point)</b>	<b>Risk-weighted assets ( RWA s)</b>
(%)	(%)	(%)	(US\$bn)

**Basel 2.5<sup>1</sup>**

<b>Core tier 1 ratio</b>	<b>Total capital ratio</b>	<b>Risk-weighted assets</b>
(%)	(%)	(US\$bn)

*For footnote, see page 39.*

HSBC HOLDINGS PLC



---

**Table of Contents**

**Strategic Report** (continued)

**Meeting our targets**

We set financial targets against which we measure our performance.

In 2011, we articulated our ambition to be the leading international bank and specified financial metrics against which we would measure performance through 2013. Targets were set under our understanding at the time of capital requirements and included a CET1 ratio of 9.5-10.5% under Basel III; return on equity ( ROE ) of 12-15%; and a cost efficiency ratio ( CER ) of 48-52% supported by US\$2.5-3.5bn in sustainable cost savings over three years. Over the period to 2013, we strengthened our capital position, realised US\$4.9bn in sustainable savings and increased dividend pay-outs to shareholders in line with targets.

In May 2013, we defined our strategic priorities for the period from 2014 to 2016 and revisited the financial metrics used to track performance. We continued to target an ROE of 12-15% and added a further target of US\$2-3bn in sustainable savings. To allow for investment in growth initiatives and to reflect the increasing requirements involved in operating as a global bank, we revised the CER target to the mid-50s, adding that revenues must grow faster than costs ( positive jaws ). We defined a target CET1 ratio, on an end point basis, as greater than 10% and continued to seek progressive dividends for shareholders. We also set a cap on our loans to deposits ratio of 90%.

During 2014, we achieved a CET1 ratio on an end point basis of 11.1% and declared US\$9.6bn of total dividends in respect of the year. We realised incremental sustainable savings of US\$1.3bn and maintained a loans-to-deposits ratio of 72%. The ROE of 7.3% and the CER of 67.3% fell short of our target.

**Changing regulatory and operating environment**

When we set our targets in 2011, we did so based on a CET1 ratio on an end point basis of greater than 10%. Whilst this factored in foreseeable capital requirements, it did not anticipate, and could not have anticipated, the full extent of capital commitments and additional costs asked of us in the years to come. These factors have included:

Progressively strengthening our capital levels in response to increasing capital requirements;

The stepped increase in costs due to the implementation of regulatory change and enhancing risk controls, notably around financial system integrity and conduct;

An increase in the bank levy;

The continuing low interest rate environment; and

The impact of significant items, notably the high level of fines, settlements, UK customer redress and associated provisions.

As a consequence, we are setting new targets that better reflect the present and ongoing operating environment.

From 2015, our return on equity target will therefore be replaced with a medium-term target of more than 10%. This is modelled on a CET1 ratio on an end point basis in the range of 12% to 13%.

At the same time, we are reaffirming our target of growing business revenues faster than operating expenses (on an adjusted basis).

We also remain committed to delivering a progressive dividend. The progression of dividends will be consistent with the growth of the overall profitability of the Group and is predicated on our continued ability to meet regulatory capital requirements.

We remain strongly capitalised, providing capacity for both organic growth and dividend return to shareholders.

### **Brand value**

**Maintenance of the HSBC brand and our overall reputation remains a priority for the Group.**

This is our fourth year of using the Brand Finance valuation method reported in *The Banker* magazine as our brand value benchmark. The Brand Finance methodology provides a comprehensive measure of the strength of the brand and its impact across all business lines and customer segments. It is wholly independent and is publicly reported. Our target is a top three position in the banking peer group and we have achieved this target with an overall value of US\$27.3bn

### **Pre-tax return on risk-weighted assets<sup>13</sup>**

(%)

### **Dividend payout ratio**

(%)

### **Brand value**

(US\$bn)

*For footnote, see page 39.*

(up 2% from 2014), placing us third. We maintain an AAA rating for our brand in this year's report.

In addition to the Brand Finance measure, we have reviewed our performance in the *Interbrand* Annual Best Global Brands report, published in September 2014. This showed HSBC as the top ranked banking brand with a valuation of US\$13.1bn (up from US\$12bn in 2013) and in second place when all financial services brands are considered.

HSBC HOLDINGS PLC

32

**Table of Contents****Strategic Report** (continued)

We believe this performance is driven by an underlying strong brand equity established in recent years and a consistent and active programme of activities in support of the brand throughout 2014.

**Economic contribution**

By running a sustainable business, HSBC is able to make a valuable contribution to the economy by paying dividends to our shareholders, salaries to our employees, payments to suppliers, and tax revenues to governments in the countries and territories where we operate. We also finance companies so that they, in turn, can create employment.

*HSBC's net tax paid*<sup>18</sup>

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
Tax on profits	<b>3.6</b>	4.7
Employer taxes	<b>1.6</b>	1.6
UK bank levy <sup>19</sup>	<b>1.0</b>	0.7
Irrecoverable value-added tax	<b>0.9</b>	0.8
Other duties and levies	<b>0.8</b>	0.8
<b>Year ended 31 December</b>	<b>7.9</b>	8.6

*For footnotes, see page 39.*

*Taxes collected for government*<sup>20</sup>

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
<b>Region</b>		
UK	<b>1.7</b>	1.5
Rest of Europe	<b>1.1</b>	1.3
Asia	<b>2.0</b>	1.5
North America	<b>1.0</b>	1.0
Latin America	<b>3.3</b>	3.5
<b>Year ended 31 December</b>	<b>9.1</b>	8.8

*For footnote, see page 39.*

*Distribution of economic benefits*

	2014	2013	2012
	US\$bn	US\$bn	US\$bn
Net cash tax outflow	7.9	8.6	9.3
Distributions to shareholders and non-controlling interests	10.6	10.2	8.7
Employee compensation and benefits	20.4	19.2	20.5
General administrative expenses including premises and procurement	18.6	17.1	20.0

*Pro-forma post-tax profit allocation*<sup>21</sup>

	2014	2013
	%	%
Retained earnings/capital	32	53
Dividends	53	35
Variable pay	15	12
<b>Year ended 31 December</b>	<b>100</b>	<b>100</b>

*For footnote, see page 39.***Market capitalisation and total shareholder return**

US\$0.50 ordinary shares  in issue	Market  capitalisation	Closing market price		
		London	Hong Kong	American Depository Share <sup>22</sup>
19,218m	US\$182bn	£6.09	HK\$74.0	US\$47.23
2013: 18,830m	2013: US\$207bn	2013: £6.62	2013: HK\$84.15	2013: US\$55.13
2012: 18,476m	2012: US\$194bn	2012: £6.47	2012: HK\$81.30	2012: US\$53.07
		Total shareholder return <sup>23</sup>		
		Over 1 year	Over 3 years	Over 5 years
<b>To 31 December 2014</b>		97	144	109
Benchmarks:		100	160	132

MSCI Bank<sup>24</sup>  
*For footnotes, see page 39.*

HSBC HOLDINGS PLC

## **Table of Contents**

### **Strategic Report** (continued)

#### **Remuneration**

##### **Our remuneration strategy rewards commercial success and compliance with our risk management framework.**

The quality of our people and their commitment to the Group are fundamental to our success. We therefore aim to attract, retain and motivate the very best people who are committed to a long-term career with HSBC in the long-term interests of shareholders.

##### **Employee remuneration**

Our remuneration strategy is designed to reward competitively the achievement of long-term sustainable performance. HSBC's reward package comprises four key elements of remuneration:

fixed pay;

benefits;

annual incentive; and

the Group Performance Share Plan ( GPSP ).

The governance of our remuneration principles and oversight of their implementation by the Group Remuneration Committee ensures what we pay our people is aligned to our business strategy and performance is judged not only on what is achieved over the short- and long-term but also, importantly, on how it is achieved, as we believe the latter contributes to the long-term sustainability of the business.

*Full details of our remuneration policy may be found under Remuneration Policy on our website (<http://www.hsbc.com/investor-relations/governance>).*

##### **Industry changes and key challenges**

New regulatory requirements such as the bonus cap have influenced how we pay our senior executives and those of our employees identified by the PRA as having a material impact on the institution's risk profile, being what are termed material risk takers ( MRTs ). This year, a new requirement has been introduced for firms to ensure that clawback (i.e. a firm's ability

to recoup paid and/or vested awards) can be applied to all variable pay awards granted on or after 1 January 2015 for a period of at least seven years from the date of award. These requirements present challenges for HSBC in ensuring that the total compensation package for our employees in all of the markets in which we operate around the world

remains competitive, in particular, relative to other banks not subject to these requirements.

Looking ahead to 2015/2016, further significant regulatory changes to executive remuneration are expected and it is possible that we will need to make changes to our remuneration policy in 2016. The number and volume of changes that have been and are being proposed hinders our ability to communicate with any certainty to our current and potential employees the remuneration policies and structures that would apply to them. It also contributes to a general misunderstanding about how our policies work and the effect of those policies on employee performance.

*For full details of industry changes and key challenges, see page 300.*

### Variable pay pool

The total variable pay pool for 2014 was US\$3.7bn, down from US\$3.9bn in 2013:

	Group 2014	2013
	US\$m	US\$m
Variable pay pool <sup>25</sup> total	<b>3,660</b>	3,920
as a percentage of pre-tax profit (pre-variable pay)	<b>16%</b>	15%
percentage of pool deferred	<b>14%</b>	18%

*For footnote, see page 39.*

The Group Remuneration Committee considers many factors in determining HSBC's variable pay pool, including the performance of the Group considered in the context of our risk appetite statement.

This ensures that the variable pay pool is shaped by risk considerations and by an integrated approach to business, risk and capital management which supports achievement of our strategic objectives.

The Group Remuneration Committee also takes into account Group profitability, capital strength, shareholder returns, the distribution of profits between capital, dividends and variable pay, the commercial requirement to remain market competitive and overall affordability.

*For full details of variable pay pool determination, see pages 309.*

### Relative importance of expenditure on pay

The following chart provides a breakdown of total staff pay relative to the amount paid out in dividends.

### Relative importance of expenditure on pay

(US\$m)



*For footnotes, see page 39.*

**Directors remuneration**

The remuneration policy for our executive and non-executive Directors was approved at the Annual General Meeting on 23 May 2014. The full policy is available in the Directors Remuneration Report in the *Annual Report and Accounts 2013*, a copy of which can be obtained by visiting the following website: <http://www.hsbc.com/investor-relations/financial-and-regulatory-reports>.

The single total figure for Directors remuneration required by Schedule 8 of the Large and Medium-Sized Companies (Accounts and Reports) Regulations 2008 is as follows:

HSBC HOLDINGS PLC

**Table of Contents****Strategic Report** (continued)*Executive Directors*

	Douglas Flint		Stuart Gulliver		Iain Mackay		Marc Moses	
	<b>2014</b>	2013	<b>2014</b>	2013	<b>2014</b>	2013	<b>2014</b>	2013
	<b>£000</b>	£000	<b>£000</b>	£000	<b>£000</b>	£000	<b>£000</b>	£000
Fixed pay								
Base salary	<b>1,500</b>	1,500	<b>1,250</b>	1,250	<b>700</b>	700	<b>700</b>	
Fixed pay allowance			<b>1,700</b>		<b>950</b>		<b>950</b>	
Pension	<b>750</b>	750	<b>625</b>	625	<b>350</b>	350	<b>350</b>	
	<b>2,250</b>	2,250	<b>3,575</b>	1,875	<b>2,000</b>	1,050	<b>2,000</b>	
Variable pay								
Annual incentive			<b>1,290</b>	1,833	<b>867</b>	1,074	<b>1,033</b>	
GPSP			<b>2,112</b>	3,667	<b>1,131</b>	2,148	<b>1,131</b>	
			<b>3,402</b>	5,500	<b>1,998</b>	3,222	<b>2,164</b>	
Total fixed and variable pay	<b>2,250</b>	2,250	<b>6,977</b>	7,375	<b>3,998</b>	4,272	<b>4,164</b>	
Benefits	<b>136</b>	48	<b>589</b>	591	<b>43</b>	33	<b>6</b>	
Non-taxable benefits	<b>105</b>	102	<b>53</b>	67	<b>28</b>	53	<b>33</b>	
Notional return on deferred cash	<b>41</b>	27			<b>11</b>	7	<b>36</b>	
<b>Total single figure of remuneration</b>	<b>2,532</b>	2,427	<b>7,619</b>	8,033	<b>4,080</b>	4,365	<b>4,239</b>	

Douglas Flint, as Group Chairman, is not eligible for an annual incentive but was eligible under the policy to receive a one-time GPSP award for 2014.

Marc Moses, the Group Chief Risk Officer, was appointed an executive Director with effect from 1 January 2014, reflecting the criticality of the Risk function to HSBC and his leadership of the function, and recognises

his personal contribution to the Group. His 2013 figures have not been disclosed.

*For full details of Directors remuneration, see page 307.*

## Remuneration policy going forward

Our remuneration policy was approved by shareholders at the 2014 Annual General

Meeting and will apply for performance year 2015. The table below summarises how each element of pay will be implemented in 2015.

## External reporting

The required remuneration disclosures for Directors, MRTs and highest paid employees in the Group are made in the Directors' Remuneration Report on pages 300 to 323.

Purpose and link to strategy	
Operation and planned changes to policy	
<b>Fixed pay</b>	
Base salary	<p>Base salary levels will remain unchanged from their 2014 levels as follows:</p> <p>Douglas Flint: £1,500,000</p> <p>Stuart Gulliver: £1,250,000</p> <p>Iain Mackay: £700,000</p> <p>Marc Moses: £700,000</p>
Fixed pay allowance <sup>28</sup>	<p>Fixed pay allowances will remain unchanged from their 2014 levels as follows:</p> <p>Douglas Flint: Nil</p> <p>Stuart Gulliver: £1,700,000</p> <p>Iain Mackay: £950,000</p> <p>Marc Moses: £950,000</p>
Pension	<p>Pension allowances to apply in 2015 as a percentage of base salary will remain unchanged as follows:</p> <p>Douglas Flint: 50%</p> <p>Stuart Gulliver: 50%</p> <p>Iain Mackay: 50%</p> <p>Marc Moses: 50%</p>
<b>Benefits</b>	
Benefits	No changes are proposed to the benefits package for 2015.

**Variable pay**

Annual incentive<sup>28</sup>

GPSP

No changes are proposed to the annual incentive.

No changes are proposed to the GPSP.

*For footnote, see page 39.*

HSBC HOLDINGS PLC

## **Table of Contents**

### **Strategic Report** (continued)

#### **Sustainability**

##### **Sustainability underpins our strategic priorities and enables us to fulfil our purpose as an international bank.**

At HSBC, how we do business is as important as what we do. For us, sustainability means building our business for the long term by balancing social, environmental and economic considerations in the decisions we make. This enables us to help businesses thrive and contribute to the health and growth of communities.

##### **Approach to corporate sustainability**

Corporate sustainability is governed by the Conduct & Values Committee, a sub-committee of the Board which oversees and advises on a range of issues including adherence to HSBC's values and ensuring we respond to the changing expectations of society and key stakeholders.

Sustainability priorities are set and programmes are led by the Global Corporate Sustainability function. HSBC's country operations, global functions and global businesses work together to ensure sustainability is embedded into the Group's business and operations and properly implemented. Executives within the Risk and the HSBC Technology and Services functions hold a specific remit to deliver aspects of the sustainability programme for the Group.

Our sustainability programme focuses on three areas: sustainable finance; sustainable operations, and sustainable communities.

##### **Sustainable finance**

We anticipate and manage the risks and opportunities associated with a changing climate, environment and economy. In a rapidly changing world, we must ensure our business anticipates and prepares for shifts in environmental priorities and societal expectations.

##### **Sustainability risk framework**

We manage the risk that the financial services which we provide to customers may have unacceptable effects on people or the environment. Sustainability risk can also lead to commercial risk for customers, credit risk for HSBC and significant reputational risk.

For over 10 years we have been working with our business customers to help them

understand and manage their environmental and social impact in relation to sensitive sectors and themes. We assess and support customers using our own policies which we regularly review and refine. We have policies covering agricultural commodities, chemicals, defence, energy, forestry, freshwater infrastructure, mining and metals, World Heritage Sites and Ramsar Wetlands. We also apply the Equator Principles.

We welcome constructive feedback from non-governmental organisations and campaign groups and regularly discuss matters of shared interest with them.

Our sustainability risk framework is based on robust policies, formal processes and well-trained, empowered people.

In 2014, we trained risk and relationship managers in sustainability risk, focusing on the recent policy updates and revised processes. Our designated Sustainability Risk Managers provided training to executives from Risk, GB&M and CMB in every geographical region.

We have used the Equator Principles since 2003. A new version of the Equator Principles – EP3 – was launched in 2013, and HSBC introduced these changes on 1 January 2014 following training and the development of clear templates to ensure the transition was smooth.

Data and the independent assurance of our application of the Equator Principles will be available at [hsbc.com](http://hsbc.com) in April 2015.

### Policy reviews and updates in 2014

In 2014, we published the reports of two independent reviews into the content and implementation of our Forest Land and Forest Products Sector Policy, by Proforest and PricewaterhouseCoopers LLP, respectively. We also issued new policies on forestry, agricultural commodities and World Heritage Sites and Ramsar Wetlands, reflecting the recommendations. These documents can be found online at [hsbc.com/sus-risk](http://hsbc.com/sus-risk).

#### Forestry policy

The new forestry policy, issued in March 2014, requires forestry customers to gain 100% certification by the Forest Stewardship Council ( FSC ) or the Programme for the Endorsement of Forest Certification ( PEFC ) in high risk countries by 31 December 2014. Certification requires that customers are operating legally and sustainably.

Feedback from stakeholders on the new policy was positive. Timber customers from affected countries such as Turkey and Mexico

were receptive to the new standards, gained certification as a result of the new requirement and benefited from advice. Other customer relationships will end as soon as contractual terms allow, in cases where customers have been unable or unwilling to meet the new standards.

#### Agricultural commodities policy

The new agricultural commodities policy requires palm oil customers to become members of the Roundtable on Sustainable Palm Oil ( RSPO ) by 30 June 2014, to have at least one operation certified by the end of 2014 and all operations by the end of 2018.

A number of customer relationships will be closed where the deadline has not been met. Other customers have succeeded in joining the RSPO and having at least one operation certified by the end of 2014. One example is an Indonesian processing, refining and export company. HSBC started to engage with this and other companies in January 2014 on the changes and continued to offer advice. The management of the company sought expert advice from third parties to understand more about RSPO certification, which they found was less complex than they had imagined. Two units of the company obtained RSPO certification in June 2014, and one further is planned.

In order to encourage the shift towards sustainable palm oil we have introduced a discounted prepayment export finance product for trade flows of certified sustainable palm oil. This structured, bespoke financing was launched in Singapore and Indonesia in 2014 and in Malaysia in early 2015.

The inaugural financing using this product was for a major palm oil exporter which has been a member of the RSPO for ten years and is now fully certified. The product is available to both existing and future clients and is hoped to encourage an expansion in the proportion of palm oil that is certified sustainable.

Customers in Malaysia, Indonesia, mainland China, Taiwan, South Korea, Thailand, Turkey and Mexico have decided to certify their operations as a result of HSBC's new policies and deadlines. A number of others were already certified. Fuller reporting on the effect of these new policies will be available in April 2015 at [hsbc.com](http://hsbc.com).

HSBC HOLDINGS PLC

**Table of Contents****Strategic Report** (continued)**The World Heritage Sites and Ramsar Wetlands policy**

This is designed to protect unique sites of outstanding international significance as listed by the UN and wetlands of international importance. The policy relates to all business customers involved in major projects, particularly in sectors such as forestry, agriculture, mining, energy, property and infrastructure development.

The policy helps HSBC to make balanced and clear decisions on whether or not to finance projects which could have an effect on these sites or wetlands. HSBC has avoided financing projects in light of the policy.

*Our approach to managing sustainability risk is described on page 237.*

**Climate business**

We understand that in response to climate change there is a shift required towards a lower-carbon economy. We are committed to accelerating that shift by supporting customers involved in climate business by seeking long-term low-carbon commercial business opportunities. Our climate business includes clients in the solar, wind, biomass, energy efficiency, low-carbon transport and water sectors. In 2014, our Climate Change Research team was recognised as the top team in the industry. We were also a leader in public markets equity-related wind financings for international companies, including the largest wind turbine equity raising since 2010 as part of the 1.4bn Vestas refinancing.

Green bonds are any type of bond instruments where the proceeds will be exclusively applied to finance climate or environmental projects. In April 2014, HSBC became a member of the International Capital Market Association Executive Committee for the Green Bond Principles. The Green Bond Principles are voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance of a green bond.

In 2014, we commissioned a report, *Bonds and Climate Change: the state of the market in 2014* from the Climate Bonds Initiative to help raise awareness of climate financing.

HSBC has been at the forefront of this fast-developing area. In 2014, we were the sole global coordinator and joint leader, manager and bookrunner for the first green bond issue by an Asian corporate issuer, Advanced Semiconductor Engineering Inc. We also acted as sole global coordinator on the first green bond issued by Abengoa, the first high-yield green bond to be issued in Europe as well as the being a joint lead manager and bookrunner for the first government issuer in the Canadian market for the Province of Ontario.

**UN Environment Programme Finance Initiative Principles for Sustainable Insurance**

As a signatory to the Principles for Sustainable Insurance (PSI), a global sustainability framework, HSBC's Insurance business has committed to integrating environmental, social and governance issues across its processes, and to publicly disclosing its progress in doing so on an annual basis. A global programme manager has been appointed to provide leadership, co-ordination and control of Insurance sustainability initiatives world-wide and ensure alignment with the Group's approach and the requirements of the PSI initiative. This includes driving appropriate activities both within the Insurance business and with partners, regulators and other industry players; disseminating industry best



practice, and developing global insurance sustainability initiatives.

### Sustainable operations

Managing our own environmental footprint supports business efficiency and is part of our long-term contribution to society. We work together and with our suppliers to find new ways to reduce the impact of our operations on the environment. We are purchasing renewable energy, designing and operating our buildings and data centres more efficiently and reducing waste. We have committed to cut our annual per employee carbon emissions from 3.5 to 2.5 tonnes by 2020.

### Sustainability Leadership Programme

To deliver our ten sustainability goals we have trained 847 senior managers through HSBC's Sustainability Leadership Programme since 2009. The programme is a mix of hands-on learning and leadership development sessions and is aligned to the HSBC Values agenda. The programme participants are expected to embed sustainability into decision-making and project delivery in the businesses and functions where they work.

### Renewable energy procurement

In 2014, we signed three power purchase agreements with renewable energy generators in the UK and India. This is expected to provide 9% of HSBC's energy. In August, a 10-megawatt solar power plant in Hyderabad, India came online to provide the Group with clean energy. This is expected to power three Global Service Centres and a Technology Centre in India. HSBC played a key role in facilitating the project by agreeing to purchase the plant's energy at a government backed fixed price for the next ten years. The plant will provide a clean and reliable source of energy. In addition, we have redefined our renewables target only to count energy from newly constructed renewable energy sources which have been commissioned by HSBC.

### Paper use

Our paper goal is being achieved in three ways: ensuring that the paper we buy is from a sustainable source in accordance with our paper sourcing policy, reducing the volume of paper consumed by our offices and branches and providing paperless banking for all retail and commercial customers. We have continued to reduce the total amount of paper purchased and to increase the proportion of paper we use that is certified as sustainably sourced by the FSC and PEFC. Since 2011, we have achieved a 53% reduction in paper purchased. Certified sustainably sourced paper reached 92% of all paper used by the end of 2014.

HSBC HOLDINGS PLC

**Table of Contents**

**Strategic Report** (continued)

**Our 10-point sustainable operations strategy**

1. Sustainability engagement: encourage employees to deliver improved efficiency by 2020
2. Supply chain collaboration: sustainable savings through efficiency and innovation
3. HSBC Eco-efficiency fund: US\$50m annually to develop new ways of working, based on employee innovations
4. Energy: reduce annual energy consumption per employee by 1MWh by 2020, compared to 6.2MWh in 2011
5. Waste: use less, and recycle 100% of our office waste and electronic waste
6. Renewables: aim to increase energy consumption from renewables to 25% by 2020 from zero
7. Green buildings: design, build and run energy efficient, sustainable buildings to the highest international standards
8. Data centres: achieve an energy efficiency (power usage effectiveness) rating of 1.5 by 2020
9. Travel: reduce travel emissions per employee
10. Paper: paperless banking available for all retail and commercial customers and 100% sustainably sourced paper

by 2020

**Carbon emissions**

HSBC's carbon dioxide emissions are calculated on the basis of the energy used in our buildings and employee business travel from over 28 countries (covering about 93% of our operations by FTE). The data gathered on energy consumption and distance travelled are converted to carbon dioxide emissions using conversion factors from the following sources, if available, in order of preference:

1. factors provided by the data/service providers;
2. factors provided by the local public environmental authorities. For electricity, if specific factors cannot be obtained from the above two sources we use the latest available carbon emission factors for national grid electricity from the International Energy Agency as recommended for use by the Greenhouse Gas Protocol; and
3. for other types of energy and travel, if no specific factors can be obtained from the first two sources, we use the latest available factors provided by the UK Department for Environment, Food and Rural Affairs and/or the Department of Energy and Climate Change in the UK.

To incorporate all of the operations over which we have financial (management) control, the calculated carbon dioxide emissions are scaled up on the basis of the FTE coverage rate to account for any missing data (typically less than 10% of FTEs). In addition, emission uplift rates are applied to allow for uncertainty on the quality and coverage of emission measurement and estimation. The rates are 4% for electricity, 10% for other energy and 6% for business travel, based on the Intergovernmental Panel on Climate Change Good Practice Guidance and Uncertainty Management in National Greenhouse Gas Inventories, and our internal analysis of data coverage and quality.

**Carbon dioxide emissions in tonnes**

	<b>2014</b>	2013
Total	<b>752,000</b>	889,000
From energy	<b>633,000</b>	755,000
From travel	<b>119,000</b>	134,000

**Carbon dioxide emissions in tonnes per FTE**

	<b>2014</b>	2013
Total	<b>2.92</b>	3.43
From energy	<b>2.46</b>	2.91
From travel	<b>0.46</b>	0.52

Our greenhouse gas reporting year runs from October to September. For the year ended 30 September 2014, carbon dioxide emissions from our global operations were 752,000 tonnes.

## Sustainable communities

We believe that education and resources such as safe water and sanitation are essential to resilient communities which are, in turn, the basis of thriving economies and businesses.

We provide financial contributions to community projects, and thousands of employees across the world get involved by volunteering their time and sharing their skills.

## Volunteering and donations

Thousands of HSBC employees globally are involved every year in volunteering for our Community Investment programmes. Further details on our programmes are available at [hsbc.com](http://hsbc.com) and will be updated with information for 2014 in April 2015.

In 2014, we donated a total of US\$114m to community projects (2013: US\$117m). Of this, US\$66m was donated in Europe (2013: US\$64m); US\$28m was donated in Asia-Pacific (2013: US\$24m); US\$3m was donated in the Middle East (2013: US\$5m); US\$10m was donated in North America (2013: US\$11m); and US\$7m was donated in Latin America (2013: US\$12m).

Employees gave 303,922 hours of their time to volunteer during the working day (2013: 255,925 hours).

## Human rights

We apply human rights considerations directly as they affect our employees and indirectly through our suppliers and customers, in the latter case in particular through our project finance lending and sustainability risk policies. Human rights issues most directly relevant for HSBC are those relating to the right to just and favourable conditions of work and remuneration, the right to equal pay for equal work, the right to form and join trade unions, the right to rest and leisure and the prohibition of slavery and child labour. Alongside our own commitments, such as our HSBC Code of Conduct for Suppliers (in place since 2005), the HSBC Global Standards Manual and HSBC Values, we have signed up to global commitments and standards, including the UN Global Compact, the Universal Declaration of Human Rights and the Global Sullivan Principles.

*Further detail on our 2014 performance will be available from the end of April 2015 on our website, along with independent assurance of our application of the Equator Principles and carbon emissions.*

On behalf of the Board

D J Flint

Group Chairman

HSBC Holdings plc

23 February 2015

HSBC HOLDINGS PLC



**Table of Contents****Strategic Report** (continued)

## Footnotes to Strategic Report

- 1 On 1 January 2014, CRD IV came into force and capital and RWAs at 31 December 2014 are calculated and presented on this basis. Prior to this, capital and RWAs were calculated and presented on a Basel 2.5 basis. In addition, capital and RWAs at 31 December 2013 were also estimated based on the Group's interpretation of final CRD IV legislation and final rules issued by the PRA. At 31 December 2012, the CRD IV estimated capital and RWAs were based on the July 2011 draft CRD IV text.
- 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. The third interim dividend for 2013 of US\$0.10 was paid on 11 December 2013. The fourth interim dividend for 2013 of US\$0.19 was paid on 30 April 2014. First, second and third interim dividends for 2014, each of US\$0.10 per ordinary share, were paid on 10 July 2014, 9 October 2014 and 10 December 2014, respectively. Note 9 on the Financial Statements provides more information on the dividends declared in 2014. On 23 February 2015, the Directors declared a fourth interim dividend for 2014 of US\$0.20 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 30 April 2015 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 20 April 2015, with a scrip dividend alternative. The reserves available for distribution at 31 December 2014 were US\$48,883m. Quarterly dividends of US\$15.5 per 6.20% non-cumulative Series A US dollar preference share, equivalent to a dividend of US\$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A US dollar preference share, were paid on 17 March 2014, 16 June 2014, 15 September 2014 and 15 December 2014.
- Quarterly coupons of US\$0.508 per security were paid with respect to 8.125% capital securities on 15 January 2014, 15 April 2014, 15 July 2014 and 15 October 2014.
- Quarterly coupons of US\$0.50 per security were paid with respect to 8% capital securities on 17 March 2014, 16 June 2014, 15 September 2014 and 15 December 2014.
- 3 The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.
- 4 The return on average ordinary shareholders' equity is defined as profit attributable to ordinary shareholders of the parent company divided by average ordinary shareholders' equity.
- 5 Established on 5 December 2014.
- 6 Intermediation of securities, funds and insurance products, including Securities Services in GB&M.
- 7 Merger and acquisition, event and project financing, and co-investments in GPB.
- 8 Including Foreign Exchange, Rates, Credit and Equities.
- 9 Including portfolio management.
- 10 Including private trust and estate planning (for financial and non-financial assets).
- 11 Including hedge funds, real estate and private equity.
- 12 The sum of balances presented does not agree to consolidated amounts because inter-company eliminations are not presented here.
- 13 Pre-tax return on average risk-weighted assets is calculated using average RWAs based on a Basel 2.5 basis for all periods up to and including 31 December 2013 and on a CRD IV end point basis for all periods from 1 January 2014.
- 14 Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue .

- 15 *Loan impairment charges and other credit risk provisions.*
- 16 *Share of profit in associates and joint ventures.*
- 17 *From 1 January 2014, non-trading reverse repos and repos are presented as separate lines in the balance sheet. Previously, non-trading reverse repos were included within Loans and advances to banks and Loans and advances to customers and non-trading repos were included within Deposits by banks and Customer accounts. Comparative data have been re-presented accordingly. Non-trading reverse repos and repos have been presented as separate lines in the balance sheet to align disclosure with market practice and provide more meaningful information in relation to loans and advances. The extent to which reverse repos and repos represent loans to/from customers and banks is set out in Note 17 on the Financial Statements.*
- 18 *Taxes paid by HSBC relate to HSBC's own tax liabilities and is reported on a cash flow basis.*
- 19 *UK bank levy paid reflects the payments made to the tax authorities during the calendar year and may differ from the recognition of liabilities charged to the income statement.*
- 20 *Taxes collected relate to those taxes which HSBC is liable to pay as agent for taxation authorities across the world and include all employee-related taxes, together with taxes withheld from payments of interest and charged on the provision of goods and services to its customers. Taxes collected are reported on a cash flow basis.*
- 21 *Excludes movements in the fair value of own debt and before variable pay distributions.*
- 22 *Each American Depositary Share represents five ordinary shares.*
- 23 *Total shareholder return is defined as the growth in share value and declared dividend income during the relevant period.*
- 24 *The Morgan Stanley Capital International World Bank Index.*
- 25 *The 2014 Group pre-tax pre-variable pay profit calculation as described in Directors' Remuneration Report page 309. The percentage of variable pay deferred for the Code Staff population was 50%.*
- 26 *Dividends per ordinary share in respect of that year. For 2014, this includes the first, second and third interim dividends paid in 2014 of US\$5.8bn (gross of scrip) and a fourth interim dividend of US\$3.8bn.*
- 27 *Employee compensation and benefits in 2013 totalled US\$19,196m which included an accounting gain arising from a change in the basis of delivering ill-health benefits in the UK of US\$430m. Excluding this accounting gain, 2013 employee compensation and benefits totalled US\$19,626m.*
- 28 *This approach applies to all executive Directors with the exception of the Group Chairman, Douglas Flint, who is not eligible for a fixed pay allowance or variable pay awards.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review****Financial summary****Use of non-GAAP financial measures**

—	<b><u>Return on equity and return on tangible equity</u></b>	40 44a
—	<b><u>Consolidated income statement</u></b>	45
—	<b><u>Group performance by income and expense item</u></b>	46
—	<u>Net interest income</u>	46
—	<u>Net fee income</u>	48
—	<u>Net trading income</u>	49
—	<u>Net income/(expense) from financial instruments designated at fair value</u>	50
—	<u>Gains less losses from financial investments</u>	51
—	<u>Net insurance premium income</u>	51
—	<u>Other operating income</u>	52
—	<u>Net insurance claims and benefits paid and movement in liabilities to policyholders</u>	53



-	<u>Loan impairment charges and other credit risk provisions</u>	53
-	<u>Operating expenses</u>	54
-	<u>Share of profit in associates and joint ventures</u>	55
-	<u>Tax expense</u>	56
-	<u>2013 compared with 2012</u>	56a
-	<b><u>Consolidated balance sheet</u></b>	57
-	<u>Movement in 2014</u>	58
-	<b><u>Average balance sheet</u></b>	60a
-	<u>Average balance sheet and net interest income</u>	60a
-	<u>Analysis of changes in net interest income and net interest expense</u>	60h
-	<u>Short-term borrowings</u>	60l
-	<u>Loan maturity and interest sensitivity analysis</u>	60m
-	<u>Deposits</u>	60n
-	<u>Certificates of deposit and other time deposits</u>	61a
-	<b><u>Ratio of earnings to fixed charges</u></b>	
-	<b><u>Reconciliation of RoRWA measures</u></b>	61b 62
-		

**Critical accounting estimates and judgements**

62

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

**Use of non-GAAP financial measures**

Our reported results are prepared in accordance with IFRSs as detailed in the Financial Statements on page 334. In measuring our performance, the financial measures that we use include those which have been derived from our reported results in order to eliminate factors which distort year-on-year comparisons. These are considered non-GAAP financial measures. The primary non-GAAP financial measure we use is adjusted

performance. Other non-GAAP financial measures are described and reconciled to the most relevant reported financial measure when used.

**Adjusted performance**

Adjusted performance is computed by adjusting reported results for the year-on-year effects of foreign currency translation differences and significant items which distort year-on-year comparisons.

Previously we used the non-GAAP financial measure of underlying performance, which was calculated by adjusting reported results for the year-on-year effects of currency translation differences, own credit spread and acquisitions, disposals and dilutions. In 2014, we modified our approach to better align it with the way we view our performance internally and with feedback received from investors. Adjusted performance builds on underlying performance by maintaining the adjustment for currency translation differences and incorporating the adjustments for own credit spread and acquisitions, disposals and dilutions into the definition of significant items. We use the term significant items to collectively describe the group of individual adjustments which are excluded from reported results when arriving at adjusted performance. Significant items, which are detailed below, are those items which management and investors would ordinarily identify and consider separately when assessing performance in order to better understand the underlying trends in the business.

We believe adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and quantifying items management believe to be significant and providing insight into how management assesses year-on-year performance.

We arrive at adjusted performance by excluding from our reported results:

the year-on-year effects of foreign currency translation differences. This is done by comparing reported results for 2014 with reported results for 2013 retranslated at 2014 exchange rates. The foreign currency translation differences reflect the movements of the US dollar against most major currencies; and

significant items which distort the year-on-year comparison of reported results by obscuring the underlying factors and trends which affect operations. Significant items include adjustments for own credit spread and acquisitions, disposals and dilutions which were previously part of our underlying measure. The following pages provide further

details, including a reconciliation from reported to adjusted results.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

For acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses, we eliminate the gain or loss on disposal or dilution and any associated gain or loss on reclassification or impairment recognised in the year incurred, and remove the operating profit or loss of the acquired, disposed of or diluted subsidiaries, associates,

joint ventures and businesses from all the years presented so we can view results on a like-for-like basis. Disposal of strategic investments other than those included in the above definition would be included in other significant items if material.

The following acquisitions, disposals and changes to ownership levels affected adjusted performance:

*Disposal gains/(losses) affecting adjusted performance*

	Date	Disposal gain/(loss) US\$m
Reclassification gain in respect of our holding in Industrial Bank Co., Limited following the issue of additional share capital to third parties <sup>1</sup>	Jan 2013	1,089
HSBC Insurance (Asia-Pacific) Holdings Limited's disposal of its shareholding in Bao Viet Holdings <sup>1</sup>	Mar 2013	104
Household Insurance Group Holding company's disposal of its insurance manufacturing business <sup>1</sup>	Mar 2013	(99)
HSBC Seguros, S.A. de C.V., Grupo Financiero HSBC's disposal of its property and Casualty Insurance business in Mexico <sup>1</sup>	Apr 2013	20
HSBC Bank plc's disposal of its shareholding in HSBC (Hellas) Mutual Funds Management SA <sup>2</sup>	Apr 2013	(7)
HSBC Insurance (Asia-Pacific) Holdings Limited disposal of its shareholding in Hana HSBC Life Insurance Company Limited <sup>1</sup>	May 2013	28
HSBC Bank plc's disposal of HSBC Assurances IARD	May 2013	(4)
The Hongkong and Shanghai Banking Corporation Limited's disposal of HSBC Life (International) Limited's Taiwan branch operations	June 2013	(36)
HSBC Markets (USA) Inc.'s disposal of its subsidiary, Rutland Plastic Technologies	Aug 2013	17
HSBC Insurance (Singapore) Pte Ltd's disposal of its Employee Benefits Insurance business in Singapore <sup>2</sup>	Aug 2013	(8)
HSBC Investment Bank Holdings plc's disposal of its investment in associate FIP Colorado <sup>2</sup>	Aug 2013	(5)

HSBC Investment Bank Holdings plc group's disposal of its investment in subsidiary, Viking Sea Tech <sup>1</sup>	Aug 2013	54
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Panama) S.Ā.	Oct 2013	1,107
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Peru) S.Ā.	Nov 2013	(18)
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Paraguay) S.A. <sup>2</sup>	Nov 2013	(21)
Reclassification loss in respect of our holding in Yantai Bank Co., Limited following an increase in its registered share capital <sup>1</sup>	Dec 2013	(38)
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Colombia) S.A. <sup>1</sup>	Feb 2014	18
Reclassification loss in respect of our holding in Vietnam Technological & Commercial Joint Stock Bank following the loss of significant influence <sup>1</sup>	Jun 2014	(32)
HSBC Bank Middle East Limited's disposal of its operations in Pakistan	Oct 2014	(27)

*For footnotes, see page 109.*

### **Foreign currency translation differences ( constant currency )**

Foreign currency translation differences reflect the movements of the US dollar against most major currencies during 2014. We exclude the translation differences when using constant currency because it allows us to assess balance sheet and income statement performance on a like-for-like basis to better understand the underlying trends in the business.

#### **Foreign currency translation differences**

Foreign currency translation differences for 2013 are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

the income statements for 2013 at the average rates of exchange for 2014; and

the balance sheet at 31 December 2013 at the prevailing rates of exchange on 31 December 2014.

Foreign currency translation differences for 2012 referred to in the 2013 commentaries are computed on the same basis, by applying average rates of exchange for 2013 to the 2012 income and rates of exchange on 31 December 2013 to the balance sheet at 31 December 2012.

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 foreign currency translation differences in tables or commentaries, comparative data reported in the functional currencies of HSBC's operations have been translated at the appropriate exchange rates applied in the current year on the basis described above.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Other significant items**

The following tables detail the effect of other significant items in 2014 and 2013 on each of our geographical segments and global businesses.

*Other significant items affecting adjusted performance Losses/(gains)*

	2014					Total US\$m
	Europe US\$m	Asia US\$m	MENA US\$m	North America US\$m	Latin America US\$m	
<b>Revenue</b>						
Debit valuation adjustment on derivative contracts	234	69	5	16	8	332
Fair value movements on non-qualifying hedges <sup>3</sup>	235	4		302		541
Gain on sale of several tranches of real estate secured accounts in the US				(168)		(168)
Gain on sale of shareholding in Bank of Shanghai		(428)				(428)
Impairment of our investment in Industrial Bank		271				271
Provisions arising from the ongoing review of compliance with the Consumer Credit Act in the UK	632					632
	<b>1,101</b>	<b>(84)</b>	<b>5</b>	<b>150</b>	<b>8</b>	<b>1,180</b>
<b>Operating expenses</b>						
Charge in relation to the settlement agreement with Federal Housing Finance Authority				550		550
Settlements and provisions in connection with foreign exchange investigations	1,187					1,187
Restructuring and other related costs	123	9	2	28	116	278

Regulatory provisions in GBP	16	49				65
UK customer redress programmes	1,275					1,275
	2,601	58	2	578	116	3,355

	RBWM US\$m	CMB US\$m	GB&M US\$m	GPB US\$m	Other US\$m	Total US\$m
--	---------------	--------------	---------------	--------------	----------------	----------------

**Revenue**

Debit valuation adjustment on derivative contracts			332			332
Fair value movements on non-qualifying hedges <sup>3</sup>	493	(1)	8	1	40	541
Gain on sale of several tranches of real estate secured accounts in the US	(168)					(168)
Gain on sale of shareholding in Bank of Shanghai					(428)	(428)
Impairment of our investment in Industrial Bank					271	271
Provisions arising from the ongoing review of compliance with the Consumer Credit Act in the UK	568	24		40		632
	893	23	340	41	(117)	1,180

**Operating expenses**

Charge in relation to the settlement agreement with Federal Housing Finance Authority	17		533			550
Settlements and provisions in connection with foreign exchange investigations			1,187			1,187
Restructuring and other related costs	88	37	27	6	120	278
Regulatory provisions in GBP				65		65
UK customer redress programmes	992	138	145			1,275
	1,097	175	1,892	71	120	3,355

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)

	2013					Total
	Europe	Asia	MENA	North	Latin	
	US\$m	US\$m	US\$m	America	America	US\$m
				US\$m	US\$m	US\$m
Revenue						
Net gain on completion of Ping An disposal		(553)				(553)
Debit valuation adjustment on derivative contracts	(65)	(40)	(2)	14	(13)	(106)
Fair value movements on non-qualifying hedges <sup>3</sup>	(297)	32		(246)		(511)
FX gains relating to sterling debt issued by HSBC Holdings	(442)					(442)
Write-off of allocated goodwill relating to the GPB Monaco business	279					279
Loss on sale of several tranches of real estate secured accounts in the US				123		123
Loss on sale of non-real estate secured accounts in the US				271		271
Loss on early termination of cash flow hedges in the US run-off portfolio				199		199
Loss on sale of an HFC Bank UK secured loan portfolio	146					146
	(379)	(561)	(2)	361	(13)	(594)
Operating expenses						
Restructuring and other related costs	217	86	4	101	75	483
UK customer redress programmes	1,235					1,235
Madoff-related litigation	298					298

costs						
Regulatory provisions in GPB	317	35				352
US customer remediation provisions relating to CRS				100		100
Accounting gain arising from change in basis of delivering ill-health benefits in the UK	(430)					(430)
	1,637	121	4	201	75	2,038
	RBWM US\$m	CMB US\$m	GB&M US\$m	GPB US\$m	Other US\$m	Total US\$m
Revenue						
Net gain on completion of Ping An disposal					(553)	(553)
Debit valuation adjustment on derivative contracts			(106)			(106)
Fair value movements on non-qualifying hedges <sup>3</sup>	(262)		18		(267)	(511)
FX gains relating to sterling debt issued by HSBC Holdings					(442)	(442)
Write-off of allocated goodwill relating to the GPB Monaco business				279		279
Loss on sale of several tranches of real estate secured accounts in the US	123					123
Loss on sale of non-real estate secured accounts in the US	271					271
Loss on early termination of cash flow hedges in the US run-off portfolio	199					199
Loss on sale of an HFC Bank UK secured loan portfolio	146					146
	477		(88)	279	(1,262)	(594)
Operating expenses						
Restructuring and other related costs	167	31	13	73	199	483
UK customer redress programmes	953	148	134			1,235
			298			298

Madoff-related litigation costs						
Regulatory provisions in GBP				352		352
US customer remediation provisions relating to CRS	100					100
Accounting gain arising from change in basis of delivering ill-health benefits in the UK	(189)	(160)	(81)			(430)
	1,031	19	364	425	199	2,038
<i>For footnote, see page 109</i>						

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

The following table reconciles selected reported items for 2014 and 2013 to adjusted items. Equivalent tables are provided for each of our global businesses and geographical segments on [www.hsbc.com](http://www.hsbc.com).

*Reconciliation of reported and adjusted items*

	<b>2014</b> <b>US\$m</b>	2013 US\$m	Change <sup>5</sup> %
<b>Revenue<sup>4</sup></b>			
Reported	<b>61,248</b>	64,645	(5)
Currency translation adjustment <sup>6</sup>		(686)	
Own credit spread <sup>7</sup>	<b>(417)</b>	1,246	
Acquisitions, disposals and dilutions	<b>(9)</b>	(2,757)	
Other significant items	<b>1,180</b>	(594)	
Adjusted	<b>62,002</b>	61,854	
<b>Loan impairment charges and other credit risk provisions</b>			
Reported	<b>(3,851)</b>	(5,849)	34
Currency translation adjustment <sup>6</sup>		168	
Acquisitions, disposals and dilutions		67	
Other significant items			
Adjusted	<b>(3,851)</b>	(5,614)	31
<b>Total operating expenses</b>			
Reported	<b>(41,249)</b>	(38,556)	(7)
Currency translation adjustment <sup>6</sup>		348	
Acquisitions, disposals and dilutions	<b>40</b>	488	
Other significant items	<b>3,355</b>	2,038	
Adjusted	<b>(37,854)</b>	(35,682)	(6)
Adjusted cost efficiency ratio	<b>61.1%</b>	57.7%	
<b>Share of profit in associates and joint ventures</b>			
Reported	<b>2,532</b>	2,325	9
Currency translation adjustment <sup>6</sup>		11	
Acquisitions, disposals and dilutions		87	
Other significant items			
Adjusted	<b>2,532</b>	2,423	4

<b>Profit before tax</b>			
Reported	<b>18,680</b>	22,565	(17)
Currency translation adjustment <sup>6</sup>		(159)	
Own credit spread <sup>7</sup>	<b>(417)</b>	1,246	
Acquisitions, disposals and dilutions	<b>31</b>	(2,115)	
Other significant items	<b>4,535</b>	1,444	
Adjusted	<b>22,829</b>	22,981	(1)

*For footnotes, see page 109.*

*Adjusted profit before tax*

	<b>2014</b>	2013	Change <sup>5</sup>
	<b>US\$m</b>	US\$m	%
<b>By global business</b>			
Retail Banking and Wealth Management	<b>7,648</b>	7,959	(4)
Commercial Banking	<b>8,940</b>	7,910	13
Global Banking and Markets	<b>8,114</b>	9,208	(12)
Global Private Banking	<b>738</b>	900	(18)
Other	<b>(2,611)</b>	(2,996)	13
<b>Year ended 31 December</b>	<b>22,829</b>	22,981	(1)
<b>By geographical region</b>			
Europe	<b>3,905</b>	4,301	(9)
Asia <sup>8</sup>	<b>14,635</b>	14,309	2
Middle East and North Africa	<b>1,854</b>	1,673	11
North America	<b>2,111</b>	2,048	3
Latin America	<b>324</b>	650	(50)
<b>Year ended 31 December</b>	<b>22,829</b>	22,981	(1)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Return on Equity and Return on Tangible Equity**

ROTE is computed by adjusting reported results for the movements in the present value of in-force long-term insurance business ( PVIF ), impairments of goodwill, and adjusting the reported equity for goodwill, intangibles and PVIF. The adjustment to reported results and reported equity excludes amounts

attributable to non-controlling interests.

We provide ROTE as an additional measure to ROE to provide a way to look at our performance which is closely aligned to our capital position.

The following table details the adjustments made to the reported results and equity:

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Profit			
Profit attributable to the ordinary shareholders of the parent company	<b>13,115</b>	15,631	13,454
Goodwill impairment (net of tax)		279	
Increase in PVIF (net of tax)	<b>(213)</b>	(397)	(537)
Profit attributable to the ordinary shareholders, excl. goodwill impairment and PVIF	<b>12,901</b>	15,513	12,917
Equity			
Average ordinary shareholders' equity	<b>178,898</b>	169,260	159,564
Effect of Goodwill and intangibles (net of deferred tax)	<b>(23,423)</b>	(24,042)	(24,859)
Effect of PVIF (net of deferred tax)	<b>(4,317)</b>	(3,982)	(3,557)
Average tangible equity	<b>151,158</b>	141,236	131,148
	<b>%</b>	%	%
Ratio			
Return on equity	<b>7.3</b>	9.2	8.4
Return on tangible equity	<b>8.5</b>	11.0	9.8

HSBC HOLDINGS PLC



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

	<b>2014</b>	2013	2012	2011	2010
	<b>US\$m</b>	US\$m	US\$m	US\$m	US\$m
Net interest income	<b>34,705</b>	35,539	37,672	40,662	39,441
Net fee income	<b>15,957</b>	16,434	16,430	17,160	17,355
Net trading income	<b>6,760</b>	8,690	7,091	6,506	7,210
Net income/(expense) from financial instruments designated at fair value	<b>2,473</b>	768	(2,226)	3,439	1,220
Gains less losses from financial investments	<b>1,335</b>	2,012	1,189	907	968
Dividend income	<b>311</b>	322	221	149	112
Net insurance premium income	<b>11,921</b>	11,940	13,044	12,872	11,146
Gains on disposal of US branch network, US cards business and Ping An Insurance (Group) Company of China, Ltd			7,024		
Other operating income	<b>1,131</b>	2,632	2,100	1,766	2,562
<b>Total operating income</b>	<b>74,593</b>	78,337	82,545	83,461	80,014
Net insurance claims and benefits paid and movement in liabilities to policyholders	<b>(13,345)</b>	(13,692)	(14,215)	(11,181)	(11,767)
<b>Net operating income before loan impairment charges and other credit risk provisions</b>	<b>61,248</b>	64,645	68,330	72,280	68,247
Loan impairment charges and other credit risk provisions	<b>(3,851)</b>	(5,849)	(8,311)	(12,127)	(14,039)
<b>Net operating income</b>	<b>57,397</b>	58,796	60,019	60,153	54,208
Total operating expenses	<b>(41,249)</b>	(38,556)	(42,927)	(41,545)	(37,688)
<b>Operating profit</b>	<b>16,148</b>	20,240	17,092	18,608	16,520
Share of profit in associates and joint ventures	<b>2,532</b>	2,325	3,557	3,264	2,517
<b>Profit before tax</b>	<b>18,680</b>	22,565	20,649	21,872	19,037
Tax expense	<b>(3,975)</b>	(4,765)	(5,315)	(3,928)	(4,846)
<b>Profit for the year</b>	<b>14,705</b>	17,800	15,334	17,944	14,191
Profit attributable to shareholders of the parent company	<b>13,688</b>	16,204	14,027	16,797	13,159
Profit attributable to non-controlling interests	<b>1,017</b>	1,596	1,307	1,147	1,032



*Five-year financial information*

	<b>2014</b>	2013	2012	2011	2010
	<b>US\$</b>	US\$	US\$	US\$	US\$
Basic earnings per share	<b>0.69</b>	0.84	0.74	0.92	0.73
Diluted earnings per share	<b>0.69</b>	0.84	0.74	0.91	0.72
Dividends per ordinary share <sup>9</sup>	<b>0.49</b>	0.48	0.41	0.39	0.34
	<b>%</b>	%	%	%	%
Dividend payout ratio <sup>10</sup>	<b>71.0</b>	57.1	55.4	42.4	46.6
Post-tax return on average total assets	<b>0.5</b>	0.7	0.6	0.6	0.6
Return on average ordinary shareholders equity	<b>7.3</b>	9.2	8.4	10.9	9.5
Average foreign exchange translation rates to US\$:					
US\$1: £	<b>0.607</b>	0.639	0.631	0.624	0.648
US\$1:	<b>0.754</b>	0.753	0.778	0.719	0.755

*For footnotes, see page 109.*

*Unless stated otherwise, all tables in the Annual Report and Accounts 2014 are presented on a reported basis.*

*For a summary of our financial performance in 2014, see page 28.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Group performance by income and expense item****Net interest income**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Interest income	<b>50,955</b>	51,192	56,702
Interest expense	<b>(16,250)</b>	(15,653)	(19,030)
<b>Net interest income<sup>11</sup></b>	<b>34,705</b>	35,539	37,672
Average interest-earning assets	<b>1,786,536</b>	1,669,368	1,625,068
Gross interest yield <sup>12</sup>	<b>2.85%</b>	3.07%	3.49%
Less: cost of funds	<b>(1.05%)</b>	(1.10%)	(1.36%)
Net interest spread <sup>13</sup>	<b>1.80%</b>	1.97%	2.13%
Net interest margin <sup>14</sup>	<b>1.94%</b>	2.13%	2.32%

*For footnotes, see page 109.*

**Summary of interest income by type of asset**

	<b>2014</b>			2013			2012		
	Average	Interest		Average	Interest		Average	Interest	
	balance	income	Yield	balance	income	Yield	balance	income	Yield
	US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
Short-term funds and loans and advances to banks <sup>27</sup>	<b>237,148</b>	<b>3,068</b>	<b>1.29</b>	236,377	2,851	1.21	235,831	3,505	1.49
Loans and advances to customers <sup>27</sup>	<b>931,311</b>	<b>37,429</b>	<b>4.02</b>	897,322	38,529	4.29	891,699	40,870	4.58
Reverse repurchase agreements non-trading <sup>26,27</sup>	<b>198,273</b>	<b>1,800</b>	<b>0.91</b>	114,324	995	0.87	83,105	975	1.17
Financial investments	<b>399,816</b>	<b>8,323</b>	<b>2.08</b>	393,309	8,002	2.03	387,329	9,078	2.34
	<b>19,988</b>	<b>335</b>	<b>1.68</b>	28,036	815	2.91	27,104	2,274	8.39

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Other interest-earning assets									
Total interest-earning assets	<b>1,786,536</b>	<b>50,955</b>	<b>2.85</b>	1,669,368	51,192	3.07	1,625,068	56,702	3.49
Trading assets and financial assets designated at fair value <sup>15,16,26</sup>	<b>238,958</b>	<b>5,596</b>	<b>2.34</b>	354,817	5,763	1.62	368,406	6,931	1.88
Impairment provisions	<b>(14,015)</b>			(15,954)			(17,421)		
Non-interest-earning assets	<b>668,564</b>			683,785			730,901		
<b>Year ended 31 December</b>	<b>2,680,043</b>	<b>56,551</b>	<b>2.11</b>	2,692,016	56,955	2.12	2,706,954	63,633	2.35

For footnotes, see page 109.

*Summary of interest expense by type of liability and equity*

	2014			2013			2012		
	Average	Interest	Cost	Average	Interest	Cost	Average	Interest	Cost
	balance	expense		balance	expense		balance	expense	
US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%	
Deposits by banks <sup>17,27</sup>	<b>61,217</b>	<b>481</b>	<b>0.79</b>	61,616	555	0.90	78,023	1,001	1.28
Financial liabilities designated at fair value – own debt issued <sup>18</sup>	<b>66,374</b>	<b>837</b>	<b>1.26</b>	72,333	967	1.34	75,016	1,325	1.77
Customer accounts <sup>19,27</sup>	<b>1,088,493</b>	<b>9,131</b>	<b>0.84</b>	1,035,500	8,794	0.85	1,012,056	10,650	1.05
Repurchase agreements non-trading <sup>26,27</sup>	<b>190,705</b>	<b>652</b>	<b>0.34</b>	94,410	405	0.43	55,536	387	0.70
Debt securities in issue	<b>129,724</b>	<b>4,554</b>	<b>3.51</b>	150,976	4,182	2.77	161,348	4,755	2.95
Other interest-bearing liabilities	<b>10,120</b>	<b>595</b>	<b>5.88</b>	11,345	750	6.61	19,275	912	4.73
Total interest-bearing	<b>1,546,633</b>	<b>16,250</b>	<b>1.05</b>	1,426,180	15,653	1.10	1,401,254	19,030	1.36

liabilities									
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued) <sup>26</sup>	<b>178,518</b>	<b>2,856</b>	<b>1.60</b>	301,353	3,027	1.00	318,883	3,445	1.08
Non-interest bearing current accounts	<b>185,990</b>			184,370			177,085		
Total equity and other non-interest bearing liabilities	<b>768,902</b>			780,113			809,732		
<b>Year ended</b>									
<b>31 December</b>	<b>2,680,043</b>	<b>19,106</b>	<b>0.71</b>	2,692,016	18,680	0.69	2,706,954	22,475	0.83

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

Reported net interest income of US\$35bn decreased by US\$834m or 2% compared with 2013. This included the significant items and currency translation summarised in the table below.

*Significant items and currency translation*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>Significant items</b>		
Provisions arising from the ongoing review of compliance with the Consumer Credit Act in the UK	<b>(632)</b>	
Acquisitions, disposals and dilutions	<b>38</b>	386
	<b>(594)</b>	386
Currency translation		518
<b>Year ended 31 December</b>	<b>(594)</b>	904

On a reported basis, net interest spread and margin both fell, reflecting lower yields on customer lending in North America and Europe. In North America, this was due to changes in the composition of the lending portfolios towards lower yielding secured assets and to the run-off of the CML portfolio. In Europe, it was principally due to a significant item, namely provisions arising from the ongoing review of compliance with the Consumer Credit Act ( CCA ) in the UK. These factors were partially offset by a lower cost of funds.

Excluding the significant items and currency translation tabulated above, net interest income rose by US\$664m or 2% from 2013, driven by increases in Asia, partly reflecting growth in customer lending volumes.

**Interest income**

Reported interest income was broadly unchanged, as decreases in interest income from customer lending (which included the effect of the CCA provisions) were offset by increases in income from short-term funds, as well as a rise due to the change in the management of reverse repo transactions (see page 48).

Interest income on loans and advances to customers decreased, principally in North America and Latin America, partially offset by increases in Asia. In North America, this was a consequence of the disposal of the higher yielding non-real estate loan portfolio and the reduction in the CML portfolio from run-off and sales. In addition, new lending

to customers in RBWM and CMB was at lower yields, reflecting a shift in the portfolio towards higher levels of lower yielding first lien real estate secured loans. In Latin America, interest income on customer lending also decreased, reflecting a fall in yields in both Brazil and Mexico, despite the rise in average balances in term lending in both countries. In Brazil, the falling yield reflected the shift in product and client mix to more secured, relationship-led lending while, in Mexico, it was driven by reductions in Central Bank interest rates. The region was also affected by the disposal of non-strategic businesses.

By contrast, we recorded increased interest income on customer lending in Asia, driven by growth in term lending volumes and, to a lesser extent, residential mortgages during the year. This increase in balances

was partially offset by compressed yields. In Europe, excluding the effect of the CCA provisions noted above, interest income on customer lending rose due to increases in mortgage and term lending balances.

Interest income on short-term funds and financial investments increased both in Latin America and Asia, as interest rates rose in certain countries in these regions (notably in Brazil, Argentina and mainland China) and average balances grew. However, in Europe, interest income on short-term funds and financial investments fell as maturing positions were replaced by longer-term but lower-yielding bonds.

### Interest expense

Reported interest expense increased in the year. We recorded increased interest expense on customer accounts in Asia and Latin America, partly offset by a reduction in North America. In Asia, the growth was principally from an increase in the average balances of customer accounts. In Latin America, interest expense on customer accounts rose as reductions in average balances were more than offset by the increase in the cost of funds due to interest rate rises, notably in Brazil. However, the effects of this were partly offset by a fall in the cost of funds in Mexico as Central Bank rates fell, and the disposal of non-strategic businesses. Conversely, in North America, interest expense on customer deposits declined as a result of a strategic decision to re-price deposits downwards. In addition, other interest expense decreased due to a release of accrued interest associated with an uncertain tax position.

Interest expense on debt issued rose. We recorded an increase in the cost of funds which was partly offset by decreased overall balances. Interest expense rose in Latin America, notably in Brazil, in line with interest rate rises and increased medium-term loan note balances. By contrast, in North America the business disposals led to a decline in our funding requirements. The cost of funds also fell as higher coupon debt matured and was repaid. In Europe, interest expense on debt also decreased, as average outstanding balances fell as a result of net redemptions and the cost of funds reduced.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Repos and reverse repos**

During the final quarter of 2013, GB&M changed the way it managed reverse repurchase ( reverse repo ) and repurchase ( repo ) activities. This had the effect of reducing the net interest margin as average interest earning assets and interest bearing liabilities increased significantly. These reverse repo and repo agreements have a lower gross yield and cost of funds, respectively, than the remainder of our portfolio.

Net interest income includes the expense of internally funded trading assets, while related revenue is reported in Net trading income . The internal cost of funding these assets decreased, as average trading asset balances fell to a greater extent than trading liabilities. In reporting our global business results, this cost is included within Net trading income .

**Net fee income**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Account services	<b>3,407</b>	3,581	3,563
Funds under management	<b>2,658</b>	2,673	2,561
Cards	<b>2,460</b>	2,455	3,030
Credit facilities	<b>1,890</b>	1,907	1,761
Broking income	<b>1,371</b>	1,388	1,350
Imports/exports	<b>1,115</b>	1,157	1,196
Unit trusts	<b>1,005</b>	891	739
Underwriting	<b>872</b>	866	739
Remittances	<b>833</b>	849	819
Global custody	<b>726</b>	698	737
Insurance	<b>516</b>	551	696
Other	<b>2,692</b>	2,957	2,958
Fee income	<b>19,545</b>	19,973	20,149
Less: fee expense	<b>(3,588)</b>	(3,539)	(3,719)
<b>Year ended 31 December</b>	<b>15,957</b>	16,434	16,430

Reported net fee income fell by US\$477m, primarily in Latin America and North America. In Latin America, the decrease included the effect of currency translation and the continued repositioning and disposal of businesses, notably the sale of our Panama operations in 2013. In North America, net fee income was lower following the expiry of the Transition Servicing Agreements we entered into with the buyer of the Card and Retail Services ( CRS ) business, and adverse adjustments to mortgage servicing rights valuations.

Account services fee income decreased, notably in Latin America and Europe. In Latin America, the fall was due to a reduction in customer numbers in Mexico, as we continued to reposition the business, and in Brazil, due to strong market competition. In Europe, account services fees were lower, primarily in Switzerland due

to the repositioning of our GPB business, and in the UK, in part reflecting the implementation of the Retail Distribution Review in 2013.

By contrast, unit trust fees rose, primarily in Asia, due to increased sales of equity funds in Hong Kong.

Other fee income declined in North America due to the expiry of the Transition Servicing Agreements and in Latin America following the sale of our operations in Panama in 2013 and the continued repositioning of the business in Mexico.

In addition, fee expenses were higher due to adverse adjustments to mortgage servicing rights valuations in North America, reflecting mortgage interest rate decreases in 2014 which compared with increases in 2013.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Net trading income**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Trading activities <sup>20</sup>	<b>5,419</b>	6,921	5,249
Ping An contingent forward sale contract		(682)	(553)
Net interest income on trading activities	<b>1,907</b>	2,047	2,683
Gain/(loss) on termination of hedges	<b>1</b>	(194)	
Other trading income – hedge ineffectiveness:			
on cash flow hedges	<b>34</b>	22	35
on fair value hedges	<b>19</b>	65	(27)
Fair value movement on non-qualifying hedges <sup>21</sup>	<b>(620)</b>	511	(296)
<b>Year ended 31 December</b>	<b>6,760</b>	8,690	7,091

*For footnotes, see page 109.*

Reported net trading income of US\$6.8bn was US\$1.9bn lower, predominantly in Europe. The reduction in net trading income was partly driven by the significant items summarised in the table below.

**Significant items and currency translation**

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>Significant items</b>		
Included within trading activities:		
Debit valuation adjustment on derivative contracts	<b>(332)</b>	548
FX gains relating to sterling debt issued by HSBC Holdings	<b>(332)</b>	106
		442
Included in other net trading income:	<b>(539)</b>	(346)
Ping An contingent forward sale contract <sup>22</sup>		(682)
Loss on early termination of cash flow hedges in the US run-off portfolio		(199)

Fair value movement on non-qualifying hedges	(541)	511
Acquisitions, disposals and dilutions	2	24
	(871)	202
Currency translation		(11)
<b>Year ended 31 December</b>	<b>(871)</b>	<b>191</b>

*For footnote, see page 109.*

Excluding the significant items and currency translation tabulated above, net trading income from trading activities decreased by US\$0.6bn, notably in Markets within GB&M. This was predominantly driven by our Foreign Exchange business, which was affected by lower volatility and reduced client flows. In Equities, revenue decreased, as 2013 benefited from higher revaluation gains which more than offset a rise in 2014 in revenue from increased client flows and higher derivatives income.

In 2014, we revised our estimation methodology for valuing uncollateralised derivative portfolios by introducing the funding fair value adjustment ( FFVA ), resulting in a reduction in net trading income of US\$263m, primarily in Rates (US\$164m) and Credit (US\$97m). Excluding the FFVA, Credit was also affected by adverse movements on credit spreads and a reduction in revenue in Legacy Credit. By contrast, Rates was affected by favourable market movements, notably in

Asia, along with minimal fair value movements on our own credit spread on structured liabilities compared with adverse movements in 2013. These factors were partly offset by a fall in Rates in Europe.

Included within net trading income from trading activities, there were favourable foreign exchange movements on assets held as economic hedges of foreign currency debt designated at fair value, compared with adverse movements in 2013. These movements offset fair value movements on the foreign currency debt which are reported in Net income/(expense) from financial instruments designated at fair value .

In addition, net interest income from trading activities fell due to lower average balances, notably relating to reverse repo and repo agreements, in line with the change in the way GB&M manages these agreements. The net interest income from these activities is now recorded in Net interest income .

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Net income/(expense) from financial instruments designated at fair value**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net income/(expense) arising from:			
financial assets held to meet liabilities under insurance and investment contracts	<b>2,300</b>	3,170	2,980
liabilities to customers under investment contracts	<b>(435)</b>	(1,237)	(996)
HSBC's long-term debt issued and related derivatives	<b>508</b>	(1,228)	(4,327)
change in own credit spread on long-term debt (significant item)	<b>417</b>	(1,246)	(5,215)
other changes in fair value <sup>22</sup>	<b>91</b>	18	888
other instruments designated at fair value and related derivatives	<b>100</b>	63	117
<b>Year ended 31 December</b>	<b>2,473</b>	768	(2,226)

*For footnote, see page 109.*

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

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Financial assets designated at fair value at 31 December	<b>29,037</b>	38,430	33,582
Financial liabilities designated at fair value at 31 December	<b>76,153</b>	89,084	87,720
Including:			
Financial assets held to meet liabilities under:			
insurance contracts and investment contracts with DPF	<b>10,650</b>	10,717	8,376
unit-linked insurance and other insurance and investment contracts	<b>16,333</b>	25,423	23,655
Long-term debt issues designated at fair value	<b>69,681</b>	75,278	74,768

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

The majority of the financial liabilities designated at fair value are fixed-rate long-term debt issues, the interest rate profile of which has been changed to floating through swaps as part of a documented interest rate management strategy. The movement in fair value of these long-term debt issues and the related hedges includes the effect of our credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. The size and direction of the changes in the credit spread on our debt and ineffectiveness, which are recognised in the income statement, can be volatile from year to year, but do not alter the cash flows expected as part of the documented interest rate management strategy. As a consequence, fair value movements arising from changes in our own credit spread on long-term debt and other fair value movements on the debt and related derivatives are not regarded internally as part of managed performance and are therefore not allocated to global businesses, but are reported in Other . Credit spread movements on own debt designated at fair value are excluded from adjusted results, and related fair value movements are not included in the calculation of regulatory capital.

Reported net income from financial instruments designated at fair value was US\$2.5bn in 2014, compared with US\$768m in 2013. The former included favourable movements in the fair value of our own long-term debt of US\$417m due to changes in credit spread, compared with adverse movements of US\$1.2bn in 2013. Excluding this significant item, net income from financial instruments designated at fair value increased by US\$42m.

Net income arising from financial assets held to meet liabilities under insurance and investment contracts of US\$2.3bn was US\$870m lower than in 2013. This was driven by weaker equity market performance in the UK and France, partly offset by improved equity market performance in Hong Kong and higher net income on the bonds portfolio in Brazil.

Investment gains or losses arising from equity markets result in a corresponding movement in liabilities to customers, reflecting the extent to which unit-linked policyholders, in particular, participate in the investment performance of the associated asset portfolio. Where these relate to assets held to back investment contracts, the corresponding movement in liabilities to customers is also recorded under Net income/(expense) from financial instruments designated at fair value . This is in contrast to gains or losses related to assets held to back insurance contracts or investment contracts with discretionary participation features ( DPF ), where the corresponding movement in liabilities to customers is recorded under Net insurance claims and benefits paid and movement in liabilities to policyholders .

Other changes in fair value reflected a net favourable movement due to interest and exchange rate hedging ineffectiveness. This was partly offset by net adverse foreign exchange movements on foreign currency debt designated at fair value and issued as part of our overall funding strategy (offset from assets held as economic hedges in Net trading income ).

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Gains less losses from financial investments**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net gains/(losses) from disposal of:			
debt securities	<b>665</b>	491	781
equity securities	<b>1,037</b>	1,697	823
other financial investments	<b>6</b>	(1)	5
	<b>1,708</b>	2,187	1,609
Impairment of available-for-sale equity securities	<b>(373)</b>	(175)	(420)
<b>Year ended 31 December</b>	<b>1,335</b>	2,012	1,189

Reported gains less losses from financial investments were US\$1.3bn, a decrease of US\$677m from 2013. The decrease

primarily reflected the significant items summarised below.

**Significant items and currency translation**

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>Significant items</b>		
Gain on sale of shareholding in Bank of Shanghai	<b>428</b>	
Impairment on our investment in Industrial Bank	<b>(271)</b>	
Net gain on completion of Ping An disposal <sup>22</sup>		1,235
Acquisitions, disposals and dilutions		5
	<b>157</b>	1,240
Currency translation		(10)
<b>Year ended 31 December</b>	<b>157</b>	1,230

*For footnote, see page 109.*

Excluding the significant items and currency translation noted above, gains less losses from financial investments increased by US\$396m, primarily driven by higher net gains on the disposal of debt securities as we actively managed the Legacy Credit portfolio. In addition, we

reported higher gains on sale of available-for-sale equity securities and lower impairments on available-for-sale equity securities from improved market conditions and business performance of the underlying portfolio.

### Net insurance premium income

	2014	2013	2012
	US\$m	US\$m	US\$m
Gross insurance premium income	12,370	12,398	13,602
Reinsurance premiums	(449)	(458)	(558)
<b>Year ended 31 December</b>	<b>11,921</b>	<b>11,940</b>	<b>13,044</b>

Reported net insurance premium income was broadly unchanged, with reductions in Europe and Latin America largely offset by higher premium income in Asia.

In Asia, premium income rose, primarily in Hong Kong, due to increased new business from deferred annuity, universal life and endowment contracts. This was partly offset by lower new business from unit-linked contracts.

In Europe, premium income decreased, mainly in the UK, reflecting lower sales following the withdrawal of external independent financial adviser distribution channels for certain linked insurance contracts in the second half of 2013. This was partly offset by increases in France, mainly reflecting higher sales of investment contracts with DPF.

Net insurance premium income also fell in Latin America, primarily in Brazil, reflecting lower sales, in part due to changes in our distribution channel.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Other operating income**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Rent received	<b>162</b>	155	210
Gains/(losses) recognised on assets held for sale	<b>220</b>	(729)	485
Gains on investment properties	<b>120</b>	113	72
Gain on disposal of property, plant and equipment, intangible assets and non-financial investments	<b>32</b>	178	187
Gains/(losses) arising from dilution of interest in Industrial Bank and other associates and joint ventures	<b>(32)</b>	1,051	
Gain on disposal of HSBC Bank (Panama) S.A.		1,107	
Change in present value of in-force long-term insurance business	<b>261</b>	525	737
Other	<b>368</b>	232	409
<b>Year ended 31 December</b>	<b>1,131</b>	2,632	2,100

*Change in present value of in-force long-term insurance business*

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Value of new business	<b>870</b>	924	1,027
Expected return	<b>(545)</b>	(505)	(420)
Assumption changes and experience variances	<b>(116)</b>	88	69
Other adjustments	<b>52</b>	18	61
<b>Year ended 31 December</b>	<b>261</b>	525	737

Reported other operating income of US\$1.1bn decreased by US\$1.5bn from 2013. This was largely due to the significant items summarised in the table below.

*Significant items and currency translation*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>Significant items</b>		
Included within gains/(losses) recognised on assets held for sale:		
write-off of allocated goodwill relating to the GPB Monaco business	<b>168</b>	(772)
gain/(loss) on sale of the non-real estate portfolio in the US		(279)
gain/(loss) on sale of several tranches of real estate secured accounts in the US	<b>168</b>	(271)
Household Insurance Group Holding company's disposal of its insurance manufacturing business <sup>2</sup>		(123)
		(99)
Included within the remaining line items:	<b>(41)</b>	2,193
reclassification gain in respect of our holding in Industrial Bank Co., Limited following the issue of additional share capital to third parties <sup>2</sup>		1,089
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Panama) S.A. <sup>3</sup>		1,107
HSBC Insurance (Asia-Pacific) Holdings Limited's disposal of its shareholding in Bao Viet Holdings <sup>2</sup>		104
loss on sale of an HFC Bank UK secured loan portfolio		(146)
acquisitions, disposals and dilutions	<b>(41)</b>	39
Currency translation		(18)
<b>Year ended 31 December</b>	<b>127</b>	1,403

Excluding the significant items and currency translation tabulated above, other operating income decreased by US\$0.2bn compared with 2013. This was primarily from lower favourable movements in 2014 in present value of in-force ( PVIF ) long-term insurance business, and lower disposal and revaluation gains on investment properties, mainly in Hong Kong. The decrease was partly offset by gains reported in Legacy Credit in GB&M in the UK as we actively managed the portfolio.

Lower favourable movements in the PVIF long-term insurance business asset in 2014 were mainly due to the following factors:

a reduction in the value of new business, mainly in Brazil, due to higher interest rates and lower volumes; and

adverse assumption changes and experience variances in 2014 compared with favourable movements in 2013. This was mainly driven by falling interest rates in France and adverse actuarial assumption updates in Hong Kong, partly offset by the favourable effects of interest rate fluctuations, mainly in Asia and Brazil.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Net insurance claims and benefits paid and movement in liabilities to policyholders**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net insurance claims and benefits paid and movement in liabilities to policyholders:			
gross	<b>13,723</b>	13,948	14,529
less reinsurers share	<b>(378)</b>	(256)	(314)
<b>Year ended 31 December</b> <sup>24</sup>	<b>13,345</b>	13,692	14,215

*For footnote, see page 109.*

Reported net insurance claims and benefits paid and movement in liabilities to policyholders were US\$347m lower than in 2013.

Movements in claims resulting from investment returns on the assets held to support policyholder contracts, where the policyholder bears investment risk, decreased. This reflected weaker equity market performance in the UK and France, partly offset by improved equity market performance in Hong Kong and higher net income on the

bonds portfolio in Brazil. The gains or losses recognised on the financial assets designated at fair value held to support these insurance and investment contract liabilities are reported in Net income from financial instruments designated at fair value .

Reductions in claims resulting from a decrease in new business written in Europe and Latin America were mostly offset by increases in Hong Kong as explained under Net earned insurance premiums .

**Loan impairment charges and other credit risk provisions**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Loan impairment charges:			
new allowances net of allowance releases	<b>5,010</b>	7,344	9,306
recoveries of amounts previously written off	<b>(955)</b>	(1,296)	(1,146)

	<b>4,055</b>	6,048	8,160
Individually assessed allowances	<b>1,780</b>	2,320	2,139
Collectively assessed allowances	<b>2,275</b>	3,728	6,021
Impairment/(releases of impairment) on available-for-sale debt securities	<b>(319)</b>	(211)	99
Other credit risk provisions	<b>115</b>	12	52
<b>Year ended 31 December</b>	<b>3,851</b>	5,849	8,311
Impairment charges on loans and advances to customers as a percentage of average gross loans and advances to customers <sup>27</sup>	<b>0.4%</b>	0.7%	0.9%

*For footnote, see page 109.*

Reported loan impairment charges and other credit risk provisions ( LICs ) of US\$3.9bn were US\$2.0bn lower than in 2013, primarily in North America, Europe and Latin America. The percentage of impairment charges to average gross loans and advances fell to 0.4% at 31 December 2014 from 0.7% at 31 December 2013.

Individually assessed charges decreased by US\$540m, primarily in Europe, partly offset by an increase in Asia and the Middle East and North Africa. In Europe, they were lower, mainly in CMB in the UK, reflecting improved quality in the portfolio and the economic environment, as well as in GB&M. In Asia, the increase was on a small number of exposures in Hong Kong and in mainland China, primarily in CMB and GB&M, while in the Middle East and North Africa we recorded net charges compared with net releases in 2013, mainly due to lower releases on a particular UAE-related exposure in GB&M.

Collectively assessed charges declined by US\$1.5bn, primarily due to decreases in North America and Latin America. In North America, the reduction was mainly in RBWM, reflecting reduced levels of delinquency and new impaired loans in the CML portfolio. A decrease in

lending balances from continued portfolio run-off and loan sales was partly offset by an increase relating to less favourable market value adjustments of underlying properties as improvements in housing market conditions were less pronounced in 2014 than in 2013. In Latin America, the reduction in collectively assessed charges was driven by the adverse effect of changes to the impairment model and assumption revisions for restructured loan portfolios in Brazil which occurred in 2013, both in RBWM and CMB. Charges were also lower due to reduced Business Banking provisions reflecting improved delinquency rates and the effect of the disposal of non-strategic businesses.

Net releases of credit risk provisions of US\$204m were broadly unchanged, as higher releases on available-for-sale ABSs in GB&M in Europe were offset by provisions in Latin America and North America. In Latin America, a provision was made in Brazil against a guarantee in GB&M. In North America we recorded provisions in Canada, compared with releases in 2013, and in the US reflecting a deterioration in the underlying asset values of a specific GB&M exposure.

**Table of Contents****Report of the Directors: Financial Review** (continued)**Operating expenses**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
<b>By expense category</b>			
Employee compensation and benefits	<b>20,366</b>	19,196	20,491
Premises and equipment (excluding depreciation and impairment)	<b>4,204</b>	4,183	4,326
General and administrative expenses	<b>14,361</b>	12,882	15,657
Administrative expenses	<b>38,931</b>	36,261	40,474
Depreciation and impairment of property, plant and equipment	<b>1,382</b>	1,364	1,484
Amortisation and impairment of intangible assets	<b>936</b>	931	969
<b>Year ended 31 December</b>	<b>41,249</b>	38,556	42,927

*Staff numbers (full-time equivalents)*

	<b>2014</b>	2013	2012
<b>Geographical regions</b>			
Europe	<b>69,363</b>	68,334	70,061
Asia <sup>8</sup>	<b>118,322</b>	113,701	112,766
Middle East and North Africa	<b>8,305</b>	8,618	8,765
North America	<b>20,412</b>	20,871	22,443
Latin America	<b>41,201</b>	42,542	46,556
<b>At 31 December</b>	<b>257,603</b>	254,066	260,591

*For footnote, see page 109.*

Reported operating expenses of US\$41bn were US\$2.7bn or 7% higher than in 2013. The increase in operating expenses was partly driven by the significant items noted in the table below, including settlements

and provisions in connection with foreign exchange investigations, of which US\$809m was recorded in the fourth quarter of 2014 (see Note 40 on the Financial Statements for further details).

*Significant items and currency translation*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>Significant items</b>		
Accounting gain arising from change in basis of delivering ill-health benefits in the UK		(430)
Charge in relation to settlement agreement with Federal Housing Finance Authority	<b>550</b>	
Madoff-related litigation costs		298
Settlements and provisions in connection with foreign exchange investigations	<b>1,187</b>	
Regulatory provisions in GBP	<b>65</b>	352
UK customer redress programmes	<b>1,275</b>	1,235
US customer remediation provision relating to CRS		100
Restructuring and other related costs	<b>278</b>	483
Acquisitions, disposals and dilutions	<b>40</b>	488
	<b>3,395</b>	2,526
Currency translation		348
<b>Year ended 31 December</b>	<b>3,395</b>	2,874

Excluding significant items and currency translation, operating expenses were US\$2.2bn or 6% higher than in 2013.

Regulatory Programmes and Compliance costs increased as a result of the continued focus on Global Standards and the broader regulatory reform programme being implemented by the industry to build the necessary infrastructure to meet today's enhanced compliance standards, along with implementation costs to meet obligations such as stress tests in different jurisdictions and structural reform.

During 2014, we accelerated the deployment of Global Standards throughout the Group. Our global businesses and Compliance function have developed operating procedures to meet our new global AML and sanctions policies and these are now being implemented in every

country, encompassing local requirements as necessary. During 2014, we invested in developing our financial crime compliance expertise and building strategic infrastructure solutions for customer due diligence, transaction monitoring and sanctions screening.

We continued to invest in strategic initiatives in support of organically growing our business, primarily in CMB in both Asia, in Business Banking and Global Trade and Receivables Finance and, to a lesser extent, in Europe. We also increased expenditure on marketing and advertising to support revenue generating initiatives, primarily in RBWM's core propositions of Premier and Advance and personal lending products.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

The increase in costs also reflected:

inflationary pressures, including wage inflation, primarily in Asia and Latin America;

the UK bank levy charge, which increased to US\$1.1bn in 2014 from US\$904m in 2013, mainly due to an increase in the rate of the levy. Both years also included adjustments relating to the previous year's bank levy charge (2014: US\$45m favourable adjustment; 2013: US\$12m adverse adjustment); and

the Financial Services Compensation Scheme levy in the UK, as a result of the timing of the recognition. During 2014, we generated further sustainable savings of US\$1.3bn, primarily driven by re-engineering our back office processes, which in part offset the investments and inflation noted above.

The average number of FTEs was broadly unchanged as reductions through sustainable savings programmes were broadly offset by the initiatives related to Regulatory Programmes and Compliance and business growth.

*Reported cost efficiency ratios<sup>25</sup>*

	2014	2013	2012
	%	%	%
<b>HSBC</b>	<b>67.3</b>	59.6	62.8
<b>Geographical regions</b>			
Europe	93.7	84.0	108.4
Asia <sup>8</sup>	44.0	40.7	39.4
Middle East and North Africa	47.7	51.5	48.0
North America	78.9	72.9	60.8
Latin America	71.7	56.1	58.7
<b>Global businesses</b>			
Retail Banking and Wealth Management	71.2	64.5	58.4
Commercial Banking	45.9	43.1	45.9
Global Banking and Markets	67.7	51.9	54.2
Global Private Banking	74.8	91.4	67.6

For footnotes, see page 109.

### Share of profit in associates and joint ventures

	2014 US\$m	2013 US\$m	2012 US\$m
Associates			
Bank of Communications Co., Limited	1,974	1,878	1,670
Ping An Insurance (Group) Company of China, Ltd			763
Industrial Bank Co., Limited			670
The Saudi British Bank	455	403	346
Other	64	5	72
Share of profit in associates	2,493	2,286	3,521
Share of profit in joint ventures	39	39	36
<b>Year ended 31 December</b>	<b>2,532</b>	<b>2,325</b>	<b>3,557</b>

HSBC's reported share of profit in associates and joint ventures was US\$2.5bn, an increase of US\$207m or 9%, in part due to the non-recurrence of an impairment charge of US\$106m on our banking associate in Vietnam in 2013. Excluding this, our share of profit in associates and joint ventures increased, driven by higher contributions from BoCom and The Saudi British Bank.

Our share of profit from BoCom rose as a result of balance sheet growth and increased trading income, partly offset by higher operating expenses and a rise in loan impairment charges.

At 31 December 2014, we performed an impairment review of our investment in BoCom and concluded that it was not impaired, based on our value in use calculation

(see Note 20 on the Financial Statements for further details).

In future periods, the value in use may increase or decrease depending on the effect of changes to model inputs. It is expected that the carrying amount will increase in 2015 due to retained profits earned by BoCom. At the point where the carrying amount exceeds the value in use, HSBC would continue to recognise its share of BoCom's profit or loss, but the carrying amount would be reduced to equal the value in use, with a corresponding reduction in income, unless the market value has increased to a level above the carrying amount.

Profits from The Saudi British Bank rose, reflecting strong balance sheet growth.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Tax expense**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Profit before tax	<b>18,680</b>	22,565	20,649
Tax expense	<b>(3,975)</b>	(4,765)	(5,315)
<b>Profit after tax for the year ended 31 December</b>	<b>14,705</b>	17,800	15,334
Effective tax rate	<b>21.3%</b>	21.1%	25.7%

The effective tax rate for 2014 of 21.3% was lower than the blended UK corporation tax rate for the year of 21.5%.

The effective tax rate in the year reflected the following recurring benefits: tax exempt income from government bonds and equities held by a number of Group entities and recognition of the Group's share of post-tax profits of associates and joint ventures within our pre-tax income. In addition, the effective tax rate reflected a current tax credit for prior periods. This was partly offset by non-tax deductible settlements and provisions in connection with foreign exchange investigations.

The tax expense decreased by US\$0.8bn to US\$4.0bn for 2014, primarily due to a reduction in accounting profits and the benefit of the current tax credit for previous years.

In 2014, the tax borne and paid by the Group to the relevant tax authorities, including tax on profits, bank levy and employer-related taxes, was US\$7.9bn (2013: US\$8.6bn). The amount differs from the tax charge reported in the income statement due to indirect taxes such as VAT and the bank levy which are included in pre-tax profit, and the timing of payments.

We also play a major role as tax collector for governments in the jurisdictions in which we operate. Such taxes include employee-related taxes and taxes withheld from payments to deposit holders. In 2014, we collected US\$9.1bn (2013: US\$8.8bn).

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**2013 compared with 2012**

2013 compared with 2012 commentaries have not been updated to reflect our change from underlying performance to adjusted performance. For comparison, adjusted PBT would have been US\$23.0bn and US\$20.5bn for 2013 and 2012 respectively as compared with underlying PBT of US\$21.6bn and US\$15.3bn for 2013 and 2012 respectively. Constant currency, underlying and adjusted are reconciled on pages 105(b) to 105(au).

**Consolidated income statement**

Reported profit before tax of US\$22.6bn in 2013 was US\$1.9bn or 9% higher than in 2012. This was primarily due to lower adverse fair value movements of US\$4.0bn on own debt designated at fair value resulting from changes in credit spreads and decreases in both loan impairment charges and other credit risk provisions ( LICs ) of US\$2.5bn and operating expenses of US\$4.4bn. These factors were partially offset by lower gains (net of losses) from disposals and reclassifications of US\$2.2bn, compared with US\$7.8bn in 2012. Gains on disposals in 2013 included the gain of US\$1.1bn on sale of our operations in Panama and US\$1.1bn from the reclassification of Industrial Bank Co. Limited ( Industrial Bank ) as a financial investment following its issue of share capital to third parties.

The Board approved a 6% increase in the final dividend in respect of 2013 to US\$0.19 per share, US\$0.01 higher than the final dividend in respect of 2012. Total dividends in respect of 2013 were US\$9.2bn (US\$0.49 per share), US\$0.9bn higher than in 2012. The core tier 1 capital ratio strengthened from 12.3% to 13.6%, and the estimated CRD IV end point basis common equity tier 1 ratio also improved from 9.5% to 10.9%. This was driven by a combination of capital generation and a reduction in risk-weighted assets from management actions. Uncertainty remains, however, around the precise amount of capital that banks will be required to hold under CRD IV as key technical standards and consultations from regulatory authorities are pending. These include the levels, timing and interaction of CRD IV capital buffers and a review of the Pillar 2 framework.

On an underlying basis, profit before tax rose by 41% to US\$21.6bn, primarily from higher net operating income before loan impairment charges and other credit risk provisions ( revenue ), lower LICs, notably in North America, Europe and Middle East and North Africa, and lower operating expenses, mainly from the non-recurrence of a charge in 2012 arising from US investigations and reduced charges relating to UK customer redress.

Underlying profit before tax in our global businesses rose with the exception of GPB which decreased by US\$0.7bn to US\$0.2bn as we continued to address legacy issues and reposition the customer base.

The following commentary is on an underlying basis.

**Revenue across the Group was stable, underpinned by a resilient performance in GB&M and growth in CMB**

Underlying revenue rose by US\$1.7bn or 3% to US\$63.3bn. This reflected a number of factors including net favourable fair value movements on non-qualifying hedges of US\$0.8bn, a net gain recognised on completion of the disposal of our investment in Ping An of US\$0.6bn offsetting the adverse fair value movements on the contingent forward sale contract recorded in 2012, and foreign exchange gains on sterling debt issued by HSBC Holdings of



US\$0.4bn.

Revenue increased in CMB following average balance sheet growth partly offset by spread compression together with higher lending fees and improved collaboration with other global businesses. In GB&M, revenue was higher, in part reflecting a resilient performance in a majority of our customer-facing businesses. These factors were partially offset by lower revenue in RBWM, primarily from the run-off of our US CML portfolio and, in GPB, from the loss on write-off of goodwill relating to our Monaco business and the repositioning of our client base.

**LICs fell in the majority of our regions, notably in North America, Europe and in the Middle East and North Africa**

Underlying LICs were US\$1.9bn or 25% lower than in 2012, primarily in North America where the decline was, in part, due to improvements in housing market conditions, reduced lending balances from continued portfolio run-off and loan sales, and lower levels of new impaired loans and delinquency in the CML portfolio. LICs were also lower in Europe, mainly in GB&M and CMB, and in the Middle East and North Africa, which benefited from an overall improvement in the loan portfolio. By contrast, LICs were higher in Latin America, particularly in Mexico from specific impairments in CMB relating to homebuilders due to a change in the public housing policy and higher collective impairments in RBWM. In Brazil, although credit quality improved following the modification of credit strategies in previous periods to mitigate rising delinquency rates, LICs increased, reflecting impairment model changes and assumption revisions for restructured loan account portfolios in RBWM and CMB, and higher specific impairments in CMB.

**Operating expenses were lower, primarily driven by the non-recurrence of certain notable items in 2012 and further sustainable cost savings**

Underlying operating expenses were US\$2.6bn or 6% less than in 2012, primarily due to the non-recurrence of a 2012 charge following US anti-money laundering ( AML ), Bank Secrecy Act ( BSA ) and Office of Foreign Asset Control ( OFAC ) investigations, lower UK customer redress charges and reduced restructuring and related costs.

HSBC HOLDINGS PLC

56a

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

Excluding these items, operating expenses were higher, mainly due to a rise in the UK bank levy, increased litigation-related expenses, notably a provision in respect of regulatory investigations in GPB, a Madoff-related charge in GB&M and investment in strategic initiatives, risk management and compliance. Higher operational costs also contributed, in part driven by general inflationary pressures and rental costs. These factors were partially offset by sustainable cost savings in the year and an accounting gain relating to changes in delivering ill-health benefits to certain employees in the UK.

The additional US\$1.5bn of sustainable cost savings across all regions, took our total annualised cost savings to US\$4.9bn since 2011 as we continued with our organisational effectiveness programmes during 2013. Together with business disposals, these led to a fall in the number of FTEs of more than 6,500 to 254,000.

Income from associates rose, mainly driven by strong results in mainland China

Underlying income from associates increased, primarily from Bank of Communications Co., Limited ( BoCom ), where balance sheet growth and increased fee income were partially offset by higher operating expenses and a rise in LICs.

The effective tax rate was 21.1% compared with 25.7% in 2012

The effective tax rate was lower than in 2012, reflecting non-taxable gains on profits associated with the reclassification of Industrial Bank as a financial investment and the disposal of our operations in Panama and our investment in Ping An Insurance (Group) Company of China, Ltd ( Ping An ). In addition, the 2012 tax expense included the non-tax deductible effect of fines and penalties paid as part of the settlement of the US AML, BSA and OFAC investigations.

### **Group performance by income and expense item**

#### **Net interest income**

The commentary in the following sections is on a constant currency basis unless stated otherwise.

Reported net interest income of US\$35.5bn decreased by 6% compared with 2012 and on a constant currency basis, net interest income fell by US\$1.5bn. Both net interest spread and margin also fell, reflecting lower yields on customer lending following the disposal in 2012 of the CRS business in the US, which was higher yielding relative to the average yield of our portfolio, and lower yields on our surplus liquidity. These factors were partially offset by a lower cost of funds, principally on customer accounts and debt issued by the Group.

On an underlying basis, which excludes the net interest income earned by the businesses sold during 2013 (see page 50) from both years (2013: US\$273m; 2012: US\$2.0bn) and currency translation movements of US\$682m, net interest income increased by 1%. This reflected balance sheet growth in Hong Kong and Europe, partly offset by lower net interest income earned in North America as a result of the run-off and disposal of

CML portfolios in the US and the consumer finance business in Canada.

## **Interest income**

On a constant currency basis, interest income fell. This was driven by lower interest income from customer lending, including loans classified within Assets held for sale, as a consequence of the disposal of the CRS business in the US in 2012 and the CML non-real estate loan portfolio and select tranches of CML first lien mortgages in the US in 2013. In addition, average yields on customer lending in Latin America fell, notably in Brazil, following lower average interest rates; re-pricing in line with local competition; a change in the composition of the lending portfolios as we focused on growing secured, lower yielding, lending balances for corporate and Premier customers. Interest income earned in Panama, where we disposed of the business, also fell. By contrast interest income on customer lending in Asia rose, driven by growth in residential mortgage balances in RBWM and term and trade-related and commercial real estate and other property-related lending in CMB. This increase in interest income was partially offset by compressed yields on trade lending and lower yields as interest rates declined in a number of countries across the region.

Interest income in Balance Sheet Management also decreased. Yields on financial investments and cash placed with banks and central banks declined as the proceeds from maturities and sales of available-for-sale debt securities were invested at prevailing rates, which were lower. This was partly offset by growth in customer deposits leading to an overall increase in the size of the Balance Sheet Management portfolio.

## **Interest expense**

Interest expense fell in the year, though to a lesser extent than interest income, driven by a lower cost of funds relating to customer accounts. The reduction in interest rates paid to customers in Europe and Asia more than offset the effect of the growth in the average balances of customer accounts. There was also a decline in the interest expense on customer accounts in Latin America, principally in Brazil, reflecting the managed reduction in term deposits as we continued to change the funding base, substituting wholesale customer deposits for medium-term loan notes, together with a lower average base interest rate. The disposal of the business in Panama also reduced interest expense.

Interest expense on debt issued by the Group decreased too. In North America, as a result of the business disposals and the run-off of the CML portfolio, our funding requirements declined and led to a fall in average outstanding balances. In Europe, average outstanding balances fell as a result of net redemptions. Additionally, the effective rate of interest declined as new issuances were at lower prevailing rates.

HSBC HOLDINGS PLC

56b

**Table of Contents****Report of the Directors: Financial Review** (continued)*Repos and reverse repos*

During the final quarter, GB&M changed the way it manages reverse repurchase ( reverse repo ) and repurchase ( repo ) activities. For full details, see page 68. This had the effect of reducing the net interest margin as average interest earning assets and interest bearing liabilities increased significantly. These reverse repo and repo agreements have a lower gross yield and cost of funds, respectively, when compared with the remainder of our portfolio.

Net interest income includes the expense of internally funded trading assets, while related revenue is reported in Net trading income . The internal cost of funding these assets declined, reflecting a decrease in the average trading asset balances in most regions and reductions in our average cost of funds in these regions. In reporting our global business results, this cost is included within Net trading income .

**Net fee income**

Net fee income was broadly unchanged on a reported basis and increased by US\$207m on a constant currency basis.

Fees from unit trusts grew, primarily in Hong Kong, as we captured improved market sentiment and strong customer demand. Fees from funds under management increased, primarily in Europe and Hong Kong, reflecting improved market conditions. Fee income from credit facilities rose, mainly in Europe in CMB.

Underwriting fees rose, notably in Europe and Hong Kong, as client demand for equity and debt capital financing increased and the collaboration between CMB and GB&M strengthened.

These factors were partly offset by the sale of the CRS business in North America, which led to a reduction in cards and insurance fee income and fee expenses. Fee income related to the sale fell following the expiry of the majority of the transition service agreements entered into during 2012. This is reported in other fee income while associated costs are reported in Operating expenses .

**Net trading income**

Reported net trading income of US\$8.7bn was US\$1.6bn higher than in 2012. On a constant currency basis, income increased by US\$1.8bn, notably in Europe. Net income from trading activities primarily arose from our Markets business within GB&M, which recorded a resilient performance during 2013.

The rise in net income from trading activities was due in part to lower adverse foreign exchange movements on assets held as economic hedges of foreign currency debt designated at fair value. These adverse movements offset favourable foreign exchange movements on the foreign currency debt which are reported in Net expense from financial instruments designated at fair value . In addition, we made foreign exchange gains of US\$442m on sterling debt issued by HSBC Holdings. We also recorded a favourable debit valuation adjustment ( DVA ) of US\$105m on derivative contracts, compared with a net reported charge of US\$385m in 2012, as a result of a change in estimation methodology in respect

of credit valuation adjustments ( CVA s) of US\$903m and a DVA of US\$518m, to reflect evolving market practices.

Net income from trading activities in Markets also rose. Trading revenue in Credit grew driven by revaluation gains from price appreciation on assets in the legacy portfolio together with increased customer activity. Foreign Exchange revenue rose as a result of increased client demand for hedging solutions, in part from increased collaboration, although this was partly offset by margin compression and reduced market volatility in the second half of 2013. Equities revenue also grew, from higher client flows and increased revaluation gains in Europe, together with minimal fair value movements on own credit spreads on structured liabilities, compared with adverse fair value movements in 2012.

Rates trading income in 2012 included a charge following a change in the CVA methodology, as noted above. In 2013, we won new client mandates and reported smaller adverse fair value movements on our credit spreads on structured liabilities. These factors were broadly offset by reduced revenue as in 2012 we benefited from a significant tightening of spreads on eurozone bonds following the ECB s liquidity intervention. Revenue in 2013 was also affected by uncertainty regarding the tapering of quantitative easing in the US.

During 2013, we reported adverse fair value movements of US\$682m compared with US\$553m in 2012 on the contingent forward sale contract relating to Ping An in Asia.

Net interest income from trading activities also declined. This was driven by lower yields on debt securities in part reflecting the downward movement in interest rates.

In addition, net trading income was adversely affected by losses of US\$194m relating to the termination of qualifying accounting hedges, mainly in HSBC Finance Corporation ( HSBC Finance ) of US\$199m, as a result of anticipated changes in funding.

In 2013, there were favourable movements on non-qualifying hedges compared with adverse movements in 2012. In North America, we reported favourable fair value movements on non-qualifying hedges as US long-term interest rates increased, compared with adverse fair value movements in 2012. There were also favourable fair value movements on non-qualifying hedges in Europe, compared with adverse movements in 2012

#### **Net income from financial instruments designated at fair value**

The accounting policies for the designation of financial instruments at fair value and the treatment of the associated income and expenses are described in Notes 2 and 25 on the Financial Statements, respectively.

The majority of the financial liabilities designated at fair value are fixed-rate long-term debt issues, the interest rate profile of which has been changed to floating through swaps as part of a documented interest rate management strategy. The movement in fair value of these long-term debt issues and the related hedges

HSBC HOLDINGS PLC

56c

**Table of Contents****Report of the Directors: Financial Review** (continued)

includes the effect of our credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. As credit spreads widen or narrow, accounting profits or losses, respectively, are booked. The size and direction of the changes in the credit spread on our debt and ineffectiveness, which are recognised in the income statement, can be volatile from year to year, but do not alter the cash flows expected as part of the documented interest rate management strategy. As a consequence, fair value movements arising from changes in our own credit spread on long-term debt and other fair value movements on the debt and related derivatives are not regarded internally as part of managed performance and are therefore not allocated to global businesses, but are reported in Other . Credit spread movements on own debt designated at fair value are excluded from underlying results, and related fair value movements are not included in the calculation of regulatory capital.

We reported net income from financial instruments designated at fair value of US\$768m in 2013 compared with a net expense of US\$2.2bn in 2012. This included credit spread-related movements in the fair value of our own long-term debt, on which we experienced adverse fair value movements of US\$1.2bn in 2013 compared with US\$5.2bn in 2012. Adverse fair value movements were less extensive in 2013 than in 2012 as HSBC spreads tightened significantly in Europe and North America, having widened during 2011.

Net income arising from financial assets held to meet liabilities under insurance and investment contracts increased reflecting higher net investment returns in 2013 than in 2012. These returns reflected favourable equity market movements in the UK and France, partly offset by weaker equity market performance and falling bond prices in Hong Kong and lower net income on the bond portfolio in Brazil.

Investment gains or losses arising from equity markets result in a corresponding movement in liabilities to customers, reflecting the extent to which unit-linked policyholders, in particular, participate in the investment performance of the associated asset portfolio. Where these relate to assets held to back investment contracts, the corresponding movement in liabilities to customers is also recorded under Net income/(expense) from financial instruments designated at fair value . This is in contrast to gains or losses related to assets held to back insurance contracts or investment contracts with discretionary participation features ( DPF ), where the corresponding movement in liabilities to customers is recorded under Net insurance claims incurred and movement in liabilities to policyholders .

Other changes in fair value reflected lower favourable foreign exchange movements in 2013 than in 2012 on foreign currency debt designated at fair value and issued as part of our overall funding strategy (offset from assets held as economic hedges in Net trading income ), and higher adverse movements due to hedging ineffectiveness in 2013.

**Gains less losses from financial investments**

Gains less losses from financial investments rose by US\$823m on a reported basis and by US\$840m on a constant currency basis.

This was driven by a significant increase in net gains from the disposal of available-for-sale equity securities in Asia following the completion of the sale of our remaining shareholding in Ping An and an increase in disposal gains in Principal Investments. These increases were partly offset by the non-recurrence of gains in from the sale of our shares in four Indian banks in 2012.

The year on year decline in impairments on available-for-sale equity securities also contributed to the rise in gains less losses from financial investments. This was driven by a reduction in write downs in our Principal Investments business.

Net gains on the disposal of debt securities fell as 2012 included significant gains on the sale of available-for-sale government debt securities, notably in Europe, arising from structural interest rate risk management of the balance sheet.

### **Net insurance premium income**

Net earned insurance premiums decreased by US\$1.1bn on a reported basis, and by US\$1.0bn on constant currency basis.

The reduction was primarily due to lower net earned premiums in Europe, Latin America and North America, partly offset by an increase in Hong Kong.

In Europe, net earned premiums decreased, mainly as a result of lower sales of investment contracts with DPF in France. In addition, 2012 benefited from a number of large sales through independent financial adviser channels which are now in run off.

In Latin America, net earned premiums decreased in Brazil due to lower sales of unit-linked pension products, primarily as a result of changes to the distribution channel. In addition, the sale of the non-life business in Argentina in 2012 contributed to the decrease.

The reduction in net earned premiums in North America was due to the sale of our insurance manufacturing business in the first half of 2013.

In Hong Kong, premium income increased as a result of higher renewal premiums for insurance contracts with DPF and unit-linked insurance contracts, partly offset by lower sales of new business in 2013 and the disposal of the non-life business during 2012.

### **Gains on disposal of US branch network, US cards business and Ping An**

In 2012, we made significant progress in exiting non-strategic markets and disposing of businesses and investments not aligned with the Group's long-term strategy. These included three major disposals:

In May 2012, HSBC USA Inc., HSBC Finance and HSBC Technology and Services (USA) Inc. sold their

HSBC HOLDINGS PLC

56d

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

US Card and Retail Services business, realising a gain on sale of US\$3.1bn.

In May 2012, HSBC Bank USA, N.A. ( HSBC Bank USA ) sold 138 out of 195 branches, primarily in upstate New York, realising a gain of US\$661m. In August 2012, it sold the remaining 57 branches to the same purchaser, realising a gain of US\$203m.

In December 2012, HSBC Insurance Holdings Limited and The Hongkong and Shanghai Banking Corporation agreed to sell their entire shareholdings in Ping An, representing 15.57% of the issued share capital of Ping An, in two tranches. The first tranche was completed on 7 December 2012, at which point we ceased to account for Ping An as an associate and recognised a gain on disposal of US\$3.0bn. The remaining shareholding in respect of the second tranche was recognised as a financial investment.

The fixing of the sale price in respect of the second tranche gave rise to a contingent forward sale contract, for which there was an adverse fair value movement of US\$553m recorded in Net trading income in 2012. The disposal of our investment in Ping An was completed in 2013. We realised a gain of US\$1.2bn, which was recorded in Gains less losses from financial investments. This was partly offset by the adverse fair value movement of US\$682m on the contingent forward sale contract recorded in Net trading income, leading to a net gain in the year of US\$553m.

**Other operating income**

Other operating income of US\$2.6bn increased by US\$532m in 2013 on a reported basis and by US\$727m on a constant currency basis.

Reported other operating income included net gains on the disposals and the reclassifications listed on page 49 of US\$2.2bn in 2013, principally relating to an accounting gain arising from the reclassification of Industrial Bank as a financial investment following its issue of additional share capital to third parties and a gain on the disposal of our operations in Panama, compared with net gains of US\$736m in 2012.

On an underlying basis, which excludes the net gains above, the results of disposed of operations and the effects of foreign currency translation, other operating income decreased. This was driven by losses totalling US\$424m on the sales of our CML non-real estate personal loan portfolio and several tranches of real estate secured loans, and a loss of US\$279m following the write-off of goodwill relating to our GPB business in Monaco. In addition, we recognised a loss of US\$146m on the sale of the HFC Bank UK secured loan portfolio in RBWM in Europe. These factors were partly offset by higher disposal and revaluation gains on investment properties in Hong Kong.

There were lower favourable movements on the present value of the in-force ( PVIF ) long-term insurance

business asset compared with 2012. This was largely due to lower values of new business in Europe and Asia, reflecting lower sales. Additionally, expected returns increased due to the growth of the opening PVIF asset year on year, particularly in Hong Kong and Brazil.



These factors were partly offset by higher favourable assumption changes in Hong Kong, which exceeded the adverse experience and assumption changes in Latin America. The lower other PVIF movements in 2013 compared with 2012 were driven by Latin America, notably the favourable effect of the recognition of a PVIF asset in Brazil in 2012 which did not recur.

### **Net insurance claims and benefits paid and movement in liabilities to policyholders**

Net insurance claims incurred and movement in liabilities to policyholders decreased by 4% on a reported basis, and by 3% on a constant currency basis.

The reduction largely reflected the decrease in premiums, notably in Latin America, North America and France, and included the effect of business disposals described under *Net earned insurance premiums* .

This reduction was partly offset by increases in reserves attributable to increased renewal premiums in Hong Kong and higher investment returns on the assets held to support policyholder contracts where the policyholder bears investment risk. These returns reflected favourable equity market movements in the UK and France, partly offset by weaker equity market performance and falling bond prices in Hong Kong and lower net income on the bond portfolio in Brazil.

The gains or losses recognised on the financial assets designated at fair value held to support these insurance and investment contract liabilities are reported in *Net income from financial instruments designated at fair value* .

### **Loan impairment charges and other credit risk provisions**

On a reported basis, loan impairment charges and other credit risk provisions ( *LICs* ) were US\$2.5bn lower than in 2012, decreasing in the majority of regions, most notably in North America, Europe and the Middle East and North Africa. Underlying LICs declined by US\$1.9bn to US\$5.8bn.

The percentage of impairment charges to average gross loans and advances reduced to 0.7% at 31 December 2013 from 0.9% at 31 December 2012.

On a constant currency basis, LICs fell by US\$2.3bn, a reduction of 28%. Collectively assessed charges decreased by US\$2.1bn while individually assessed impairment charges increased by US\$198m. Credit risk provisions on available-for-sale debt securities reflected net releases of US\$211m in 2013 compared with charges in 2012.

The fall in collectively assessed charges largely arose in North America, in part due to improvements in housing market conditions. In addition, the decrease reflected lower lending balances, reduced new impaired loans and

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

lower delinquency levels in the CML portfolio. This was partially offset by increases in Latin America, principally in Mexico due to higher collective impairments in RBWM. In Brazil, improvements in credit quality were broadly offset by higher charges from model changes and assumption revisions for restructured loan portfolios in RBWM and Business Banking in CMB.

The increase in individually assessed loan impairment charges reflected higher levels of impairment in Latin America, particularly on exposures to homebuilders in Mexico and across a number of corporate exposures in Brazil. These were partly offset by releases in the Middle East and North Africa, mainly in GB&M for a small number of customers as a result of an overall improvement in the loan portfolio compared with charges in 2012. In Europe, higher provisions in GB&M were broadly offset by decreases in CMB, mainly in the UK and Greece.

The movement in credit risk provisions on available-for-sale debt securities was largely in GB&M as a result of net releases in Europe compared with charges in 2012, and a credit risk provision on an available-for-sale debt security in 2012 in Asia.

In *North America*, LICs decreased by US\$2.3bn to US\$1.2bn, mainly in the US, in part due to improvements in housing market conditions. In addition, the decrease reflected lower lending balances from continued run-off and loan sales, and lower levels of new impaired loans and delinquency in the CML portfolio. US\$322m of the decline in loan impairment charges was due to the sale of the CRS business in 2012. These factors were partly offset by an increase of US\$130m relating to a rise in the estimated average period of time from a loss event occurring to writing off real estate loans to twelve months (previously a period of ten months was used). In CMB, loan impairment charges increased by US\$77m, reflecting higher collectively assessed charges in the US as a result of increased lending balances in key growth markets and higher individually assessed impairments on a small number of exposures mainly in Canada.

In *Europe*, LICs decreased by 20% to US\$1.5bn. In the UK, GB&M reported net releases of credit risk provisions on available-for-sale asset backed securities (ABSs), compared with impairment charges in 2012, offset in part by higher individually assessed provisions. In addition, there were lower loan impairment charges in CMB due to lower collectively and individually assessed provisions, and in RBWM due to lower collectively assessed provisions reflecting recoveries from debt sales. In other countries in Europe, lower individually assessed impairment provisions in Greece were partly offset by increases in Turkey, where there was growth in unsecured lending in RBWM and a rise in Spain, where the challenging economic conditions continued to affect the market.

In the *Middle East and North Africa*, LICs reflected a net release of US\$42m compared with a charge of US\$282m in 2012. We recorded provision releases, mainly in GB&M, for a small number of UAE-related exposures, reflecting an overall improvement in the loan portfolio

compared with charges in 2012. In addition, loan impairment charges declined, due to lower individually assessed loan impairments in the UAE in CMB, and lower provisions in RBWM on residential mortgages following a repositioning of the book towards higher quality lending and improved property prices.

In *Latin America*, LICs increased by US\$693m, primarily in Mexico due to specific impairments in CMB relating to homebuilders from a change in the public housing policy, and higher collective impairments in RBWM as a result of increased volumes and higher delinquency in our unsecured lending portfolio. In Brazil, LICs increased due to changes to the impairment model and assumption revisions for restructured loan account portfolios in RBWM and CMB, following a realignment of local practices to Group standard policy. LICs were also adversely affected by higher specific impairments in CMB across a number of corporate exposures. These factors were partly offset by improvements in credit quality in Brazil following the modification of credit strategies in previous years to mitigate rising delinquency rates.

LICs in *Asia* were in line with 2012 as higher charges in Hong Kong due to a revision to the assumptions used in our collective assessment models in RBWM and a rise in individual impairment charges in CMB, were broadly offset by the non-recurrence of a large individually assessed impairment of a corporate exposure in Australia and a credit risk provision on an available-for-sale debt security in GB&M.

### **Operating expenses**

Reported operating expenses of US\$38.6bn were US\$4.4bn or 10% lower than 2012. On an underlying basis, costs fell by 6%.

On a constant currency basis, operating expenses in 2013 were US\$3.7bn or 9% lower than in 2012, primarily due to the non-recurrence of a charge for US AML, BSA, and OFAC investigations of US\$1.9bn, and a reduction in restructuring and other related costs of US\$369m. UK customer redress programmes were also lower than in 2012. These included:

a charge for additional estimated redress for possible mis-selling in previous years of payment protection insurance ( PPI ) policies of US\$756m (US\$1.7bn in 2012);

US\$261m in respect of interest rate protection products (US\$586m in 2012);

US\$149m in respect of wealth management products; and

The provision for the UK customer redress programmes at 31 December 2013 is US\$2.1bn. The business disposals, primarily the disposal of the CRS business and the non-strategic branches in the US in 2012, resulted in a lower cost base in 2013.

Excluding the above, expenses were US\$808m higher than in 2012. The UK bank levy charge of US\$904m in 2013 increased compared with US\$571m in 2012, mainly due to an increase in its rate. In addition,

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

operating expenses in both years included adjustments relating to the prior year charge for the UK bank levy (2013: US\$12m adverse adjustment; 2012: US\$99m favourable adjustment).

Litigation-related expenses increased primarily due to a provision in respect of regulatory investigations in GPB, Madoff-related litigation costs in GB&M, and a customer remediation provision connected with our former CRS business.

During 2013:

we increased our investment in digital and wealth management capabilities in RBWM;

in CMB we continued our ongoing expansion into the large corporate market in the US; and

increased investment spend on regulatory requirements particularly through the Global Standards programme. In addition, other costs rose due to higher operational expenses in part driven by general inflationary pressures including wage inflation across the Group and rental costs in Asia. Cost growth in the Middle East and North Africa resulted from a customer redress programme in RBWM relating to fees charged on overseas credit card transactions, the acquisition of the Lloyds business in the UAE in 2012 and the merger with Oman International Bank S.A.O.G. ( OIB ). Operating expenses also increased in Hong Kong and North America as a result of changes to the recognition of pension costs.

These cost increases were in part offset by further sustainable cost savings of US\$1.5bn from our ongoing organisational effectiveness programmes. In addition, we recorded an accounting gain of US\$430m from changes in delivering ill-health benefits to certain employees in the UK (see Note 6 on the Financial Statements).

The number of employees expressed in full-time equivalent numbers ( FTE s) at the end of 2013 was 3% lower than at the end of 2012 due to sustainable cost savings initiatives and business disposals. Average staff numbers fell by 6% compared with 2012

**Share of profit in associates and joint ventures**

The share of profit in associates and joint ventures was US\$2.3bn, a decrease of 35% compared with 2012 on both a reported and constant currency basis. This was driven by the disposal of Ping An in 2012 and the reclassification in 2013 of Industrial Bank as a financial investment.

The recognition of profits ceased from Ping An following the agreement to sell our shareholding in December 2012, and from Industrial Bank following the issuance of additional share capital to third parties in January 2013, which resulted in our diluted shareholding being classified as a financial investment. In addition, in 2013, we recorded an

impairment charge of US\$106m on our banking associate in Vietnam.

Our share of profit from BoCom rose as a result of balance sheet growth and increased fee income, partly offset by higher operating expenses and a rise in loan impairment charges.

At 31 December 2013, we performed an impairment review of our investment in BoCom and concluded that it was not impaired at the year end, based on our value in use calculation (see Note 21 on the Financial Statements for further details). In future years, the value in use will remain relatively stable if the current calculation assumptions remain broadly the same. However, it is expected that the carrying amount will increase in 2014 due to retained profits earned by BoCom. At the point where the carrying amount exceeds the value in use, the carrying amount would be reduced to equal value in use, with a corresponding reduction in income, unless the market value has increased to a level above the carrying amount.

Profits from The Saudi British Bank rose, reflecting strong lending growth and effective cost management.

### **Tax expense**

The effective tax rate for 2013 of 21.1% was lower than the UK corporation tax rate of 23.25%.

The lower effective tax rate reflected the geographical distribution of our profit, the non-taxable gain on profits resulting from the reclassification of our holding in Industrial Bank as a financial investment and the disposal of our operations in Panama and our investment in Ping An.

The tax expense decreased by US\$0.6bn to US\$4.8bn despite a US\$2.0bn increase in accounting profit before tax, due to the combination of benefits noted above and because the 2012 tax expense included the non-tax deductible effect of fines and penalties paid as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanction laws.

In 2013, the tax borne and paid by the Group to the relevant tax authorities, including tax on profits, bank levy and employer-related taxes, was US\$8.6bn (2012: US\$9.3bn). The amount differs from the tax charge reported in the income statement due to indirect taxes such as VAT and the bank levy included in pre-tax profit, and the timing of payments.

We also play a major role as tax collector for governments in the jurisdictions in which we operate. Such taxes include employee-related taxes and taxes withheld from payments to deposit holders. In 2013, we collected US\$8.8bn (2012: US\$8.5bn).

HSBC HOLDINGS PLC

56g

**Table of Contents****Report of the Directors: Financial Review** (continued)**Consolidated balance sheet***Five-year summary consolidated balance sheet*

	<b>2014</b>	2013	2012	2011	2010
	<b>US\$m</b>	US\$m	US\$m	US\$m	US\$m
<b>ASSETS</b>					
Cash and balances at central banks	<b>129,957</b>	166,599	141,532	129,902	57,383
Trading assets <sup>26</sup>	<b>304,193</b>	303,192	408,811	330,451	385,052
Financial assets designated at fair value	<b>29,037</b>	38,430	33,582	30,856	37,011
Derivatives	<b>345,008</b>	282,265	357,450	346,379	260,757
Loans and advances to banks <sup>27</sup>	<b>112,149</b>	120,046	117,085	139,078	141,869
Loans and advances to customers <sup>27,28</sup>	<b>974,660</b>	992,089	962,972	899,010	897,847
Reverse repurchase agreements non-trading <sup>26,27</sup>	<b>161,713</b>	179,690	70,112	83,328	126,921
Financial investments	<b>415,467</b>	425,925	421,101	400,044	400,755
Other assets	<b>161,955</b>	163,082	179,893	196,531	147,094
<b>Total assets at 31 December</b>	<b>2,634,139</b>	2,671,318	2,692,538	2,555,579	2,454,689
<b>LIABILITIES AND EQUITY</b>					
<b>Liabilities</b>					
Deposits by banks <sup>27</sup>	<b>77,426</b>	86,507	95,480	95,205	87,221
Customer accounts <sup>27</sup>	<b>1,350,642</b>	1,361,297	1,311,396	1,223,140	1,190,763
Repurchase agreements non-trading <sup>26,27</sup>	<b>107,432</b>	164,220	40,567	48,402	60,325
Trading liabilities <sup>26</sup>	<b>190,572</b>	207,025	304,563	265,192	300,703
Financial liabilities designated at fair value	<b>76,153</b>	89,084	87,720	85,724	88,133
Derivatives	<b>340,669</b>	274,284	358,886	345,380	258,665
Debt securities in issue	<b>95,947</b>	104,080	119,461	131,013	145,401
Liabilities under insurance contracts	<b>73,861</b>	74,181	68,195	61,259	58,609
Other liabilities	<b>121,459</b>	120,181	123,141	134,171	109,954
<b>Total liabilities at 31 December</b>	<b>2,434,161</b>	2,480,859	2,509,409	2,389,486	2,299,774
<b>Equity</b>					
Total shareholders' equity	<b>190,447</b>	181,871	175,242	158,725	147,667

Non-controlling interests	<b>9,531</b>	8,588	7,887	7,368	7,248
<b>Total equity at 31 December</b>	<b>199,978</b>	190,459	183,129	166,093	154,915
<b>Total liabilities and equity at 31 December</b>	<b>2,634,139</b>	2,671,318	2,692,538	2,555,579	2,454,689

*Five-year selected financial information*

	<b>2014</b>	2013	2012	2011	2010
	<b>US\$m</b>	US\$m	US\$m	US\$m	US\$m
Called up share capital	<b>9,609</b>	9,415	9,238	8,934	8,843
Capital resources <sup>29,30</sup>	<b>190,730</b>	194,009	180,806	170,334	167,555
Undated subordinated loan capital	<b>2,773</b>	2,777	2,778	2,779	2,781
Preferred securities and dated subordinated loan capital <sup>31</sup>	<b>47,208</b>	48,114	48,260	49,438	54,421
Risk-weighted assets <sup>29</sup>	<b>1,219,765</b>	1,092,653	1,123,943	1,209,514	1,103,113
<b>Financial statistics</b>					
Loans and advances to customers as a percentage of customer accounts <sup>27</sup>	<b>72.2</b>	72.9	73.4	73.5	75.4
Average total shareholders' equity to average total assets	<b>7.01</b>	6.55	6.16	5.64	5.53
Net asset value per ordinary share at year-end <sup>32</sup> (US\$)	<b>9.28</b>	9.27	9.09	8.48	7.94
Number of US\$0.50 ordinary shares in issue (millions)	<b>19,218</b>	18,830	18,476	17,868	17,686
Closing foreign exchange translation rates to US\$:					
US\$1: £	<b>0.642</b>	0.605	0.619	0.646	0.644
US\$1:	<b>0.823</b>	0.726	0.758	0.773	0.748

*For footnotes, see page 109.*

*A more detailed consolidated balance sheet is contained in the Financial Statements on page 337.*

HSBC HOLDINGS PLC

## Table of Contents

### Report of the Directors: Financial Review (continued)

#### **Movement in 2014**

Total reported assets were US\$2.6 trillion, 1% lower than at 31 December 2013. On a constant currency basis, total assets were US\$85bn or 3% higher.

Our balance sheet remains strong with a ratio of customer advances to customer accounts of 72%. Although customer loans and customer accounts have fallen on a reported basis, both have increased on a constant currency basis, notably rising in Asia.

The following commentary is on a reported basis unless otherwise stated.

#### **Assets**

*Cash and balances at central banks* decreased by US\$37bn, notably in Europe, in part reflecting net reductions in repurchase and reverse repurchase agreements.

*Trading assets* were broadly unchanged. Excluding adverse foreign exchange movements of US\$18bn, trading assets grew, primarily from the holdings of debt securities in Asia to support GB&M's Rates business. In Europe, trading assets were broadly unchanged as increased holdings of equity securities were broadly offset by reductions in several other asset classes.

*Financial assets designated at fair value* decreased by US\$9bn, notably in Europe, largely from the transfer to Assets held for sale of balances relating to the UK Pension business of HSBC Life (UK) Limited.

*Derivative assets* increased by 22%, notably in Europe relating to interest rate and foreign exchange derivative contracts reflecting market movements, including changes in yield curves and foreign exchange rates.

*Loans and advances to customers* marginally decreased by US\$17bn or 2% including adverse foreign exchange movements of US\$45bn. Excluding these movements, customer lending grew by US\$28bn, or 3%, largely from growth in Asia of US\$32bn and, to a lesser extent, in North America and Latin America. By contrast, balances decreased in Europe by US\$15bn, as term lending growth in CMB and GB&M was more than offset by a fall in corporate overdraft balances relating to a small number of customers, as explained further below.

In Asia, term lending to CMB and GB&M customers grew, which included growth in commercial real estate and other property-related lending. Mortgage balances also increased, mainly in Hong Kong. In North America, the growth in balances was driven by increased term lending to corporate and commercial customers in CMB and GB&M, partly offset by a decline in RBWM from the continued reduction in the US run-off portfolio and the transfer to Assets held for sale of US first lien mortgage balances. Balances also rose in Latin America, mainly in CMB in Brazil and GB&M in Mexico.

The fall in lending in Europe of US\$15bn was driven by a reduction in corporate overdraft balances. In the UK, a small number of clients benefit from the use of net interest arrangements across their overdraft and deposit positions.



During the year, as we aligned our approach in our Payments and Cash Management business to be more globally consistent, many of these clients increased the frequency with which they settled these balances, reducing their overdraft and deposit balances which fell by US\$28bn. Other customer loans and advances increased by US\$13bn, mainly in CMB and GB&M, driven by an increase in term lending to corporate and commercial customers, notably in the second half of the year.

*Reverse repurchase agreements* decreased by US\$18bn, driven by a managed reduction in Europe as we reassessed the overall returns of these activities in light of new regulatory requirements. This decrease was partly offset by increases in Asia and North America.

## Liabilities

*Repurchase agreements* decreased by US\$57bn or 35%, driven by a decrease in Europe, notably in the UK and France, reflecting the managed reduction in reverse repurchase agreements in Europe as noted above.

*Customer accounts* decreased marginally by US\$11bn, and included adverse foreign exchange movements of US\$58bn. Excluding these movements, balances increased by US\$47bn or 4%, with growth in all regions, notably Asia, of US\$36bn. The increase in Asia reflected growth in our Payments and Cash Management business in CMB and GB&M, an increase in balances in Securities Services in GB&M and a rise in RBWM, in part reflecting successful deposit campaigns. In Europe, balances increased marginally despite a US\$28bn fall in corporate current accounts, mainly in GB&M, in line with the fall in corporate overdraft balances, and a reduction in client deposits in GPB. These factors were more than offset by growth in CMB and, to a lesser extent, in GB&M as deposits from our Payments and Cash Management business increased together with a rise in RBWM balances reflecting customers continued preference for holding balances in current and savings accounts.

*Trading liabilities* fell by US\$16bn including adverse foreign exchange movements of US\$12bn. Excluding these, balances fell reflecting changes in client demand.

*Financial liabilities designated at fair value* reduced by US\$13bn, mainly in Europe reflecting the transfer to Liabilities held for sale of balances relating to the UK Pension business of HSBC Life (UK) Limited.

The increase in *derivative liabilities* was in line with that of Derivative assets as the underlying risk is broadly matched.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Equity**

Total shareholders' equity rose by 5%, driven by profits generated in the year, which were partially offset by dividends paid. In addition, shareholders' equity increased as we issued new contingent convertible securities of US\$5.7bn during 2014. For further details

of these securities, see Note 35 on the Financial Statements. These movements were partly offset by a reduction of US\$9bn in our foreign exchange reserve reflecting the notable appreciation in the US dollar against sterling and the euro, particularly in the second half of the year.

**Reconciliation of consolidated reported and constant currency assets and liabilities**

	31 December 2014 compared with 31 December 2013					
	31 Dec 13 as reported US\$m	Currency translation adjustment <sup>33</sup> US\$m	31 Dec 13 at 31 Dec 14 exchange rates US\$m	31 Dec 14 Reported reported US\$m	Constant currency change %	Constant change %
Cash and balances at central banks	166,599	(9,384)	157,215	129,957	(22)	(17)
Trading assets	303,192	(18,176)	285,016	304,193		7
Financial assets designated at fair value	38,430	(2,467)	35,963	29,037	(24)	(19)
Derivative assets	282,265	(16,582)	265,683	345,008	22	30
Loans and advances to banks <sup>27</sup>	120,046	(4,923)	115,123	112,149	(7)	(3)
Loans and advances to customers <sup>27</sup>	992,089	(45,494)	946,595	974,660	(2)	3
Reverse repurchase agreements non-trading <sup>26,27</sup>	179,690	(9,961)	169,729	161,713	(10)	(5)
Financial investments	425,925	(15,285)	410,640	415,467	(2)	1
Other assets	163,082	(385)	162,697	161,955	(1)	
<b>Total assets</b>	<b>2,671,318</b>	<b>(122,657)</b>	<b>2,548,661</b>	<b>2,634,139</b>	<b>(1)</b>	<b>3</b>

Deposits by banks <sup>27</sup>	86,507	(3,317)	83,190	77,426	(10)	(7)
Customer accounts <sup>27</sup>	1,361,297	(57,673)	1,303,624	1,350,642	(1)	4
Repurchase agreements non-trading <sup>26, 27</sup>	164,220	(7,730)	156,490	107,432	(35)	(31)
Trading liabilities	207,025	(12,208)	194,817	190,572	(8)	(2)
Financial liabilities designated at fair value	89,084	(3,930)	85,154	76,153	(15)	(11)
Derivative liabilities	274,284	(16,214)	258,070	340,669	24	32
Debt securities in issue	104,080	(5,089)	98,991	95,947	(8)	(3)
Liabilities under insurance contracts	74,181	(4,447)	69,734	73,861		6
Other liabilities	120,181	(4,221)	115,960	121,459	1	5
<b>Total liabilities</b>	<b>2,480,859</b>	<b>(114,829)</b>	<b>2,366,030</b>	<b>2,434,161</b>	<b>(2)</b>	<b>3</b>
Total shareholders' equity	181,871	(7,720)	174,151	190,447	5	9
Non-controlling interests	8,588	(108)	8,480	9,531	11	12
<b>Total equity</b>	<b>190,459</b>	<b>(7,828)</b>	<b>182,631</b>	<b>199,978</b>	<b>5</b>	<b>9</b>
<b>Total liabilities and equity</b>	<b>2,671,318</b>	<b>(122,657)</b>	<b>2,548,661</b>	<b>2,634,139</b>	<b>(1)</b>	<b>3</b>

*For footnotes, see page 109.*

## HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Combined view of lending and deposits<sup>26,27</sup>*

	2014	2013	Change
	US\$m	US\$m	%
<b>Customers amortised cost</b>			
Loans and advances to customers	974,660	992,089	(2)
Loans and advances to customers reported in Assets held for sale <sup>34</sup>	577	1,703	(66)
Reverse repurchase agreements non-trading	66,310	88,215	(25)
Combined customer lending	1,041,547	1,082,007	(4)
Customer accounts	1,350,642	1,361,297	(1)
Customer accounts reported in Liabilities of disposal groups held for sale	145	2,187	(93)
Repurchase agreements non-trading	79,556	121,515	(35)
Combined customer deposits	1,430,343	1,484,999	(4)
<b>Banks amortised cost</b>			
Loans and advances to banks	112,149	120,046	(7)
Reverse repurchase agreements non-trading	95,403	91,475	4
Combined bank lending	207,552	211,521	(2)
Deposits by banks	77,426	86,507	(10)
Repurchase agreements non-trading	27,876	42,705	(35)
Combined bank deposits	105,302	129,212	(19)
<b>Customers and banks fair value</b>			
Trading assets reverse repos	1,297	10,120	(87)
loans and advances to customers	908	7,180	(87)
loans and advances to banks	389	2,940	(87)
Trading liabilities repos	3,798	17,421	(78)
customer accounts	898	9,611	(91)
deposits by banks	2,900	7,810	(63)

*For footnotes, see page 109.*

*Financial investments*

2014

2013

	Equity	Debt	Equity	Debt	Total
	securities	securities	securities	securities	Total
	US\$bn	US\$bn	US\$bn	US\$bn	US\$bn
Balance Sheet Management		<b>306.8</b>	<b>306.8</b>		314.4
Insurance entities		<b>48.5</b>	<b>48.5</b>		46.4
Structured entities	<b>0.1</b>	<b>14.9</b>	<b>15.0</b>	0.1	22.6
Principal Investments	<b>2.0</b>		<b>2.0</b>	2.7	2.7
Other	<b>8.6</b>	<b>34.6</b>	<b>43.2</b>	6.3	33.4
<b>At 31 December</b>	<b>10.7</b>	<b>404.8</b>	<b>415.5</b>	9.1	416.8

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Average balance sheet****Average balance sheet and net interest income**

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

Average balances are based on daily averages for the principal areas of our banking activities with monthly or less frequent averages used elsewhere. Balances and transactions with fellow subsidiaries are reported gross in the principal commercial banking and consumer finance entities and the elimination entries are included within Other operations .

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. Total interest-earning assets include loans where the carrying amount has been adjusted as a result of impairment allowances. In accordance with IFRSs, we recognise interest income on assets after the carrying amount has been adjusted as a result of impairment. Fee income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and recorded in Interest income .

*Assets*

	2014			2013			2012		
	Average	Interest	Yield	Average	Interest	Yield	Average	Interest	Yield
	balance	income		balance	income		balance	income	
	US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
<b>Summary</b>									
Interest-earning assets measured at amortised cost (itemised below)	<b>1,786,536</b>	<b>50,955</b>	<b>2.85</b>	1,669,368	51,192	3.07	1,625,068	56,702	3.49
	<b>238,958</b>	<b>5,596</b>	<b>2.34</b>	354,817	5,763	1.62	368,406	6,931	1.88

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Trading assets and financial assets designated at fair value <sup>61,62</sup>										
Impairment provisions		(14,015)			(15,954)			(17,421)		
Non-interest-earning assets		668,564			683,785			730,901		
Total assets and interest income		2,680,043	56,551	2.11	2,692,016	56,955	2.12	2,706,954	63,633	2.35
Average yield on all interest-earning assets				2.79			2.81			3.19
<b>Short-term funds and loans and advances to banks<sup>27</sup></b>										
Europe	HSBC Bank	96,638	997	1.03	89,921	880	0.98	82,206	1,000	1.22
	HSBC Private Banking Holdings (Suisse)	9,704	10	0.10	15,400	10	0.06	2,072	9	0.43
	HSBC France	7,055	66	0.94	10,603	93	0.88	13,204	115	0.87
Asia <sup>63</sup>	Hang Seng Bank	15,374	279	1.81	16,496	251	1.52	16,396	283	1.73
	The Hongkong and Shanghai Banking Corporation	57,141	822	1.44	53,372	809	1.52	54,148	837	1.55
	HSBC Bank Malaysia	5,060	158	3.12	5,487	162	2.95	4,243	123	2.90
MENA	HSBC Bank Middle East	4,678	29	0.62	5,018	27	0.54	5,530	32	0.58
North America	HSBC Bank USA	28,148	105	0.37	24,907	84	0.34	23,707	104	0.44
	HSBC Bank Canada	606	4	0.66	425	3	0.71	389	4	1.03
Latin America	HSBC Mexico	2,675	86	3.21	2,846	109	3.83	3,053	119	3.90
	Brazilian operations	5,416	498	9.19	5,579	388	6.95	9,008	735	8.16
	HSBC Bank Argentina	1,083	12	1.11	1,199	18	1.50	82	18	21.95
Other operations		3,570	2	0.06	5,124	17	0.33	21,793	126	0.58
		237,148	3,068	1.29	236,377	2,851	1.21	235,831	3,505	1.49

HSBC HOLDINGS PLC

60a

**Table of Contents****Report of the Directors: Financial Review (continued)**

		2014			2013			2012		
		Average	Interest		Average	Interest		Average	Interest	
		balance	income	Yield	balance	income	Yield	balance	income	Yield
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
<b>Loans and advances to customers<sup>27</sup></b>										
Europe	HSBC Bank	<b>302,817</b>	<b>10,423</b>	<b>3.44</b>	292,200	10,631	3.64	281,255	10,565	3.76
	HSBC Private Banking Holdings (Suisse)	<b>13,026</b>	<b>159</b>	<b>1.22</b>	15,235	194	1.27	12,591	199	1.58
	HSBC France	<b>43,736</b>	<b>1,626</b>	<b>3.72</b>	47,404	1,656	3.49	45,030	1,649	3.66
	HSBC Finance				173	10	5.78	886	42	4.74
Asia <sup>63</sup>	Hang Seng Bank	<b>79,586</b>	<b>2,410</b>	<b>3.03</b>	72,537	2,179	3.00	64,907	1,895	2.92
	The Hongkong and Shanghai Banking Corporation	<b>263,732</b>	<b>8,517</b>	<b>3.23</b>	237,915	8,022	3.37	208,961	7,627	3.65
	HSBC Bank Malaysia	<b>13,548</b>	<b>672</b>	<b>4.96</b>	13,928	683	4.90	13,456	707	5.25
MENA	HSBC Bank Middle East	<b>26,618</b>	<b>1,133</b>	<b>4.26</b>	25,537	1,124	4.40	24,012	1,214	5.06
North America	HSBC Bank USA	<b>63,770</b>	<b>1,791</b>	<b>2.81</b>	56,538	1,776	3.14	53,555	1,715	3.20
	HSBC Finance	<b>26,446</b>	<b>2,171</b>	<b>8.21</b>	34,146	3,064	8.97	43,565	3,903	8.96
	HSBC Bank Canada	<b>37,472</b>	<b>1,371</b>	<b>3.66</b>	39,199	1,431	3.65	41,151	1,551	3.77
Latin America	HSBC Mexico	<b>15,770</b>	<b>1,542</b>	<b>9.78</b>	15,335	1,658	10.81	14,411	1,613	11.19
	Brazilian operations	<b>27,275</b>	<b>4,579</b>	<b>16.79</b>	25,688	4,604	17.92	27,621	5,468	19.80
	HSBC Bank Argentina	<b>3,078</b>	<b>798</b>	<b>25.93</b>	3,615	799	22.10	3,644	718	19.70



Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Other operations		<b>14,437</b>	<b>237</b>	<b>1.64</b>	17,872	698	3.91	56,654	2,004	3.54
		<b>931,311</b>	<b>37,429</b>	<b>4.02</b>	897,322	38,529	4.29	891,699	40,870	4.58
<b>Reverse repurchase agreements non-trading<sup>27</sup></b>										
Europe	HSBC Bank HSBC	<b>66,360</b>	<b>450</b>	<b>0.68</b>	28,131	113	0.40	12,621	71	0.56
	France	<b>29,703</b>	<b>62</b>	<b>0.21</b>	45,929	48	0.10	43,986	125	0.28
Asia <sup>63</sup>	The Hongkong and Shanghai Banking Corporation	<b>23,562</b>	<b>333</b>	<b>1.41</b>	11,722	272	2.32	7,585	206	2.72
	HSBC Bank Malaysia	<b>991</b>	<b>31</b>	<b>3.13</b>	378	11	2.91	1,132	34	3.00
MENA	HSBC Bank Middle East	<b>18</b>	<b>2</b>	<b>11.11</b>	620	7	1.13	392	9	2.30
North America	HSBC Bank USA	<b>1,196</b>	<b>10</b>	<b>0.84</b>	1,837	13	0.71	6,312	29	0.46
	HSBC Finance							322	1	0.31
	HSBC Bank Canada	<b>7,169</b>	<b>84</b>	<b>1.17</b>	9,196	93	1.01	4,810	50	1.04
Latin America	HSBC Mexico	<b>90</b>	<b>3</b>	<b>3.33</b>	133	5	3.76			
	Brazilian operations	<b>7,241</b>	<b>753</b>	<b>10.40</b>	5,541	404	7.29	5,602	420	7.50
	HSBC Bank Argentina	<b>88</b>	<b>10</b>	<b>11.36</b>	138	13	9.42	314	27	8.60
Other operations		<b>61,855</b>	<b>62</b>	<b>0.10</b>	10,699	16	0.15	29	3	10.34
		<b>198,273</b>	<b>1,800</b>	<b>0.91</b>	114,324	995	0.87	83,105	975	1.17
<b>Financial investments</b>										
Europe	HSBC Bank HSBC Private Banking Holdings (Suisse)	<b>100,609</b>	<b>867</b>	<b>0.86</b>	88,406	1,223	1.38	80,475	1,275	1.58
	HSBC France	<b>10,890</b>	<b>114</b>	<b>1.05</b>	13,509	183	1.35	5,722	107	1.87
	HSBC France	<b>12,685</b>	<b>113</b>	<b>0.89</b>	13,733	94	0.68	11,208	130	1.16
Asia <sup>63</sup>	Hang Seng Bank	<b>33,246</b>	<b>655</b>	<b>1.97</b>	31,502	601	1.91	29,319	590	2.01
	The Hongkong and Shanghai Banking Corporation	<b>118,096</b>	<b>2,109</b>	<b>1.79</b>	104,740	1,781	1.70	94,790	1,821	1.92
		<b>2,749</b>	<b>94</b>	<b>3.42</b>	2,197	72	3.28	1,798	59	3.28

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

MENA	HSBC Bank Malaysia Middle East	<b>10,515</b>	<b>104</b>	<b>0.99</b>	11,838	113	0.95	10,266	113	1.10
North America	HSBC Bank USA	<b>47,963</b>	<b>774</b>	<b>1.61</b>	56,302	884	1.57	61,510	1,092	1.78
	HSBC Finance							941	67	7.12
Latin America	HSBC Bank Canada	<b>17,970</b>	<b>246</b>	<b>1.37</b>	20,364	279	1.37	21,179	297	1.40
	HSBC Mexico	<b>9,914</b>	<b>409</b>	<b>4.13</b>	7,782	351	4.51	8,021	379	4.73
	Brazilian operations	<b>8,350</b>	<b>1,003</b>	<b>12.01</b>	7,404	740	9.99	9,527	1,019	10.70
	HSBC Bank Argentina	<b>518</b>	<b>130</b>	<b>25.10</b>	451	71	15.74	701	96	13.69
Other operations		<b>26,311</b>	<b>1,705</b>	<b>6.48</b>	35,081	1,610	4.59	51,872	2,033	3.92
		<b>399,816</b>	<b>8,323</b>	<b>2.08</b>	393,309	8,002	2.03	387,329	9,078	2.34

HSBC HOLDINGS PLC

60b

**Table of Contents****Report of the Directors: Financial Review** (continued)*Assets (continued)*

		2014			2013			2012		
		Average	Interest		Average	Interest		Average	Interest	
		balance	income	Yield	balance	income	Yield	balance	income	Yield
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
<b>Other interest-earning assets</b>										
Europe	HSBC Bank	<b>85,604</b>	<b>25</b>	<b>0.03</b>	73,607	64	0.09	119,175	153	0.13
	HSBC Private Banking Holdings (Suisse)	<b>5,220</b>	<b>32</b>	<b>0.61</b>	7,441	69	0.93	14,461	189	1.31
	HSBC France	<b>6,016</b>	<b>97</b>	<b>1.61</b>	14,294	111	0.78	13,107	121	0.92
Asia <sup>63</sup>	Hang Seng Bank	<b>2,504</b>	<b>14</b>	<b>0.56</b>	2,088	14	0.67	1,003	9	0.90
	The Hongkong and Shanghai Banking Corporation	<b>86,361</b>	<b>583</b>	<b>0.68</b>	62,369	498	0.80	59,191	481	0.81
	HSBC Bank Malaysia	<b>152</b>			456	2	0.44	553	4	0.72
MENA	HSBC Bank Middle East	<b>2,221</b>	<b>32</b>	<b>1.44</b>	1,888	87	4.61	1,914	72	3.76
North America	HSBC Bank USA	<b>6,936</b>	<b>123</b>	<b>1.77</b>	6,386	103	1.61	12,324	872	7.08
	HSBC Finance	<b>6,081</b>	<b>5</b>	<b>0.08</b>	6,821	19	0.28	7,723	656	8.49
	HSBC Bank Canada	<b>292</b>	<b>5</b>	<b>1.71</b>	1,691	42	2.48	2,340	69	2.95
Latin America	HSBC Mexico	<b>324</b>			265	6	2.26	614	39	6.35
	Brazilian operations	<b>1,215</b>	<b>136</b>	<b>11.19</b>	2,394	107	4.47	1,338	100	7.47

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	HSBC Bank Argentina	61			93			106	4	4
Other operations		(182,999)	(717)		(151,757)	(307)		(206,745)	(495)	
		19,988	335	1.68	28,036	815	2.91	27,104	2,274	8.39
<b>Total interest-earning assets</b>										
Europe	HSBC Bank	652,028	12,762	1.96	572,265	12,911	2.26	575,732	13,064	2.27
	HSBC Private Banking Holdings (Suisse)	38,840	315	0.81	51,585	456	0.88	34,846	504	1.45
	HSBC France	99,195	1,964	1.98	131,963	2,002	1.52	126,535	2,140	1.69
Asia <sup>63</sup>	Hang Seng Bank	130,710	3,358	2.57	122,623	3,045	2.48	111,625	2,777	2.49
	The Hongkong and Shanghai Banking Corporation	548,892	12,364	2.25	470,118	11,382	2.42	424,675	10,972	2.58
	HSBC Bank Malaysia	22,500	955	4.24	22,446	930	4.14	21,182	927	4.38
MENA	HSBC Bank Middle East	44,050	1,300	2.95	44,901	1,358	3.02	42,114	1,440	3.42
North America	HSBC Bank USA	148,013	2,803	1.89	145,970	2,860	1.96	157,408	3,812	2.42
	HSBC Finance	32,527	2,176	6.69	40,967	3,083	7.53	54,342	4,627	8.51
	HSBC Bank Canada	63,509	1,710	2.69	70,875	1,848	2.61	69,869	1,971	2.82
Latin America	HSBC Mexico	28,773	2,040	7.09	26,361	2,129	8.08	26,099	2,150	8.24
	Brazilian operations	49,497	6,969	14.08	46,606	6,243	13.40	53,096	7,742	14.58
	HSBC Bank Argentina	4,828	950	19.68	5,496	901	16.39	4,847	863	17.80
Other operations		(76,826)	1,289		(82,808)	2,044		(77,302)	3,713	
		1,786,536	50,955	2.85	1,669,368	51,192	3.07	1,625,068	56,702	3.49

For footnotes, see page 109.

HSBC HOLDINGS PLC

60c

**Table of Contents****Report of the Directors: Financial Review** (continued)*Equity and liabilities*

		2014			2013			2012		
		Average	Interest		Average	Interest		Average	Interest	
		balance	expense	Cost	balance	expense	Cost	balance	expense	Cost
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
<b>Summary</b>										
Interest-bearing liabilities measured at amortised cost (itemised below)		<b>1,546,633</b>	<b>16,250</b>	<b>1.05</b>	1,426,180	15,653	1.10	1,401,254	19,030	1.36
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued)		<b>178,518</b>	<b>2,856</b>	<b>1.60</b>	301,353	3,027	1.00	318,883	3,445	1.08
Non-interest bearing current accounts		<b>185,990</b>			184,370			177,085		
Total equity and other non-interest bearing liabilities		<b>768,902</b>			780,113			809,732		
Total equity and liabilities		<b>2,680,043</b>	<b>19,106</b>	<b>0.71</b>	2,692,016	18,680	0.69	2,706,954	22,475	0.83
Average cost on all interest-bearing liabilities				<b>1.11</b>			1.08			1.31
<b>Deposits by banks<sup>27,64</sup></b>										
Europe	HSBC Bank	<b>20,508</b>	<b>139</b>	<b>0.68</b>	21,230	165	0.78	26,708	402	1.51
	HSBC Private Banking Holdings (Suisse)	<b>354</b>	<b>1</b>	<b>0.28</b>	351	1	0.28	657	2	0.30
	HSBC France	<b>6,191</b>	<b>53</b>	<b>0.86</b>	7,747	69	0.89	14,833	142	0.96
Asia <sup>63</sup>	Hang Seng Bank	<b>960</b>	<b>9</b>	<b>0.94</b>	1,095	15	1.37	1,305	15	1.15
	The Hongkong and Shanghai Banking	<b>19,589</b>	<b>79</b>	<b>0.40</b>	15,663	90	0.57	17,154	122	0.71

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	Corporation									
	HSBC Bank									
	Malaysia	<b>1,095</b>	<b>26</b>	<b>2.37</b>	864	20	2.31	961	20	2.08
	HSBC Bank									
MENA	Middle East	<b>982</b>	<b>3</b>	<b>0.31</b>	1,471	3	0.20	1,586	6	0.38
North America	HSBC Bank									
	USA	<b>6,436</b>	<b>12</b>	<b>0.19</b>	8,131	16	0.20	7,552	19	0.25
	HSBC Bank									
Latin America	Canada	<b>371</b>	<b>1</b>	<b>0.27</b>	607	2	0.33	648	3	0.46
	HSBC									
	Mexico	<b>2,078</b>	<b>73</b>	<b>3.51</b>	1,018	46	4.52	1,103	52	4.71
	Brazilian									
	operations	<b>2,309</b>	<b>84</b>	<b>3.64</b>	3,356	94	2.80	3,931	154	3.92
	HSBC Bank									
	Argentina	<b>10</b>	<b>1</b>	<b>10.00</b>	20	2	10.00	44	3	6.82
Other operations		<b>334</b>			63	32	50.79	1,541	61	3.96
		<b>61,217</b>	<b>481</b>	<b>0.79</b>	61,616	555	0.90	78,023	1,001	1.28

**Financial liabilities  
designated at fair value  
own debt issued<sup>65</sup>**

Europe	HSBC									
	Holdings	<b>18,745</b>	<b>234</b>	<b>1.25</b>	19,719	366	1.86	23,864	446	1.87
	HSBC Bank	<b>27,762</b>	<b>421</b>	<b>1.52</b>	28,969	443	1.53	28,046	556	1.98
	HSBC									
	France	<b>8,232</b>	<b>66</b>	<b>0.80</b>	9,173	67	0.73	7,147	118	1.65
North America	HSBC Bank									
	USA	<b>2,032</b>	<b>33</b>	<b>1.62</b>	1,933	35	1.81	1,853	38	2.05
	HSBC									
	Finance	<b>7,195</b>	<b>58</b>	<b>0.81</b>	8,878	80	0.90	12,147	184	1.51
Other operations		<b>2,408</b>	<b>25</b>	<b>1.04</b>	3,661	(24)	(0.66)	1,959	(17)	(0.87)
		<b>66,374</b>	<b>837</b>	<b>1.26</b>	72,333	967	1.34	75,016	1,325	1.77

HSBC HOLDINGS PLC

60d

**Table of Contents****Report of the Directors: Financial Review** (continued)*Equity and liabilities (continued)*

		2014			2013			2012		
		Average Interest			Average	Interest		Average	Interest	
		balance	expense	Cost	balance	expense	Cost	balance	expense	Cost
		US\$m	US\$m	%	US\$m	US\$m		US\$m	US\$m	%
<b>Customer accounts<sup>27,66</sup></b>										
Europe	HSBC Bank	372,151	2,268	0.61	329,867	2,229	0.68	303,178	2,421	0.80
	HSBC Private Banking Holdings (Suisse)	8,165	31	0.38	16,414	70	0.43	15,912	84	0.53
	HSBC France	20,988	189	0.90	24,519	237	0.97	23,912	320	1.34
Asia <sup>63</sup>	Hang Seng Bank	98,794	472	0.48	91,778	360	0.39	85,425	365	0.43
	The Hongkong and Shanghai Banking Corporation	377,748	2,743	0.73	344,968	2,548	0.74	320,028	2,628	0.82
	HSBC Bank Malaysia	13,457	291	2.16	13,673	295	2.16	13,567	310	2.28
MENA	HSBC Bank Middle East	16,533	75	0.45	18,387	106	0.58	17,477	163	0.93
North America	HSBC Bank USA	57,015	78	0.14	56,411	104	0.18	63,581	223	0.35
	HSBC Bank Canada	40,682	319	0.78	41,905	330	0.79	41,842	328	0.78
Latin America	HSBC Mexico	15,050	300	1.99	15,316	383	2.50	16,718	489	2.92
	Brazilian operations	18,542	1,828	9.86	20,602	1,467	7.12	29,569	2,351	7.95
	HSBC Bank Argentina	2,758	373	13.52	3,318	343	10.34	3,594	268	7.46

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Other operations	<b>46,610</b>	<b>164</b>	<b>0.35</b>	58,342	322	0.55	77,253	700	0.91
	<b>1,088,493</b>	<b>9,131</b>	<b>0.84</b>	1,035,500	8,794	0.85	1,012,056	10,650	1.05

**Repurchase agreements  
non-trading<sup>27</sup>**

Europe	HSBC Bank	<b>72,481</b>	<b>213</b>	<b>0.29</b>	29,019	111	0.38	7,660	57	0.74
	HSBC Private Banking Holdings (Suisse)	<b>74</b>			67		0.14	14		0.00
	France	<b>29,539</b>	<b>59</b>	<b>0.20</b>	37,554	34	0.09	35,255	112	0.32
Asia <sup>63</sup>	Hang Seng Bank	<b>11</b>			6		4.24			
	The Hongkong and Shanghai Banking Corporation	<b>1,760</b>	<b>56</b>	<b>3.18</b>	779	32	4.11	1,207	52	4.31
	Malaysia	<b>35</b>	<b>1</b>	<b>2.86</b>	65	1	1.54	57	1	1.75
MENA	HSBC Bank Middle East	<b>2</b>			17	1	5.88	2		0.00
North America	HSBC Bank USA	<b>11,485</b>	<b>20</b>	<b>0.17</b>	9,269	12	0.13	4,588	1	0.02
	Canada	<b>2,167</b>	<b>25</b>	<b>1.15</b>	2,996	30	1.00	4,239	22	0.52
Latin America	HSBC Mexico Brazilian operations	<b>4,748</b>	<b>152</b>	<b>3.20</b>	1,842	90	4.89	1,017	39	3.83
	HSBC Bank Argentina	<b>910</b>	<b>96</b>	<b>10.55</b>	1,104	87	7.88	1,175	100	8.51
Other operations		<b>67,490</b>	<b>30</b>	<b>0.04</b>	11,692	7	0.06	322	3	0.93
		<b>190,705</b>	<b>652</b>	<b>0.34</b>	94,410	405	0.43	55,536	387	0.70

**Debt securities in issue**

Europe	HSBC Holdings	<b>16,781</b>	<b>945</b>	<b>5.63</b>	13,405	807	6.02	12,719	797	6.27
	HSBC Bank	<b>56,949</b>	<b>589</b>	<b>1.03</b>	64,528	768	1.19	69,294	989	1.43
	France	<b>10,846</b>	<b>52</b>	<b>0.48</b>	13,365	54	0.40	14,801	118	0.80
Asia <sup>63</sup>	Hang Seng Bank	<b>1,155</b>	<b>8</b>	<b>0.69</b>	1,393	12	0.86	1,606	15	0.93
	The Hongkong	<b>6,365</b>	<b>176</b>	<b>2.77</b>	7,586	186	2.45	7,732	241	3.12



Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	and Shanghai Banking Corporation HSBC Bank									
MENA	Malaysia	<b>461</b>	<b>19</b>	<b>4.12</b>	967	26	2.69	1,016	25	2.46
	HSBC Bank Middle East	<b>2,262</b>	<b>45</b>	<b>1.99</b>	3,057	64	2.09	3,769	83	2.20
North America	HSBC Bank USA	<b>15,935</b>	<b>414</b>	<b>2.60</b>	14,012	415	2.96	12,738	390	3.06
	HSBC Finance	<b>13,045</b>	<b>483</b>	<b>3.70</b>	19,888	739	3.72	29,198	1,059	3.63
	HSBC Bank Canada	<b>10,232</b>	<b>257</b>	<b>2.51</b>	13,158	342	2.60	12,675	390	3.08
Latin America	HSBC Mexico	<b>1,061</b>	<b>57</b>	<b>5.37</b>	813	41	5.04	897	51	5.69
	Brazilian operations	<b>12,707</b>	<b>1,565</b>	<b>12.32</b>	10,963	863	7.87	9,114	732	8.03
	HSBC Bank Argentina	<b>1</b>			52	10	19.23	121	20	16.53
Other operations		<b>(18,076)</b>	<b>(56)</b>		(12,211)	(145)		(14,332)	(155)	
		<b>129,724</b>	<b>4,554</b>	<b>3.51</b>	150,976	4,182	2.77	161,348	4,755	2.95

HSBC HOLDINGS PLC

60e

**Table of Contents****Report of the Directors: Financial Review** (continued)

		2014			2013			2012		
		Average	Interest		Average	Interest		Average	Interest	
		balance	expense	Cost	balance	expense	Cost	balance	expense	Cost
		US\$m	US\$m	%	US\$m	US\$m	%	US\$m	US\$m	%
<b>Other interest-bearing liabilities</b>										
Europe	HSBC Bank	<b>103,819</b>	<b>646</b>	<b>0.62</b>	96,464	659	0.68	126,279	671	0.53
	HSBC Private Banking Holdings (Suisse)	<b>7,903</b>	<b>23</b>	<b>0.29</b>	7,869	13	0.17	4,195	4	0.10
	HSBC France	<b>12,838</b>	<b>34</b>	<b>0.26</b>	26,159	77	0.29	20,853	28	0.13
	HSBC Finance				23			303	2	0.66
Asia <sup>63</sup>	Hang Seng Bank	<b>1,918</b>	<b>45</b>	<b>2.35</b>	2,021	48	2.38	1,715	39	2.27
	The Hongkong and Shanghai Banking Corporation	<b>91,468</b>	<b>635</b>	<b>0.69</b>	60,056	490	0.82	52,040	477	0.92
	HSBC Bank Malaysia	<b>1,342</b>	<b>14</b>	<b>1.04</b>	1,339	8	0.60	1,069	16	1.50
MENA	HSBC Bank Middle East	<b>2,617</b>	<b>57</b>	<b>2.18</b>	2,557	58	2.27	1,681	76	4.52
North America	HSBC Bank USA	<b>17,632</b>	<b>11</b>	<b>0.06</b>	17,793	176	0.99	26,255	408	1.55
	HSBC Finance	<b>5,817</b>	<b>258</b>	<b>4.44</b>	5,265	220	4.18	3,196	162	5.07
	HSBC Bank Canada	<b>599</b>	<b>4</b>	<b>0.67</b>	3,007	25	0.83	772	4	0.52
Latin America	HSBC Mexico	<b>1,031</b>	<b>13</b>	<b>1.26</b>	1,658	19	1.15	1,305	19	1.46
	Brazilian operations	<b>3,927</b>	<b>357</b>	<b>9.09</b>	3,497	189	5.40	4,705	362	7.69
		<b>40</b>	<b>7</b>	<b>17.50</b>	29	3	10.34	26	3	11.54

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	HSBC Bank Argentina									
Other operations		(240,831)	(1,509)		(216,392)	(1,235)		(225,119)	(1,359)	
		10,120	595	5.88	11,345	750	6.61	19,275	912	4.73
<b>Total interest-bearing liabilities</b>										
Europe	HSBC Holdings	35,526	1,179	3.32	33,125	1,173	3.54	36,583	1,243	3.40
	HSBC Bank	653,670	4,276	0.65	570,077	4,375	0.77	561,165	5,096	0.91
	HSBC Private Banking Holdings (Suisse)	16,496	55	0.33	24,701	84	0.34	20,778	90	0.43
	HSBC France	88,634	453	0.51	118,517	538	0.45	116,801	838	0.72
	HSBC Finance				23			303	2	0.66
Asia <sup>63</sup>	Hang Seng Bank	102,927	535	0.52	96,293	435	0.45	90,051	434	0.48
	The Hongkong and Shanghai Banking Corporation	496,930	3,689	0.74	428,959	3,346	0.78	398,161	3,520	0.88
	HSBC Bank Malaysia	16,390	351	2.14	16,908	350	2.07	16,670	372	2.23
MENA	HSBC Bank Middle East	22,994	190	0.83	25,489	232	0.91	24,515	328	1.34
North America	HSBC Bank USA	110,535	568	0.51	107,549	758	0.70	116,567	1,079	0.93
	HSBC Finance Canada	26,057	799	3.07	34,031	1,039	3.05	44,541	1,405	3.15
Latin America	HSBC Bank Mexico	54,051	606	1.12	61,673	729	1.18	60,176	747	1.24
	HSBC Mexican operations	23,968	595	2.48	20,647	579	2.80	21,040	650	3.09
	Brazilian operations	38,395	3,930	10.24	39,522	2,700	6.83	48,494	3,699	7.63
	HSBC Bank Argentina	2,812	381	13.55	3,419	358	10.47	3,785	294	7.77
Other operations		(142,752)	(1,357)		(154,753)	(1,043)		(158,376)	(767)	
		1,546,633	16,250	1.05	1,426,180	15,653	1.10	1,401,254	19,030	1.36

For footnotes, see page 109.

HSBC HOLDINGS PLC

60f

**Table of Contents****Report of the Directors: Financial Review** (continued)*Net interest margin<sup>67</sup>*

		<b>2014</b>	2013	2012
		%	%	%
<b>Total</b>				
		<b>1.94</b>	2.13	2.32
Europe	HSBC Bank	<b>1.30</b>	1.49	1.38
	HSBC Private Banking Holdings (Suisse)	<b>0.67</b>	0.72	1.19
	HSBC France	<b>1.52</b>	1.11	1.03
	HSBC Finance		5.78	4.50
Asia <sup>63</sup>	Hang Seng Bank	<b>2.16</b>	2.13	2.10
	The Hongkong and Shanghai Banking Corporation	<b>1.58</b>	1.70	1.75
	HSBC Bank Malaysia	<b>2.68</b>	2.58	2.62
MENA	HSBC Bank Middle East	<b>2.52</b>	2.51	2.64
North America	HSBC Bank USA	<b>1.51</b>	1.44	1.74
	HSBC Finance	<b>4.23</b>	4.99	5.93
	HSBC Bank Canada	<b>1.74</b>	1.58	1.75
Latin America	HSBC Mexico	<b>5.02</b>	5.88	5.75
	Brazilian operations	<b>6.14</b>	7.60	7.61
	HSBC Bank Argentina	<b>11.79</b>	9.88	11.74

*Distribution of average total assets*

		<b>2014</b>	2013	2012
		%	%	%
Europe	HSBC Bank	<b>39.2</b>	40.1	44.8
	HSBC Private Banking Holdings (Suisse)	<b>1.5</b>	2.0	1.7
	HSBC France	<b>9.0</b>	11.4	11.5
Asia <sup>63</sup>	Hang Seng Bank	<b>5.7</b>	5.3	4.8
	The Hongkong and Shanghai Banking Corporation	<b>26.3</b>	25.0	23.3
	HSBC Bank Malaysia	<b>0.9</b>	1.0	1.0
MENA	HSBC Bank Middle East	<b>1.9</b>	2.0	1.8
North America	HSBC Bank USA	<b>8.5</b>	8.7	10.2
	HSBC Finance	<b>1.3</b>	1.7	2.1
	HSBC Bank Canada	<b>3.0</b>	3.2	3.2
Latin America	HSBC Mexico	<b>1.5</b>	1.5	1.5
	Brazilian operations	<b>2.4</b>	2.3	2.7
	HSBC Bank Argentina			0.2

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Other operations (including consolidation adjustments)	(1.2)	(4.2)	(8.8)
	<b>100.0</b>	100.0	100.0

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

60g

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

The following tables allocate changes in net interest income and net interest expense between volume and rate for 2014 compared with 2013, and for 2013 compared with 2012. We isolate volume variances and allocate any change arising from both volume and rate to rate.

*Interest income*

		Increase/(decrease)			Increase/(decrease)			
		in 2014 compared with 2013			in 2013 compared with 2012			
		2014	Volume	Rate	2013	Volume	Rate	2012
		US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<b>Short-term funds and loans and advances to banks<sup>27</sup></b>								
Europe	HSBC Bank	997	66	51	880	94	(214)	1,000
	HSBC Private Banking Holdings (Suisse)	10	(4)	4	10	57	(56)	9
	HSBC France	66	(31)	4	93	(23)	1	115
Asia <sup>63</sup>	Hang Seng Bank	279	(17)	45	251	2	(34)	283
	The Hongkong and Shanghai Banking Corporation	822	57	(44)	809	(12)	(16)	837
	HSBC Bank Malaysia	158	(13)	9	162	36	3	123
MENA	HSBC Bank Middle East	29	(2)	4	27	(3)	(2)	32
North America	HSBC Bank USA	105	11	10	84	5	(25)	104
	HSBC Bank Canada	4	1		3		(1)	4
Latin America	HSBC Mexico	86	(7)	(16)	109	(8)	(2)	119
	Brazilian operations	498	(11)	121	388	(280)	(67)	735
	HSBC Bank Argentina	12	(2)	(4)	18	245	(245)	18
Other operations		2	(5)	(10)	17	(97)	(12)	126
		<b>3,068</b>	<b>9</b>	<b>208</b>	<b>2,851</b>	<b>8</b>	<b>(662)</b>	<b>3,505</b>
<b>Loans and advances to customers<sup>27</sup></b>								
Europe	HSBC Bank	10,423	386	(594)	10,631	412	(346)	10,565

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	HSBC Private Banking Holdings (Suisse)	159	(28)	(7)	194	42	(47)	199
	HSBC France	1,626	(128)	98	1,656	87	(80)	1,649
	HSBC Finance		(10)		10	(34)	2	42
Asia <sup>63</sup>	Hang Seng Bank	2,410	211	20	2,179	223	61	1,895
	The Hongkong and Shanghai Banking Corporation	8,517	870	(375)	8,022	1,057	(662)	7,627
	HSBC Bank Malaysia	672	(19)	8	683	25	(49)	707
	HSBC Bank Middle East	1,133	48	(39)	1,124	77	(167)	1,214
MENA								
North America	HSBC Bank USA	1,791	227	(212)	1,776	95	(34)	1,715
	HSBC Finance	2,171	(691)	(202)	3,064	(844)	5	3,903
	HSBC Bank Canada	1,371	(63)	3	1,431	(74)	(46)	1,551
Latin America	HSBC Mexico	1,542	47	(163)	1,658	103	(58)	1,613
	Brazilian operations	4,579	284	(309)	4,604	(383)	(481)	5,468
	HSBC Bank Argentina	798	(119)	118	799	(6)	87	718
Other operations		237	(134)	(327)	698	(1,373)	67	2,004
		37,429	1,458	(2,558)	38,529	258	(2,599)	40,870

HSBC HOLDINGS PLC

60h



**Table of Contents****Report of the Directors: Financial Review** (continued)*Interest income (continued)*

		Increase/(decrease)			Increase/(decrease)			
		in 2014 compared with 2013			in 2013 compared with 2012			
		2014	Volume	Rate	2013	Volume	Rate	2012
		US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<b>Reverse repurchase agreements non-trading<sup>27</sup></b>								
Europe	HSBC Bank	450	153	184	113	87	(45)	71
	HSBC France	62	(16)	30	48	5	(82)	125
Asia <sup>63</sup>	The Hongkong and Shanghai Banking Corporation	333	275	(214)	272	113	(47)	206
	HSBC Bank Malaysia	31	18	2	11	(23)		34
MENA	HSBC Bank Middle East	2	(7)	2	7	5	(7)	9
North America	HSBC Bank USA	10	(5)	2	13	(21)	5	29
	HSBC Finance					(1)		1
	HSBC Bank Canada	84	(20)	11	93	46	(3)	50
Latin America	HSBC Mexico	3	(2)		5		5	
	Brazilian operations	753	124	225	404	(5)	(11)	420
	HSBC Bank Argentina	10	(5)	2	13	(15)	1	27
Other operations		62	77	(31)	16	1,103	(1,090)	3
		<b>1,800</b>	<b>730</b>	<b>75</b>	<b>995</b>	<b>365</b>	<b>(345)</b>	<b>975</b>
<b>Financial investments</b>								
Europe	HSBC Bank	867	168	(524)	1,223	125	(177)	1,275
	HSBC Private Banking Holdings (Suisse)	114	(35)	(34)	183	146	(70)	107
	HSBC France	113	(7)	26	94	29	(65)	130
Asia <sup>63</sup>	Hang Seng Bank	655	33	21	601	44	(33)	590
	The Hongkong and Shanghai Banking Corporation	2,109	227	101	1,781	126	(166)	1,821
	HSBC Bank Malaysia	94	18	4	72	13		59
MENA	HSBC Bank Middle East	104	(13)	4	113	17	(17)	113
North America	HSBC Bank USA	774	(131)	21	884	(93)	(115)	1,092
	HSBC Finance					(67)		67
	HSBC Bank Canada	246	(33)		279	(11)	(7)	297

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Latin America	HSBC Mexico	<b>409</b>	<b>96</b>	<b>(38)</b>	351	(11)	(17)	379
	Brazilian operations	<b>1,003</b>	<b>94</b>	<b>169</b>	740	(227)	(52)	1,019
	HSBC Bank Argentina	<b>130</b>	<b>11</b>	<b>48</b>	71	(34)	9	96
Other operations		<b>1,705</b>	<b>(403)</b>	<b>498</b>	1,610	(658)	235	2,033
		<b>8,323</b>	<b>132</b>	<b>189</b>	8,002	140	(1,216)	9,078

*For footnote, see page 109.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Interest expense*

		Increase/(decrease) in 2014 compared with 2013			Increase/(decrease) in 2013 compared with 2012			
		2014	Volume	Rate	2013	Volume	Rate	2012
		US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<b>Deposits by banks<sup>27</sup></b>								
Europe	HSBC Bank	139	(6)	(20)	165	(83)	(154)	402
	HSBC Private Banking							
	Holdings (Suisse)	1			1	(1)		2
	HSBC France	53	(14)	(2)	69	(68)	(5)	142
Asia <sup>63</sup>	Hang Seng Bank	9	(2)	(4)	15	(2)	2	15
	The Hongkong and Shanghai							
	Banking Corporation	79	22	(33)	90	(11)	(21)	122
	HSBC Bank Malaysia	26	5	1	20	(2)	2	20
MENA	HSBC Bank Middle East	3	(1)	1	3		(3)	6
North America	HSBC Bank USA	12	(3)	(1)	16	1	(4)	19
	HSBC Bank Canada	1	(1)		2		(1)	3
Latin America	HSBC Mexico	73	48	(21)	46	(4)	(2)	52
	Brazilian operations	84	(29)	19	94	(23)	(37)	154
	HSBC Bank Argentina	1	(1)		2	(2)	1	3
Other operations			138	(170)	32	(59)	30	61
		481	(4)	(70)	555	(210)	(236)	1,001
<b>Customer accounts<sup>27</sup></b>								
Europe	HSBC Bank	2,268	288	(249)	2,229	214	(406)	2,421
	HSBC Private Banking							
	Holdings (Suisse)	31	(35)	(4)	70	3	(17)	84
	HSBC France	189	(34)	(14)	237	8	(91)	320
Asia <sup>63</sup>	Hang Seng Bank	472	27	85	360	27	(32)	365
	The Hongkong and Shanghai							
	Banking Corporation	2,743	243	(48)	2,548	205	(285)	2,628
	HSBC Bank Malaysia	291	(5)	1	295	2	(17)	310
MENA	HSBC Bank Middle East	75	(11)	(20)	106	8	(65)	163
North America	HSBC Bank USA	78	1	(27)	104	(25)	(94)	223
	HSBC Bank Canada	319	(10)	(1)	330		2	328
Latin America	HSBC Mexico	300	(7)	(76)	383	(41)	(65)	489

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Brazilian operations	<b>1,828</b>	<b>(147)</b>	<b>508</b>	1,467	(713)	(171)	2,351
HSBC Bank Argentina	<b>373</b>	<b>(58)</b>	<b>88</b>	343	(21)	96	268
Other operations	<b>164</b>	<b>(65)</b>	<b>(93)</b>	322	(172)	(206)	700
	<b>9,131</b>	<b>450</b>	<b>(113)</b>	8,794	246	(2,102)	10,650

HSBC HOLDINGS PLC

60j

**Table of Contents****Report of the Directors: Financial Review** (continued)

		Increase/(decrease)			Increase/(decrease)			
		in 2014 compared with 2013			in 2013 compared with 2012			
		2014	Volume	Rate	2013	Volume	Rate	2012
		US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
<b>Repurchase agreements non-trading<sup>27</sup></b>								
Europe	HSBC Bank	213	165	(63)	111	158	(104)	57
	HSBC France	59	(7)	32	34	7	(85)	112
	The Hongkong and Shanghai							
Asia <sup>63</sup>	Banking Corporation	56	40	(16)	32	(18)	(2)	52
	HSBC Bank Malaysia	1	(1)	1	1			1
MENA	HSBC Bank Middle East		(1)		1		1	
North America	HSBC Bank USA	20	3	5	12	1	10	1
	HSBC Bank Canada	25	(8)	3	30	(6)	14	22
Latin America	HSBC Mexico	152	141	(79)	90	32	19	39
	Brazilian operations	96	(15)	24	87	(6)	(7)	100
	HSBC Bank Argentina							
Other operations		30	33	(10)	7	106	(102)	3
		652	414	(167)	405	272	(254)	387
<b>Financial liabilities designated at fair value</b>								
<b>own debt issued</b>								
<b>Debt securities in issue</b>								
Europe	HSBC Holdings	945	203	(65)	807	43	(33)	797
	HSBC Bank	589	(90)	(89)	768	(68)	(153)	989
	HSBC France	52	(10)	8	54	(11)	(53)	118
Asia <sup>63</sup>	Hang Seng Bank	8	(2)	(2)	12	(2)	(1)	15
	The Hongkong and Shanghai							
	Banking Corporation	176	(28)	18	186	(7)	(48)	241
	HSBC Bank Malaysia	19	(14)	7	26	(1)	2	25
MENA	HSBC Bank Middle East	45	(17)	(2)	64	(16)	(3)	83
North America	HSBC Bank USA	414	57	(58)	415	39	(14)	390
	HSBC Finance	483	(255)	(1)	739	(338)	18	1,059
	HSBC Bank Canada	257	(76)	(9)	342	15	(63)	390
Latin America	HSBC Mexico	57	12	4	41	(5)	(5)	51
	Brazilian operations	1,565	137	565	863	148	(17)	732
	HSBC Bank Argentina		(10)		10	(11)	1	20
Other operations		(56)		89	(145)		10	(155)

4,554 (589) 961 4,182 (306) (267) 4,755

*For footnote, see page 109.*

HSBC HOLDINGS PLC

60k

**Table of Contents****Report of the Directors: Financial Review** (continued)**Short-term borrowings**

Short-term borrowings in the form of repurchase agreements are shown separately on the face of the balance sheet. Other forms of short-term borrowings are included within customer accounts, deposits by banks, debt securities in issue and trading liabilities. Short-term borrowings are defined by the US Securities and Exchange Commission as Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings.

Our only significant short-term borrowings are securities sold under agreements to repurchase and certain debt securities in issue. For securities sold under agreements to repurchase, we run matched repo and reverse repo trading books. We generally observe lower year-end demand in our reverse repo lending business which results in lower repo balances at the balance sheet date. Additional information on these is provided in the table below.

*Repos and short-term bonds*

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
<b>Securities sold under agreements to repurchase</b>			
Outstanding at 31 December	<b>111,230</b>	181,641	170,790
Average amount outstanding during the year	<b>195,482</b>	218,580	206,352
Maximum quarter-end balance outstanding during the year	<b>227,637</b>	210,452	176,162
Weighted average interest rate during the year	<b>0.3%</b>	0.3%	0.4%
Weighted average interest rate at the year-end	<b>0.6%</b>	0.5%	0.5%
<b>Short-term bonds</b>			
Outstanding at 31 December	<b>38,868</b>	40,667	44,240
Average amount outstanding during the year	<b>39,547</b>	46,455	40,349
Maximum quarter-end balance outstanding during the year	<b>41,117</b>	54,933	44,240
Weighted average interest rate during the year	<b>1.7%</b>	1.4%	1.4%
Weighted average interest rate at the year-end	<b>1.6%</b>	0.7%	1.3%
<b>Contractual obligations</b>			

The table below provides details of our material contractual obligations as at 31 December 2014.

Total	Payments due by period		
	Less than	1 3 years	3 5 years

	<b>US\$m</b>	<b>1 year US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>More than 5 years US\$m</b>
Long-term debt obligations	<b>198,051</b>	<b>56,704</b>	<b>46,735</b>	<b>27,135</b>	<b>67,477</b>
Term deposits and certificates of deposit	<b>128,790</b>	<b>121,865</b>	<b>3,825</b>	<b>2,528</b>	<b>572</b>
Capital (finance) lease obligations	<b>87</b>	<b>32</b>	<b>29</b>	<b>5</b>	<b>21</b>
Operating lease obligations	<b>5,372</b>	<b>1,022</b>	<b>1,555</b>	<b>1,000</b>	<b>1,795</b>
Purchase obligations	<b>656</b>	<b>540</b>	<b>40</b>	<b>53</b>	<b>23</b>
Short positions in debt securities and equity shares	<b>64,917</b>	<b>44,466</b>	<b>6,913</b>	<b>2,729</b>	<b>10,809</b>
Current tax liability	<b>1,213</b>	<b>1,213</b>			
Pension/healthcare obligation	<b>17,466</b>	<b>1,536</b>	<b>3,198</b>	<b>3,398</b>	<b>9,334</b>
	<b>416,552</b>	<b>227,378</b>	<b>62,295</b>	<b>36,848</b>	<b>90,031</b>

HSBC HOLDINGS PLC

601



**Table of Contents****Report of the Directors: Financial Review (continued)****Loan maturity and interest sensitivity analysis**

At 31 December 2014, the geographical analysis of loan maturity and interest sensitivity by loan type on a contractual repayment basis was as follows:

	Europe US\$m	Asia US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
<b>Maturity of 1 year or less</b>						
Loans and advances to banks	16,736	58,142	10,013	6,957	9,025	100,873
Commercial loans to customers						
Manufacturing and international trade and services	76,974	88,223	9,441	11,333	14,894	200,865
Real estate and other property related	10,708	23,722	1,395	3,634	1,511	40,970
Non-bank financial institutions	14,887	10,458	1,876	4,978	958	33,157
Governments	1,104	250	1,072	10	398	2,834
Other commercial	31,419	19,586	2,047	2,780	3,468	59,300
	135,092	142,239	15,831	22,735	21,229	337,126
<b>Maturity after 1 year but within 5 years</b>						
Loans and advances to banks	4,667	3,497	483	370	335	9,352
Commercial loans to customers						
Manufacturing and international trade and services	29,570	21,185	1,969	15,257	4,984	72,965
Real estate and other property related	17,122	36,462	664	8,082	618	62,948
Non-bank financial institutions	7,115	3,436	1,336	3,868	403	16,158
Governments	235	359	481	33	172	1,280
Other commercial	18,377	14,714	1,563	7,829	2,477	44,960
	72,419	76,156	6,013	35,069	8,654	198,311
Interest rate sensitivity of loans and advances to banks and commercial loans to customers						
Fixed interest rate	14,799	2,182	1,277	3,988	3,150	25,396
Variable interest rate	62,289	77,471	5,219	31,451	5,839	182,269
	77,088	79,653	6,496	35,439	8,989	207,665
<b>Maturity after 5 years</b>						
Loans and advances to banks	523	1,321		80		1,924

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Commercial loans to customers						
Manufacturing and international trade and services	9,742	1,175	677	2,193	361	14,148
Real estate and other property related	7,482	9,873	185	3,774	442	21,756
Non-bank financial institutions	941	103	78	187	31	1,340
Governments	923	585		121	400	2,029
Other commercial	9,064	4,666	1,092	2,946	998	18,766
	28,152	16,402	2,032	9,221	2,232	58,039
Interest rate sensitivity of loans and advances to banks and commercial loans to customers						
Fixed interest rate	7,698	1,220	695	724	351	10,688
Variable interest rate	20,977	16,503	1,337	8,577	1,881	49,275
	28,675	17,723	2,032	9,301	2,232	59,963

HSBC HOLDINGS PLC

60m

**Table of Contents****Report of the Directors: Financial Review** (continued)**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.

*Deposits by banks<sup>27</sup>*

	2014		2013		2012	
	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %
Europe	36,427		42,687		52,274	
Demand and other non-interest bearing	8,819		13,198		9,377	
Demand interest bearing	5,778	0.4	5,154	0.5	8,988	0.4
Time	14,191	1.0	17,465	1.1	24,698	1.5
Other	7,639	0.4	6,870	0.7	9,211	2.0
Asia <sup>63</sup>	26,524		26,928		26,676	
Demand and other non-interest bearing	5,189		9,606		7,222	
Demand interest bearing	13,828	0.5	12,181	0.6	11,832	0.6
Time	3,581	0.7	4,282	0.8	5,891	1.2
Other	3,926	0.3	859	1.6	1,731	0.9
Middle East and North Africa	1,546		2,529		1,890	
Demand and other non-interest bearing	563		1,058		301	
Demand interest bearing	3		12		8	6.5
Time	938	0.2	1,422	0.2	1,543	0.4
Other	42		37		38	1.4
North America	10,497		12,237		12,696	
Demand and other non-interest bearing	3,686		3,488		4,470	
Demand interest bearing	2,557	0.1	2,787	0.1	2,996	0.1
Time	3,308	0.3	5,110	0.3	4,756	0.4
Other	946	0.1	852		474	0.2

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Latin America	4,642		4,703		6,070	
Demand and other non-interest bearing	162		118		212	
Demand interest bearing	837	3.8	333	4.5	333	3.9
Time	2,244	3.0	2,783	3.1	3,665	3.7
Other	1,399	4.4	1,469	4.4	1,860	5.1
<b>Total</b>	<b>79,636</b>		<b>89,084</b>		<b>99,606</b>	
<b>Demand and other non-interest bearing</b>	<b>18,419</b>		<b>27,467</b>		<b>21,582</b>	
<b>Demand interest bearing</b>	<b>23,003</b>	<b>0.6</b>	<b>20,468</b>	<b>0.5</b>	<b>24,157</b>	<b>0.5</b>
<b>Time</b>	<b>24,262</b>	<b>1.0</b>	<b>31,062</b>	<b>1.1</b>	<b>40,553</b>	<b>1.4</b>
<b>Other</b>	<b>13,952</b>	<b>0.7</b>	<b>10,087</b>	<b>1.2</b>	<b>13,314</b>	<b>2.2</b>

For footnotes, see page 109.

HSBC HOLDINGS PLC

60n

**Table of Contents****Report of the Directors: Financial Review** (continued)*Customer accounts*<sup>27</sup>

	2014		2013		2012	
	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %
Europe	490,511		462,669		436,756	
Demand and other non-interest bearing	73,088		75,480		71,342	
Demand interest bearing	314,374	0.4	272,973	0.4	242,769	0.4
Savings	57,464	1.4	63,585	1.4	62,626	1.8
Time	43,760	1.0	50,010	1.1	59,034	1.3
Other	1,825	2.6	621	8.2	985	4.0
Asia <sup>63</sup>	566,595		533,002		505,395	
Demand and other non-interest bearing	62,988		59,023		55,628	
Demand interest bearing	374,026	0.2	347,526	0.2	314,762	0.3
Savings	108,074	2.3	104,099	2.2	107,176	2.1
Time	21,381	0.9	20,978	0.7	26,633	1.0
Other	126	2.4	1,376	0.4	1,196	0.8
Middle East and North Africa	39,076		40,451		37,604	
Demand and other non-interest bearing	18,410		16,801		14,564	
Demand interest bearing	11,587	0.4	13,248	0.4	10,967	0.6
Savings	7,974	2.1	9,981	2.6	11,555	3.0
Time	1,074	1.2	357	1.4	452	2.2
Other	31		64		66	1.5
North America	135,692		137,181		145,230	
Demand and other non-interest bearing	27,361		27,992		28,403	
Demand interest bearing	38,843	0.3	37,837	0.3	38,419	0.3
Savings	60,075	0.5	63,565	0.6	68,039	0.7
Time	9,290	0.2	7,673	0.3	9,587	0.4
Other	123	0.8	114	1.8	782	0.4
Latin America	50,918		54,585		71,212	
Demand and other non-interest bearing	12,452		13,092		14,203	
Demand interest bearing	7,412	1.2	7,237	1.8	8,258	2.2
Savings	22,062	10.0	24,652	7.4	35,294	7.5
Time	8,850	2.8	9,459	4.4	13,095	4.0
Other	142	5.6	145	9.7	362	4.1
<b>Total</b>	<b>1,282,792</b>		<b>1,227,888</b>		<b>1,196,197</b>	

<b>Demand and other non-interest bearing</b>	<b>194,299</b>		192,388		184,140	
<b>Demand interest bearing</b>	<b>746,242</b>	<b>0.3</b>	678,821	0.3	615,175	0.4
<b>Savings</b>	<b>255,649</b>	<b>2.3</b>	265,882	2.1	284,690	2.4
<b>Time</b>	<b>84,355</b>	<b>1.1</b>	88,477	1.3	108,801	1.5
<b>Other</b>	<b>2,247</b>	<b>2.6</b>	2,320	3.1	3,391	2.0

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

60o

**Table of Contents****Report of the Directors: Financial Review** (continued)*Customer accounts by country*

	2014	2013
	US\$m	US\$m
<b>Europe</b>	<b>545,959</b>	581,933
UK	439,313	462,796
France <sup>35</sup>	40,750	45,149
Germany	15,757	16,615
Switzerland	11,058	16,796
Turkey	7,856	7,795
Other	31,225	32,782
<b>Asia<sup>8</sup></b>	<b>577,491</b>	548,483
Hong Kong	389,094	365,905
Australia	19,312	19,812
India	11,678	11,549
Indonesia	5,788	5,865
Mainland China	46,588	40,579
Malaysia	16,292	17,093
Singapore	43,731	43,988
Taiwan	14,901	12,758
Other	30,107	30,934
<b>Middle East and North Africa</b> (excluding Saudi Arabia)	<b>39,720</b>	38,683
Egypt	7,663	7,401
UAE	19,771	18,433
Other	12,286	12,849
<b>North America</b>	<b>138,884</b>	140,809
US	84,894	80,037
Canada	43,871	47,872
Other	10,119	12,900
<b>Latin America</b>	<b>48,588</b>	51,389
Argentina	4,384	4,468
Brazil	23,204	23,999
Mexico	18,360	21,529
Other	2,640	1,393
<b>At 31 December</b>	<b>1,350,642</b>	1,361,297

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

61



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

	2014		2013		2012	
	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %	Average balance US\$m	Average rate %
Europe	20,970	0.4	28,680	0.5	32,602	0.4
Asia	2,441	1.6	3,199	2.0	5,321	2.4
North America	5,406	0.3	5,583	0.6	9,339	0.6
Latin America	12,035	12.1	9,335	8.3	7,344	8.5
	<b>40,852</b>	<b>3.9</b>	46,797	2.3	54,606	1.8

**Certificates of deposit and other time deposits**

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

	At 31 December 2014					Total US\$m
	3 months or less US\$m	After 3 months but within 6 months US\$m	After 6 months but within 12 months US\$m	After 12 months US\$m		
Europe	48,787	11,442	5,078	4,515		69,822
Certificates of deposit	8,315	6,115	1,005			15,435
Time deposits:						
banks	10,446	1,160	321	2,166		14,093
customers	30,026	4,167	3,752	2,349		40,294
Asia	23,299	1,177	1,039	1,023		26,538
Certificates of deposit	641	221	44	717		1,623
Time deposits:						
banks	2,080	34	4	21		2,139
customers	20,578	922	991	285		22,776
Middle East and North Africa	913	150	721	215		1,999

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Time deposits:					
banks	541	134	13		688
customers	372	16	708	215	1,311
North America	13,336	3,028	713	526	17,603
Time deposits:					
banks	3,369	2		87	3,458
customers	9,967	3,026	713	439	14,145
Latin America	10,189	1,131	864	646	12,830
Certificates of deposit	983	697	31	496	2,207
Time deposits:					
banks	1,900	135	725	123	2,883
customers	7,306	299	108	27	7,740
<b>Total</b>	<b>96,524</b>	<b>16,928</b>	<b>8,415</b>	<b>6,925</b>	<b>128,792</b>
<b>Certificates of deposit</b>	<b>9,939</b>	<b>7,033</b>	<b>1,080</b>	<b>1,213</b>	<b>19,265</b>
<b>Time deposits:</b>					
<b>banks</b>	<b>18,336</b>	<b>1,465</b>	<b>1,063</b>	<b>2,397</b>	<b>23,261</b>
<b>customers</b>	<b>68,249</b>	<b>8,430</b>	<b>6,272</b>	<b>3,315</b>	<b>86,266</b>

HSBC HOLDINGS PLC

61a

**Table of Contents****Report of the Directors: Financial Review** (continued)**Ratio of earnings to fixed charges<sup>69</sup>**

	2014	2013	2012	2011	2010
<b>Ratio of earnings to fixed charges</b>					
excluding interest on deposits	3.39	3.84	3.03	2.82	2.71
including interest on deposits	1.86	2.09	1.76	1.68	1.73
<b>Ratio of earnings to combined fixed charges and preference share dividends</b>					
excluding interest on deposits	3.07	3.50	2.79	2.64	2.56
including interest on deposits	1.79	2.01	1.71	1.64	1.69

*For footnote, see page 109.*

HSBC HOLDINGS PLC

61b

**Table of Contents****Report of the Directors: Financial Review** (continued)**Reconciliation of RoRWA measures****Performance Management**

During 2014, we targeted a return on average ordinary shareholders' equity of 12%–15%. For internal management purposes we monitored global businesses and geographical regions by pre-tax return on RWAs, a metric which combines return on equity and regulatory capital efficiency objectives. We targeted a return on average risk-weighted assets of 2.2%–2.6% in 2014.

In addition to the return on average risk-weighted assets (RoRWA) we measure our performance internally using the non-GAAP measure of adjusted RoRWA, which is adjusted profit before tax as a percentage of average risk-weighted assets adjusted for the effects of foreign

currency translation differences and the effects of significant items. Excluded from adjusted RoRWA are certain items which distort year-on-year performance as explained on page 40.

We also present the non-GAAP measure of adjusted RoRWA which is further adjusted for the effect of operations that are not regarded as contributing to the long-term performance of the Group. These include the run-off portfolios and the CRS business which was sold in 2012.

The CRS average RWAs in the table below represent the average of the associated operational risk RWAs that were not immediately released on disposal and have not already been adjusted as part of the adjusted RoRWA calculation. At the end of 2014, the residual CRS operational risk RWAs relating to the CRS portfolio were fully amortised.

*Reconciliation of adjusted RoRWA (excluding run-off portfolios and Card and Retail Services)*

	2014			2013		
	Pre-tax return US\$m	Average RWAs <sup>36</sup> US\$bn	RoRWA <sup>36</sup> %	Pre-tax return US\$m	Average RWAs <sup>36</sup> US\$bn	RoRWA <sup>36</sup> %
Reported	18,680	1,209	1.5	22,565	1,104	2.0
	22,829	1,207	1.9	22,981	1,071	2.1

Adjusted <sup>37</sup> Run-off portfolios	<b>870</b>	<b>115</b>	<b>0.8</b>	443	121	0.4
Legacy credit in GB&M	<b>172</b>	<b>48</b>	<b>0.4</b>	186	33	0.6
US CML and other <sup>38</sup>	<b>698</b>	<b>67</b>	<b>1.0</b>	257	88	0.3
Card and Retail Services					4	
Adjusted (excluding run-off portfolios and CRS)	<b>21,959</b>	<b>1,092</b>	<b>2.0</b>	22,538	946	2.4

*Reconciliation of reported and adjusted average risk-weighted assets*

	Year ended 31 December		
	<b>2014</b> US\$bn	2013 US\$bn	Change %
Average reported RWAs <sup>36</sup>	<b>1,209</b>	1,104	9.5
Currency translation adjustment <sup>33</sup>		(8)	
Acquisitions, disposals and dilutions	<b>(2)</b>	(21)	
Other significant items		(4)	
Average adjusted RWAs <sup>36</sup>	<b>1,207</b>	1,071	12.6

*For footnotes, see page 109.*

## Critical accounting

### estimates and judgements

The results of HSBC reflect the choice of accounting policies, assumptions and estimates that underlie the preparation of HSBC's consolidated financial statements. The significant accounting policies, including the policies which include critical accounting estimates and judgements, are described in Note 1 and in the individual Notes on the Financial Statements. The accounting policies listed below are highlighted as they involve a high degree of judgement and estimation uncertainty and have a material impact on the financial statements:

Impairment of loans and advances: Note 1(k) on page 349;  
Deferred tax assets: Note 8 on page 365;

Valuation of financial instruments: Note 13 on page 378;

Impairment of interests in associates: Note 20 on page 403;

Goodwill impairment: Note 21 on page 407; and

Provisions: Note 29 on page 420.

In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of the items above, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based, resulting in the recognition and measurement of materially different amounts from those estimated by management in the 2014 Financial Statements.

HSBC HOLDINGS PLC

62

**Table of Contents****Report of the Directors: Financial Review (continued)****Global businesses**

<b><u>Summary</u></b>	63
<b><u>Retail Banking and Wealth Management</u></b>	64
<b><u>Commercial Banking</u></b>	67
<b><u>Global Banking and Markets</u></b>	70
<b><u>Global Private Banking</u></b>	72
<b><u>Other</u></b>	75
<b><u>Analysis by global business</u></b>	76

**Summary**

HSBC reviews operating activity on a number of bases, including by geographical region and by global business.

The commentaries below present global businesses followed by geographical regions (page 78). Performance is discussed in this order because certain strategic themes, business initiatives and trends affect more than one geographical region. All commentaries are on an

adjusted basis (page 40) unless stated otherwise, while tables are on a reported basis unless stated otherwise.

**Basis of preparation**

The results of global businesses are presented in accordance with the accounting policies used in the preparation of HSBC's consolidated financial statements. Our operations are closely integrated and, accordingly, the presentation of global business data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and global 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 some subjectivity.

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

The expense of the UK bank levy is included in the Europe geographical region as HSBC regards the levy as a cost of being headquartered in the UK. For the purposes of the presentation by global business, the cost of the levy is included in Other.

*Profit/(loss) before tax*

	2014		2013		2012	
	US\$m	%	US\$m	%	US\$m	%
Retail Banking and Wealth Management	5,651	30.3	6,649	29.5	9,575	46.4
Commercial Banking	8,744	46.8	8,441	37.4	8,535	41.3
Global Banking and Markets	5,889	31.5	9,441	41.8	8,520	41.3
Global Private Banking	626	3.4	193	0.9	1,009	4.9
Other <sup>39</sup>	(2,230)	(12.0)	(2,159)	(9.6)	(6,990)	(33.9)
<b>Year ended 31 December</b>	<b>18,680</b>	<b>100.0</b>	<b>22,565</b>	<b>100.0</b>	<b>20,649</b>	<b>100.0</b>

*Total assets<sup>40</sup>*

	2014		2013	
	US\$m	%	US\$m	%
Retail Banking and Wealth Management	499,083	18.9	517,085	19.4
Commercial Banking	372,739	14.2	360,623	13.5
Global Banking and Markets	1,839,644	69.8	1,975,509	74.0
Global Private Banking	88,342	3.4	97,655	3.7
Other	164,537	6.2	171,812	6.4
Intra-HSBC items	(330,206)	(12.5)	(451,366)	(17.0)



<b>At 31 December</b>	<b>2,634,139</b>	<b>100.0</b>	2,671,318	100.0
-----------------------	------------------	--------------	-----------	-------

*For footnotes, see page 109.*

### *Risk-weighted assets*

	<b>2014</b>		2013	
	<b>US\$bn</b>	<b>%</b>	US\$bn	%
Retail Banking and Wealth Management	<b>205.1</b>	<b>16.8</b>	233.5	21.4
Commercial Banking	<b>432.4</b>	<b>35.4</b>	391.7	35.8
Global Banking and Markets	<b>516.1</b>	<b>42.3</b>	422.3	38.6
Global Private Banking	<b>20.8</b>	<b>1.8</b>	21.7	2.0
Other	<b>45.4</b>	<b>3.7</b>	23.5	2.2
<b>At 31 December</b>	<b>1,219.8</b>	<b>100.0</b>	1,092.7	100.0

### **Principal Retail Banking and Wealth Management business**

RBWM comprises the Principal RBWM business, the US run-off portfolio and the disposed-of US CRS business. We believe that looking at the Principal RBWM business allows management to more clearly discuss the cause of material changes from year-to-year in the ongoing

business and to assess the factors and trends in the business which are expected to have a material effect in future years. The reconciliation of RBWM to Principal RBWM is on page 64. Tables which reconcile reported to adjusted financial measures are available on [www.hsbc.com](http://www.hsbc.com).

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Retail Banking and Wealth Management**

**RBWM provides banking and wealth management services for our personal customers to help them secure their future prosperity and realise their ambitions.**

	<b>Total RBWM US\$m</b>	<b>US CRS US\$m</b>	<b>US run-off portfolio US\$m</b>	<b>Principal RBWM US\$m</b>
<b>2014</b>				
Net interest income	16,782		1,390	15,392
Net fee income	6,668		(4)	6,672
Other income/(expense) <sup>42</sup>	1,144		(49)	1,193
<b>Net operating income<sup>4</sup></b>	<b>24,594</b>		<b>1,337</b>	<b>23,257</b>
LICs <sup>43</sup>	(1,819)		(30)	(1,789)
<b>Net operating income</b>	<b>22,775</b>		<b>1,307</b>	<b>21,468</b>
Total operating expenses	(17,522)		(738)	(16,784)
<b>Operating profit</b>	<b>5,253</b>		<b>569</b>	<b>4,684</b>
Income from associates <sup>44</sup>	398			398
Profit before tax	5,651		569	5,082
RoRWA <sup>36</sup>	2.6%		0.8%	3.3%

<b>2013</b>				
Net interest income	18,339		2,061	16,278
Net fee income	7,021		11	7,010
Other income/(expense) <sup>42</sup>	1,380		(400)	1,780
<b>Net operating income<sup>4</sup></b>	<b>26,740</b>		<b>1,672</b>	<b>25,068</b>
LICs <sup>43</sup>	(3,227)		(705)	(2,522)
<b>Net operating income</b>	<b>23,513</b>		<b>967</b>	<b>22,546</b>
Total operating expenses	(17,248)		(1,166)	(16,082)
<b>Operating profit/(loss)</b>	<b>6,265</b>		<b>(199)</b>	<b>6,464</b>
Income/(expense) from associates <sup>44</sup>	384		(1)	385
Profit/(loss) before tax	6,649		(200)	6,849
RoRWA <sup>36</sup>	2.6%		(0.2%)	4.4%

<b>2012</b>				
Net interest income	20,298	1,267	2,563	16,468

Net fee income	7,205	395	33	6,777
Other income/(expense) <sup>42</sup>	6,358	3,155	(200)	3,403
Net operating income <sup>4</sup>	33,861	4,817	2,396	26,648
LICs <sup>43</sup>	(5,515)	(322)	(2,569)	(2,624)
Net operating income/ (expense)	28,346	4,495	(173)	24,024
Total operating expenses	(19,769)	(729)	(1,103)	(17,937)
Operating profit/(loss)	8,577	3,766	(1,276)	6,087
Income from associates <sup>44</sup>	998		2	996
Profit/(loss) before tax	9,575	3,766	(1,274)	7,083
RoRWA <sup>36</sup>	3.1%	14.7%	(1.1%)	4.2%

*For footnotes, see page 109.*

### **Principal RBWM RoRWA**

**3.3%**

### **Global mobile application**

**downloads surpass**

**6 million**

### **Best Mobile Banking Application 2014**

*(Global Finance Magazine)*

## **Strategic direction**

RBWM provides retail banking and wealth management services for personal customers in markets where we have, or can build, the scale in our target customer segments to do so cost effectively.

We focus on three strategic imperatives:

building a consistent, high standard, customer needs-driven wealth management service for retail customers drawing on our Insurance and Asset Management businesses;

using our global expertise to improve customer service and productivity to provide a high standard of banking solutions and service to our customers efficiently; and

simplifying and re-shaping the RBWM portfolio of businesses to focus our capital and resources on key markets.

Our three growth priorities are customer growth in target segments, deepening customer relationships through wealth management and relationship-led lending, and enhancing distribution capabilities, including digital.

Implementing Global Standards, enhancing risk management control models and simplifying processes also remain top priorities for RBWM.

### **Review of reported performance**

On a reported basis, RBWM profit before tax reduced by US\$1.0bn to US\$5.7bn, while Principal RBWM profit before tax fell by US\$1.8bn to US\$5.1bn. The reduction in RBWM partly reflected the effects of significant items (see page 42) including provisions of US\$568m arising from the ongoing review of compliance with the CCA in the UK, adverse movements in non-qualifying hedges of US\$493m in 2014 compared with favourable movements of US\$262m in 2013, UK customer redress provisions of US\$992m compared with US\$953m in 2013, and disposals.

In the US run-off portfolio, a profit before tax was recorded compared with a loss in 2013. A reduction in revenue was more than offset by lower LICs reflecting decreased lending balances, reduced new impaired loans and lower delinquency levels. Operating expenses also fell, mainly from the non-recurrence of a customer remediation provision relating to our former CRS business and lower divestiture costs.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Review of adjusted performance<sup>45</sup>**

The commentary that follows reflects performance in our Principal RBWM<sup>46</sup> business (see page 63).

*Profit before tax (US\$m)*

**Profit before tax** fell by US\$0.7bn to US\$6.9bn. Revenue was broadly unchanged, while lower LICs were more than offset by higher operating expenses.

*Revenue (US\$m)*

**Revenue** was broadly unchanged despite the effect of de-risking initiatives and against a backdrop of continued low interest rates and muted growth in certain key markets. Higher income from current accounts, savings and deposits was broadly offset by lower revenues from personal lending and wealth management products.

*Principal RBWM: management view of adjusted revenue*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Current accounts, savings and deposits	<b>5,839</b>	5,606
Wealth management products	<b>6,201</b>	6,263
investment distribution <sup>47</sup>	<b>3,456</b>	3,568
life insurance manufacturing	<b>1,603</b>	1,602
asset management	<b>1,142</b>	1,093
Personal lending	<b>11,300</b>	11,455
mortgages	<b>3,169</b>	3,182
credit cards	<b>4,339</b>	4,310
other personal lending <sup>48</sup>	<b>3,792</b>	3,963
Other <sup>49</sup>	<b>645</b>	873
<b>Net operating income<sup>4</sup></b>	<b>23,985</b>	24,197

For footnotes, see page 109.

Revenue from current accounts, savings and deposits increased by 4%. This reflected an increase in customer account balances, of 4% compared with 2013, mainly in Hong Kong and the UK. In addition, higher revenue reflected increased spreads on savings products in the UK and, to a lesser extent, on deposits in mainland China where market interest rates increased.

Revenue from wealth management products reduced by 1%. Investment distribution income declined, mainly as a result of lower fees in the UK, in part reflecting the Retail Distribution Review undertaken in 2013, and in Brazil reflecting a change in product mix. Life insurance manufacturing income was broadly unchanged. This reflected higher new business sales and investment income in Hong Kong, and a net favourable movement in the PVIF asset in Brazil, offset by a reduction in the PVIF asset in France where a fall in long-term yields increased the cost of guarantees on savings business.

Personal lending revenue was down by 1%. While mortgage and credit card revenues were broadly unchanged, other personal lending income declined by 4%, notably in the UK due to the cessation of certain overdraft fees.

**LICs** decreased by 22% with reductions across all regions, mainly in Brazil due to impairment model changes and assumption revisions for restructured loans in 2013 which were not repeated in 2014. LICs also reduced in the US and the UK, partly reflecting lower delinquency levels and reduced outstanding credit card and UK loan balances.

*Operating expenses (US\$m)*

**Operating expenses** increased by 7%, reflecting inflationary pressures, particularly in Latin America, in addition to higher costs associated with Regulatory Programmes and Compliance. The increase also reflected the timing of the recognition of the Financial Services Compensation Scheme levy in the UK and higher marketing costs across the regions. These factors were partly offset by sustainable cost savings of over US\$200m.

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

#### **Growth priorities**

##### **Focus on relationship-led personal lending to drive balance sheet growth**

In 2014, we continued to focus on improving the quality of our revenue through the ongoing implementation of de-risking initiatives, although these have weighed on income. They included the introduction of a new discretionary incentive framework for our Retail Banking customer-facing staff similar to the one launched for Wealth Management relationship managers ( RM s) in 2013, removing the formulaic link between product sales and variable pay for front line staff. We also continued to simplify our product range, improve our risk governance and align our practices following regulatory changes.

We aim to deepen relationships with our existing customers and use personal lending to generate new business, targeting different segments and offerings in each market. To achieve this we continued to use improved analytics to support product decisions. Based on pricing and customer response measures, we enhanced revenue and grew balances in certain targeted segments, including the re-launch of the Advance segment in 17 markets in 2014. Lending and deposit balances and revenue per customer for Advance increased compared with 2013.

We maintained discipline around growing lending within our risk appetite in our home and priority growth markets. Home loan average balances increased by 3% in 2014, reflecting growth in our priority markets, notably with double-digit growth in approximately half of these countries as we re-balanced the product mix towards secured loans, although this mix change translated into lower spreads. In our home markets, we continued to target growth in unsecured lending, with average balances marginally higher including an increase in average card balances in Hong Kong, partly offset by a reduction in the UK. Despite overall balance growth, LICs remained lower than in 2013.

Customer recommendation levels improved in several markets during 2014, with the total volume of complaints related to products and services decreasing by more than 20% in the second half of the year, compared with the equivalent period in 2013. Further work is required and is ongoing to better meet our customer needs as they continue to evolve.

##### **Continue to develop wealth management with a focus on growing customer balances**

We remain committed to capturing opportunities from wealth creation, primarily through our Premier offering with its customers generating nearly four times the average revenue of non-Premier clients.

Although revenue from wealth management products remained lower than expected we continued to grow wealth balances, which comprise investment and insurance balances. These balances increased compared with 2013 across insurance, mutual funds and equities trading.

In 2014, Global Asset Management continued its strategy of strengthening collaboration across the global businesses to serve their customers. This helped to attract US\$29bn of net new money principally in fixed income and liquidity products, in particular with GB&M clients. The investment performance in over 74% of Global Asset Management's eligible funds by value were above the market median.

In 2014, we improved our RMs' productivity through new training programmes and tools. Client contact and coverage rates increased from 2013 with higher numbers of client appointments, financial reviews and needs fulfilled per RM.

**Develop digital capabilities to support customers and reduce cost**

We continue to develop our digital channels and streamline processes to improve the customer experience and to deliver cost savings through our distribution network.

In 2014, downloads of our global mobile application, now with enriched functionality, were over 3m with the total number of downloads surpassing 6m. *Global Finance* magazine presented HSBC with the award for Best Mobile Banking App at its 2014 World's Best Internet Bank event based on the application's global reach and functionality.

In addition, we launched our first straight-through on-line mortgage application service in the UK and, by the end of 2014, 14% of our annual approvals were produced online. We also deployed new Premier platforms, digital capabilities and tablet-based tools to enhance the end-to-end delivery process and customer experience. Across our priority growth markets, the revenue derived from digital channels increased by 18% compared with 2013.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Commercial Banking**

**CMB offers a full range of commercial financial services and tailored solutions to more than 2.5 million customers ranging from small and medium-sized enterprises to publicly quoted companies in almost 60 countries.**

	2014 US\$m	2013 US\$m	2012 US\$m
Net interest income	<b>10,506</b>	10,200	10,361
Net fee income	<b>4,738</b>	4,717	4,470
Other income <sup>42</sup>	<b>1,059</b>	1,448	1,720
<b>Net operating income<sup>4</sup></b>	<b>16,303</b>	16,365	16,551
LICs <sup>43</sup>	<b>(1,675)</b>	(2,384)	(2,099)
<b>Net operating income</b>	<b>14,628</b>	13,981	14,452
Total operating expenses	<b>(7,489)</b>	(7,049)	(7,598)
<b>Operating profit</b>	<b>7,139</b>	6,932	6,854
Income from associates <sup>44</sup>	<b>1,605</b>	1,509	1,681
<b>Profit before tax</b>	<b>8,744</b>	8,441	8,535
RoRWA <sup>36</sup>	<b>2.1%</b>	2.2%	2.2%

**Record reported profit before tax of**

**US\$8.7bn**

**10%**

**Growth in customer lending balances**

(excluding the effect of currency translation)

**Best Global Cash Management Bank for  
Corporates and Financial Institutions**

for the third consecutive year

(Euromoney 2014)

## Strategic direction

CMB aims to be the banking partner of choice for our customers building on our rich heritage, international capabilities and relationships to enable global connectivity.

We have four growth priorities:

providing consistency and efficiency for our customers through a business model organised around global customer segments and products;

utilising our distinctive geographical network to support and facilitate global trade and capital flows;

delivering excellence in our core flow products specifically in Trade and in Payments and Cash Management; and

enhancing collaboration with other global businesses.

Implementing Global Standards, enhancing risk management controls and simplifying processes also remain top priorities for CMB.

*For footnotes, see page 109.*

## Review of reported performance

In 2014, CMB reported a record profit before tax of US\$8.7bn, 4% higher than in 2013. Reported profit before tax included the effect of a number of significant items (see page 42), notably the gain on sale of our operations in Panama of US\$479m in 2013. The increase in reported profit before tax was also driven by a reduction in LICs, although this was partly offset by higher operating expenses.

## Review of adjusted performance<sup>45</sup>

*Profit before tax (US\$m)*

**Profit before tax** grew by 13% to US\$8.9bn. This was driven by increased revenue and a reduction in LICs, partly offset by a rise in operating expenses.

*Revenue (US\$m)*

**Revenue** grew by 5%, driven by Credit and Lending and Payments and Cash Management, notably in our home markets of Hong Kong and the UK. This was due to higher net interest income from growth in average lending and deposit balances in Hong Kong and rising average deposit balances and wider lending spreads in the UK. Higher net fee income was driven by an increase in term lending fees in the UK.

Despite lending spread compression compared with 2013, spreads in 2014 stabilised and showed signs of recovery in certain markets. In addition, we saw notable growth in our UK lending balances in the second half of 2014.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Management view of adjusted revenue*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Global Trade and Receivables Finance	<b>2,680</b>	2,625
Credit and Lending	<b>6,316</b>	5,938
Payments and Cash Management, current accounts and savings deposits	<b>5,018</b>	4,709
Markets products, Insurance and Investments and Other <sup>51</sup>	<b>2,298</b>	2,207
<b>Net operating income<sup>4</sup></b>	<b>16,312</b>	15,479

*For footnotes, see page 109.*

*The table above has been restated to reclassify Foreign Exchange revenue. In 2014, Markets products, Insurance and Investments and Other included Foreign Exchange revenue of US\$207m previously included within Global Trade and Receivables Finance (2013: US\$213m) and US\$516m previously included within Payments and Cash Management (2013: US\$462m).*

Global Trade and Receivables Finance revenue increased by 2% compared with 2013. Average balances rose, with growth in Asia, Europe and Latin America. The effect was partly offset by spread compression in Latin America, reflecting a change in portfolio mix in Brazil. In 2014, spread compression stabilised and showed signs of recovery in certain markets.

Credit and Lending revenue increased by 6% compared with 2013, reflecting higher average balances in Hong Kong and the US and, to a lesser extent, in Brazil. Revenue also increased in the UK due to wider lending spreads and increased fee income from term lending due to higher new business volumes. These factors were partly offset by spread compression in Latin America, primarily in Brazil as discussed above and in Mexico due to the repositioning of the business, and in mainland China.

Payments and Cash Management revenue increased by 7% compared with 2013. This reflected strong deposit growth, notably in the UK and Hong Kong, along with an increase in high value payment transaction volumes. This was partly offset by spread compression, notably in Europe.

Markets products, Insurance and Investments and Other revenue was 4% higher, primarily in North America. In Canada, this reflected the non-recurrence of a write-down of an investment property held for sale in 2013 and a gain on sale of an investment portfolio in 2014. In the US, higher revenue was driven by a gain on sale of a real

estate portfolio.

**LICs** decreased by US\$663m, mainly in Europe and Latin America. Lower LICs in Europe reflected a reduction in individually assessed loan impairment charges in the UK. The reduction in Latin America was driven by lower individually assessed charges in Mexico, in particular relating to homebuilders, and lower collectively assessed impairments in Brazil due to impairment model changes and assumption revisions for restructured loans in the Business Banking portfolios in 2013 not repeated in 2014. These factors were partly offset by higher individually assessed charges in Asia, notably in mainland China and Hong Kong.

#### *Operating expenses (US\$m)*

**Operating expenses** increased by 8%, principally in Europe, Latin America and Asia. In Europe and Asia, higher costs reflected increased investment in staff to support business growth and inflationary pressures, while in Latin America costs rose due to inflation which was largely attributable to union-agreed salary increases in Brazil and Argentina. In addition, operating expenses increased due to higher Regulatory Programmes and Compliance costs.

**Income from associates** increased by 4% due to the improved performance of BoCom and The Saudi British Bank.

#### **Growth priorities**

##### *Providing consistency through a globally led business model*

Our business strategy is built on the foundation of global scale and consistency, focusing on customer segments and customer behaviour to ensure we provide tailored products to suit their needs. We continue to invest in providing global product coverage for our business segments. This enables us to manage risk more efficiently.

The creation of new senior management positions and a more defined global strategy within our customer segments enabled us to improve client coverage. In 2014, we appointed a new Global Head of International Subsidiary Banking to drive investment in supporting our international customers across our network. We also established dedicated RM teams for international subsidiary banking in key markets to focus on meeting the needs of these subsidiaries and growing the associated revenue streams.

We appointed a new Global Head of Lending and Transaction Management with a remit to support all segments. This globally-aligned product group is designed to optimise capital allocation and improve revenue mix within our risk appetite.

In 2014, we redefined our Large Corporate segment to focus on a smaller number of higher-value clients. The Large Corporate segment experienced strong



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

growth in most markets fuelled by multi-country flow mandates and increased event-driven capital markets activity. The increased focus on global wallet and connectivity led to increased awareness amongst our customers of our franchise and capabilities, resulting in stronger global strategic partnerships.

In addition, we increased our market presence in six of our key MME markets (Hong Kong, the UK, Canada, the US, Mexico and Brazil). We made further progress by appointing regional and country heads of MME and by enhancing our client management system.

In Business Banking, we invested in additional RMs in key markets, increased training worldwide and continued to deploy a globally consistent customer management system within our relationship-managed portfolios. Six major campaigns were launched in 2014 to help SME customers achieve their growth ambitions and expand overseas, including offering funds in the UK, France, the US, Canada, Australia and Turkey totalling US\$18bn.

**Utilising our geographical network to support our customers' international growth ambitions**

HSBC's network across the major global trade corridors continued to assist us to provide value-added solutions for our clients. For example, we helped one of the largest retailers in the US to improve its supply chain management by providing holistic financing and liquidity solutions including working capital, trade and supply chain finance.

In Payments and Cash Management, CMB remained well positioned to benefit from global trends such as the increase in cross-border payment flows as we are strategically located where more than 85% of the world's payment activity originates. For example, new customer mandates increased by 23% on 2013. In addition, we improved our digital offering, migrating over 80,000 customers to date from legacy platforms to core electronic banking channels, and continued to develop innovative products. These included the enhancement of our Global Liquidity Solutions, which enables customers in mainland China to connect their operating cash with their liquidity structures globally.

**Delivering excellence in our core products**

HSBC is one of the largest trade finance banks in the world with access to more than 85% of the world's trade and capital flows. We continued to enhance our open account financing capabilities through investment in Receivables Finance and Supply Chain, specifically the launch of a new Supply Chain Solutions platform and the consolidation of the existing Receivables platform into regional hubs. This offers customers broader access to expertise and liquidity and gives us the ability to deploy our capabilities rapidly in new markets, providing better risk management and lower operating costs.

Against the backdrop of declining commodity prices, we achieved double-digit asset balance growth in Commodity and Structured Trade Finance compared with 2013.

**Enhancing collaboration with other global businesses**

We maintained our focus on strengthening CMB's collaboration with GB&M and GPB by increasing product coverage across the Group to our customers. In 2014, CMB customers generated over 80% of HSBC's total collaboration revenues. Revenue from collaboration remained broadly unchanged compared with 2013. This was driven by lower sales of Markets products to CMB customers, notably in the Foreign Exchange business, offset by growth in the sale of Capital Financing products with regard to mergers and acquisitions and debt capital markets.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review (continued)****Global Banking and Markets**

**GB&M provides tailored financial solutions to major government, corporate and institutional clients worldwide.**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net interest income	<b>7,022</b>	6,766	6,960
Net fee income	<b>3,560</b>	3,482	3,329
Net trading income <sup>50</sup>	<b>5,861</b>	6,780	5,690
Other income <sup>42</sup>	<b>1,335</b>	2,148	2,294
<b>Net operating income</b> <sup>4</sup>	<b>17,778</b>	19,176	18,273
LICs <sup>43</sup>	<b>(365)</b>	(207)	(670)
<b>Net operating income</b>	<b>17,413</b>	18,969	17,603
Total operating expenses	<b>(12,028)</b>	(9,960)	(9,907)
<b>Operating profit</b>	<b>5,385</b>	9,009	7,696
Income from associates <sup>44</sup>	<b>504</b>	432	824
<b>Profit before tax</b>	<b>5,889</b>	9,441	8,520
RoRWA <sup>36</sup>	<b>1.2%</b>	2.3%	2.1%

**Client flows up in Equities,**

**although subdued in Foreign Exchange**

**Sustained growth in revenues in**

**Payments and Cash Management**

**Bond and Derivatives**

**House of the year**

*(International Finance Review 2014)*

**Strategic direction**

GB&M's business model and strategy is well established with the objective of being a top 5 bank to our priority clients and in our chosen products and geographies.

We focus on the following growth priorities:

connecting clients to international growth opportunities;

continuing to be well positioned in products that will benefit from global trends; and

leveraging our distinctive international expertise and geographical network which connects developed and faster-growing regions.

Enhancing risk management controls, implementing Global Standards and collaborating with other global businesses also remain top priorities for GB&M.

*For footnotes, see page 109.*

### **Review of reported performance**

GB&M's reported profit before tax of US\$5.9bn was down by US\$3.6bn, primarily in Europe and North America, from higher operating expenses and lower revenue. The increase in operating expenses and decrease in revenue reflected a number of significant items (see page 42). Operating expenses included settlements and provisions of US\$1.2bn in connection with foreign exchange investigations, of which US\$809m was recorded in the fourth quarter of 2014, and a charge of US\$533m in the US relating to a settlement agreement with the Federal Housing Finance Agency, which are included in significant items.

### **Review of adjusted performance<sup>45</sup>**

*Profit before tax (US\$m)*

**Profit before tax** of US\$8.1bn was US\$1.1bn lower than in 2013, driven by higher operating expenses and a fall in revenue, which included the introduction of the FFVA on certain derivative contracts that resulted in a charge of

US\$263m.  
*Revenue (US\$m)*

**Revenue** was lower principally due to the effect of the FFVA and a reduction in our Foreign Exchange business which was partly offset by an increase in Capital Financing.

HSBC HOLDINGS PLC

70

**Table of Contents****Report of the Directors: Financial Review** (continued)*Management view of adjusted revenue*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Markets <sup>52</sup>	<b>6,262</b>	6,933
Credit	<b>567</b>	801
Rates	<b>1,563</b>	1,678
Foreign Exchange	<b>2,916</b>	3,140
Equities	<b>1,216</b>	1,314
Capital Financing	<b>4,066</b>	3,981
Payments and Cash Management	<b>1,794</b>	1,743
Securities Services	<b>1,698</b>	1,653
Global Trade and Receivables Finance	<b>767</b>	723
Balance Sheet Management	<b>3,020</b>	3,046
Principal Investments	<b>531</b>	450
Other <sup>53</sup>	<b>(32)</b>	3
<b>Total operating income<sup>4</sup></b>	<b>18,106</b>	18,532

*For footnotes, see page 109.*

The table below outlines the effect on businesses and total adjusted operating income of the FFVA:  
*Effect of FFVA on total operating income*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Total operating income	<b>18,106</b>	18,532
FFVA in Rates	<b>(164)</b>	
FFVA in Credit	<b>(97)</b>	
FFVA in other businesses	<b>(2)</b>	
Total operating income excluding FFVA	<b>18,369</b>	18,532
of which Rates excluding FFVA	<b>1,727</b>	1,678
of which Credit excluding FFVA	<b>664</b>	801

Excluding the above, revenue in the majority of our Markets businesses was lower. This was predominantly driven by a decline in our Foreign Exchange business, which was affected by lower volatility, notably in the first half of 2014, and reduced client flows. Credit revenue also decreased due to adverse movements in credit spreads and a reduction in Legacy Credit. Equities revenue fell too, as 2013 benefited from higher revaluation gains which more than offset a rise in revenue from increased client flows and higher derivatives income in 2014. By contrast, Rates revenue rose due to favourable market movements, notably in Asia, along with minimal fair value movements on our own credit spread on structured liabilities compared with adverse movements in 2013. These factors were partly offset by a fall in Rates revenue in Europe.

In Capital Financing, revenue grew by US\$85m, as the effects of increased volumes and market share gains across our advisory, equity capital markets and lending products were partly offset by spread and fee compression.

Payments and Cash Management revenue was marginally higher, due to both increased deposit balances, notably in Asia, and a rise in high value transaction volumes, partly offset by spread compression. We also experienced growth in Securities Services revenue, in part from new business in Europe, and Global Trade and Receivables Finance from growth in lending balances.

LICs were higher due to a revision to certain estimates used in our corporate collective loan impairment calculation and increased individually assessed provisions, including a provision against a guarantee in Brazil recorded as a credit risk provision. These were partially offset by higher net releases on available-for-sale ABSs in our legacy portfolio than in 2013.

#### *Operating expenses (US\$m)*

**Operating expenses** increased by 6%, primarily due to higher Regulatory Programmes and Compliance related costs and from increased staff costs. These factors were partially offset by sustainable savings of over US\$80m.

#### **Growth priorities**

##### **Connecting clients to international growth opportunities**

Following the re-shaping of GB&M in 2013, as part of which we brought together all our financing businesses into Capital Financing, including lending, debt capital markets and equity capital markets, we continued to focus on better aligning our resources with clients' needs. We segmented our client base and created a Client Strategy Group to ensure that GB&M's product, sector and coverage expertise supports clients in the growth of their business activities. Strong collaboration between these teams was recently demonstrated by our appointment as the joint global coordinator and joint book runner on the largest European corporate equity rights issue since 2011. This was our fifth transaction with this client in the last 12 months.

We are utilising our global network to provide solutions for our clients in both established markets and faster-growing regions. Our ability to connect clients to opportunities was highlighted by the first Sukuk bond issued outside the Islamic world on which we acted as sole structuring advisor, joint lead manager and joint book runner.

We continued to strengthen our Foreign Exchange franchise by enhancing our risk management capabilities and further developing our distribution platforms and electronic pricing capabilities. This will improve our systems and governance whilst enabling us to better serve clients with a robust and efficient offering.

HSBC HOLDINGS PLC

71

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Continuing to be well positioned in products that will benefit from global trends**

Capturing new opportunities arising from the internationalisation of the renminbi continues to be one of our key growth priorities. Recently, we acted as joint lead manager, book runner and financial advisor on a pioneering Formosa bond issue, which simultaneously listed on three exchanges worldwide. We were also voted Best Overall for Products and Services by *Asiamoney* Offshore RMB Services Survey 2014 for the third consecutive year, demonstrating our continued leading position in the overseas renminbi market.

In November 2014 we launched the Stock Connect programme, a mechanism linking trading and clearing between the Shanghai and Hong Kong securities markets. This will give our clients direct access to the Chinese A-share market and the ability to fund equity purchases in renminbi.

Geographical expansion of large corporates and rising world trade are expected to increase the demand for cross-border payments and related services. Our strength in Payments and Cash Management was recognised by *Euromoney*, who named HSBC the Best Global Cash Manager for Non-financial Institutions and Best Global Cash Manager for Corporate and Financial Institutions, for the second and third consecutive years, respectively. We were also able to win a mandate for renminbi cash management and additional foreign exchange and deposit business from a global automotive group which is seeking to expand into mainland China.

**Leveraging our distinctive international expertise and geographical network which connects developed and faster-growing regions**

Our distinctive geographical network and global expertise allows us to provide a truly international service to our clients. We recently demonstrated the value of our global capital markets capabilities and leading position in faster-growing markets to a European automotive group. We advised and acted as joint sub-underwriter on a domestic securitisation in mainland China which was structured to attract both international and domestic investors. We were the first foreign bank to advise on the structuring of an internationally rated ABS transaction in mainland China.

GB&M continues to focus on collaborating with other global businesses and supporting clients in accessing a range of products across our Markets and Capital Financing businesses. In 2014, collaboration revenue between GB&M and CMB was broadly unchanged, driven by a reduction in Foreign Exchange which was offset by growth in Capital Financing, notably in advisory.

**Global Private Banking**

**GPB serves high net worth individuals and families with complex and international needs within the Group's priority markets.**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net interest income	<b>994</b>	1,146	1,294
Net fee income	<b>1,056</b>	1,150	1,232
Other income <sup>42</sup>	<b>327</b>	143	646
<b>Net operating income<sup>4</sup></b>	<b>2,377</b>	2,439	3,172
LICs <sup>43</sup>	<b>8</b>	(31)	(27)
<b>Net operating income</b>	<b>2,385</b>	2,408	3,145
Total operating expenses	<b>(1,778)</b>	(2,229)	(2,143)
Operating profit	<b>607</b>	179	1,002
Income from associates <sup>44</sup>	<b>19</b>	14	7
<b>Profit before tax</b>	<b>626</b>	193	1,009
RoRWA <sup>36</sup>	<b>2.9%</b>	0.9%	4.6%

**Positive net new money of**

**US\$14bn**

**in areas targeted for growth**

**since December 2013**

**Performance continued to be affected by**

**actions taken to reposition the customer**

**base**

**Best Family Office Offering**

(Private Banker International Global Wealth Awards)

## Strategic direction

GPB aims to build on HSBC's commercial banking heritage to be the leading private bank for high net worth business owners by:



capturing growth opportunities in home and priority growth markets, particularly from intra-Group collaboration by accessing owners and principals of CMB and GB&M clients; and

repositioning the business to concentrate on onshore markets and a smaller number of target offshore markets, aligned with Group priorities.

Implementing Global Standards, enhancing risk management controls, tax transparency and simplifying processes also remain top priorities for GPB.

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

72

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Review of reported performance**

Reported profit before tax of US\$626m was US\$433m higher than in 2013. This was due to a small number of significant items (see page 42), most notably in 2013 from the loss on write-off of allocated goodwill relating to our Monaco business of US\$279m and regulatory provisions of US\$352m.

We expect our GPB results in 2015 to be affected by the reduction in our client assets as we continue to reposition our business model, including reducing the number of clients in non-priority markets.

**Review of adjusted performance<sup>45</sup>**

*Profit before tax (US\$m)*

**Profit before tax** fell by US\$162m to US\$738m, mainly due to reduced revenue as we continued to reposition the business, partly offset by lower operating expenses and LICs.

*Revenue (US\$m)*

**Revenue** decreased by 11% compared with 2013, due to lower trading income and net fee income reflecting a managed reduction in client assets and lower market volatility. Net interest income also declined, mainly in Europe and Asia, driven by a reduction in deposit balances and lower treasury income, respectively, both reflecting actions to reposition the business. In addition, lending spreads narrowed compared with 2013.

**Net loan impairment releases** in 2014 compared with charges of US\$33m in 2013, largely due to releases of collective impairment allowances in the UK and in the US.

*Operating expenses (US\$m)*

**Operating expenses** decreased by 5%, primarily due to the release of a UK customer redress provision recognised in 2012, the non-recurrence of the UK provision relating to a bilateral Rubik tax agreement between the UK and Swiss governments, and the managed reduction in staff numbers.

*Reported client assets<sup>54</sup>*

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
At 1 January	<b>382</b>	398
Net new money	<b>(3)</b>	(26)
Of which: areas targeted for growth	<b>14</b>	(7)
Value change	<b>8</b>	12
Disposals	<b>(11)</b>	(3)
Exchange and other	<b>(11)</b>	1
<b>At 31 December</b>	<b>365</b>	382

*Reported client assets by geography*

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
Europe	<b>179</b>	197
Asia	<b>112</b>	108
North America	<b>63</b>	65
Latin America	<b>11</b>	12
<b>At 31 December</b>	<b>365</b>	382

*For footnote, see page 109.*

On a reported basis, client assets, which include funds under management and cash deposits, decreased, mainly in Europe, due to the effect of the sale of a portfolio of clients in Switzerland, the disposal of our HSBC Trinkaus & Burkhardt AG business in Luxembourg and negative net new money. In addition there were unfavourable foreign exchange movements, mainly in Europe. This was partly offset by favourable market movements. Negative net new money of US\$3bn was mainly driven by the continued repositioning of our business, though we attracted positive net new money of US\$14bn in areas that we have targeted for growth, including our home and priority growth markets and the high net worth client segment.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

On a reported basis, our return on assets, defined as the percentage of revenue to average client assets, was 63bps in 2014, broadly unchanged compared with 2013. On an adjusted basis, our return on assets was 6bps lower in 2014, reflecting the effect of the repositioning and reduced market volatility. Our client return on assets, which excludes treasury and capital revenue, also decreased by 4bps.

In January 2015, the Swiss National Bank removed its currency cap with the euro which resulted in the appreciation of the Swiss franc. We monitor the impact of foreign exchange rate fluctuations on a continuing basis and do not expect any significant effect on the reported results of our GPB business.

**Strategic direction**

**Capture growth in our home and priority growth markets and focus on collaboration revenues**

In 2014, new referrals from other global businesses generated net new money of over US\$10bn, which was US\$5.5bn higher than in 2013. In total, 74% of our net new money from areas targeted for growth in 2014 came from Group-referred clients, helped by adopting a more coordinated and systematic approach to identifying client needs in conjunction with the other global businesses.

We integrated our collaboration efforts with GB&M and CMB into one team, the Corporate Client Group ( CCG ). This was established to improve client introductions to and from GPB by standardising best practices and developing tailored offerings to meet client needs more effectively. The CCG is also responsible for enhancing coverage of existing personal and corporate relationships through a coordinated approach. In addition, the Global Solutions Group was established to deliver bespoke solutions to ultra-high net worth and global priority clients. This involves working closely with GB&M and CMB to enhance the service we offer to these sophisticated clients.

We also established the Wealth Client Group with responsibility for ensuring greater alignment and increased collaboration with RBWM, including utilising RBWM's transactional banking capabilities.

To support client growth, we expanded our product offering with investment opportunities in three new Alternatives products, comprising one private equity fund and two real estate funds. We strengthened our investment group by ensuring that the majority of clients with assets greater than US\$5m now have access to a dedicated investment counsellor. We partnered with the GB&M Global Research team to improve the advisory services for our clients supported by easy client access to a wider range of investment research reports. We plan to deploy this globally by the end of 2015. We also worked closely with HSBC Securities Services to provide our ultra-high net worth and family office clients with access to our institutional global custody platform in Europe and the Middle East and North Africa, providing

clients with access to trade capture, clearing and settlement, safekeeping and investment administration services.

### **Repositioning the business**

We continued to reposition the GPB business model and client base in 2014 by reviewing our portfolio and seeking to ensure that all clients comply with our Global Standards, including financial crime compliance and tax transparency standards.

We remain focused on clients with wider Group connectivity within our home and priority growth markets. Following the announcement of the sale of a portfolio of clients in Switzerland to LGT Bank (Switzerland) Ltd earlier this year, we completed the migration of US\$8bn of client assets in the second half of 2014. We also continued to reduce the number of clients in non-priority markets.

In 2014, we continued to streamline and rationalise the business, closing a number of non-strategic representative offices, and we announced the consolidation of our trust business in Europe into a regional hub in Jersey. We also commenced development of a new global IT banking platform. This is expected to deliver improved efficiency, enhanced services and a consistent client offering by consolidating GPB's multiple systems onto a single banking platform. We remain on track to deliver the first phase of the implementation in 2015.

We enhanced our digital capabilities with the deployment of a new mobile application in Switzerland, Monaco, Luxembourg and Guernsey, enabling clients to view their investment holdings and transactions while on the move. We introduced a secure tablet application for front office staff in Switzerland delivering digital document browsing during client visits, and also deployed video meeting capabilities in the US. Wider deployment of these and other applications is scheduled for 2015.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Other**<sup>39</sup>

**Other** contains the results of HSBC's holding company and financing operations, central support and functional costs with associated recoveries, unallocated investment activities, centrally held investment companies, certain property transactions and movements in fair value of own debt.

	2014 US\$m	2013 US\$m	2012 US\$m
Net interest expense	(501)	(737)	(730)
Net fee income/(expense)	(65)	64	194
Net trading income/(expense) <sup>50</sup>	(92)	6	(537)
Changes in fair value of long-term debt issued and related derivatives	508	(1,228)	(4,327)
Changes in other financial instruments designated at fair value	(9)	(576)	(1,136)
Net income/(expense) from financial instruments designated at fair value	499	(1,804)	(5,463)
Other income	6,524	8,122	8,868
<b>Net operating income</b> <sup>4</sup>	<b>6,365</b>	5,651	2,332
LICs <sup>43</sup>			
<b>Net operating income</b>	<b>6,365</b>	5,651	2,332
Total operating expenses	(8,601)	(7,796)	(9,369)
<b>Operating loss</b>	<b>(2,236)</b>	(2,145)	(7,037)
Income/(expense) from associates <sup>44</sup>	6	(14)	47
<b>Loss before tax</b>	<b>(2,230)</b>	(2,159)	(6,990)

*For footnotes, see page 109.*

**Review of reported performance**

Reported loss before tax of US\$2.2bn was 3% higher than in 2013. This was driven by increased operating costs partly offset by higher revenue.

The increase in loss before tax of US\$71m included favourable movements in the fair value of own debt of US\$417m in 2014 compared with adverse movements of US\$1.2bn in 2013. These results also included the following items in 2013:

gain on derecognition of Industrial Bank as an associate (US\$1.1bn);

net gain on disposal of Ping An Insurance (Group) Company of China, Ltd ( Ping An ) (US\$553m); and

foreign exchange gains relating to sterling debt issued by HSBC Holdings (US\$442m);  
and the following items in 2014:

gain on sale of our shareholding in Bank of Shanghai in 2014 (US\$428m); and

an impairment on our investment in Industrial Bank (US\$271m).

*For further details of all significant items, see page 42.*

### **Review of adjusted performance<sup>45</sup>**

*Loss before tax (US\$m)*

The **loss before tax** decreased, reflecting increased revenue partly offset by higher operating costs.

*Revenue (US\$m)*

**Revenue** rose by US\$1.3bn, primarily due to favourable movements in 2014 of US\$96m on interest and exchange rate ineffectiveness in the hedging of long-term debt designated at fair value issued principally by HSBC Holdings and its European subsidiaries, compared with adverse movements of US\$551m in 2013. In addition, recoveries of certain expenses from global businesses increased, reflecting higher operating expenses, and we recorded a gain arising from the external hedging of an intra-Group financing transaction in Europe. There was also a release of accrued interest on uncertain tax reserves in the US. These factors were partly offset by the expiry of the TSAs relating to the sale of the CRS business in the US and lower income from investment properties in Asia.

*Operating expenses (US\$m)*





**Table of Contents****Report of the Directors: Financial Review** (continued)

**Operating expenses** increased by US\$946m due to higher costs associated with Regulatory Programmes and Compliance, an increase in Global Resourcing costs in India and mainland China and the 2013 release of a litigation provision in Asia. In addition, the UK bank levy charge of US\$1.1bn in 2014 was higher than the charge of US\$916m in 2013, primarily due to an increase in the rate of the levy. This was partly offset by a reduction in North America by the expiry of the TSAs relating to the sale of the CRS business.

**Analysis by global business***HSBC profit/(loss) before tax and balance sheet data*

	2014						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other <sup>39</sup> US\$m	Inter- segment elimination <sup>55</sup> US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	16,782	10,506	7,022	994	(501)	(98)	34,705
Net fee income/(expense)	6,668	4,738	3,560	1,056	(65)		15,957
Trading income/(expense) excluding net interest income	(28)	620	4,063	298	(100)		4,853
Net interest income/(expense) on trading activities	9	(2)	1,798	(4)	8	98	1,907
Net trading income/(expense) <sup>50</sup>	(19)	618	5,861	294	(92)	98	6,760
Changes in fair value					508		508

value of long- term debt issued and related derivatives							
Net income/(expense) from other financial instruments designated at fair value	1,675	288	12	(1)	(9)		1,965
Net income/(expense) from financial instruments designated at fair value	1,675	288	12	(1)	499		2,473
Gains less losses from financial investments	14	31	1,117	9	164		1,335
Dividend income	24	18	80	5	184		311
Net insurance premium income	10,570	1,296	5	50			11,921
Other operating income	719	248	124	33	6,176	(6,169)	1,131
<b>Total operating income</b>	<b>36,433</b>	<b>17,743</b>	<b>17,781</b>	<b>2,440</b>	<b>6,365</b>	<b>(6,169)</b>	<b>74,593</b>
Net insurance claims <sup>56</sup>	(11,839)	(1,440)	(3)	(63)			(13,345)
<b>Net operating income<sup>4</sup></b>	<b>24,594</b>	<b>16,303</b>	<b>17,778</b>	<b>2,377</b>	<b>6,365</b>	<b>(6,169)</b>	<b>61,248</b>
Loan impairment (charges)/recoveries and other credit risk provisions	(1,819)	(1,675)	(365)	8			(3,851)
<b>Net operating income</b>	<b>22,775</b>	<b>14,628</b>	<b>17,413</b>	<b>2,385</b>	<b>6,365</b>	<b>(6,169)</b>	<b>57,397</b>
Employee expenses <sup>57</sup>	(5,038)	(2,439)	(3,655)	(732)	(8,502)		(20,366)
Other operating expenses	(12,484)	(5,050)	(8,373)	(1,046)	(99)	6,169	(20,883)
Total operating expenses	(17,522)	(7,489)	(12,028)	(1,778)	(8,601)	6,169	(41,249)
<b>Operating profit/(loss)</b>	<b>5,253</b>	<b>7,139</b>	<b>5,385</b>	<b>607</b>	<b>(2,236)</b>		<b>16,148</b>
Share of profit in associates and joint ventures	398	1,605	504	19	6		2,532
<b>Profit/(loss) before tax</b>	<b>5,651</b>	<b>8,744</b>	<b>5,889</b>	<b>626</b>	<b>(2,230)</b>		<b>18,680</b>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	%	%	%	%	%	%
Share of HSBC s profit before tax	30.3	46.8	31.5	3.4	(12.0)	100.0
Cost efficiency ratio	71.2	45.9	67.7	74.8	135.1	67.3

*Balance sheet data*<sup>40</sup>

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net) <sup>27</sup>	359,744	313,999	254,463	44,102	2,352	974,660
Total assets	499,083	372,739	1,839,644	88,342	164,537	(330,206) 2,634,139
Customer accounts <sup>27</sup>	581,421	363,654	319,121	85,465	981	1,350,642

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	2013							
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other <sup>39</sup> US\$m	Inter- segment elimination <sup>55</sup> US\$m	Total US\$m	
<i>Profit/(loss) before tax</i>								
Net interest income/(expense)	18,339	10,200	6,766	1,146	(737)	(175)	35,539	
Net fee income	7,021	4,717	3,482	1,150	64		16,434	
Trading income/(expense) excluding net interest income	689	649	4,953	390	(38)		6,643	
Net interest income/(expense) on trading activities	(3)		1,827	4	44	175	2,047	
Net trading income <sup>50</sup>	686	649	6,780	394	6	175	8,690	
Changes in fair value of long-term debt issued and related derivatives								
Net income/(expense) from other financial instruments designated at fair value	1,638	332	599	4	(576)	(1)	1,996	
Net income/(expense) from financial instruments designated at fair value	1,638	332	599	4	(1,804)	(1)	768	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Gains less losses from financial investments	55	1	747	(3)	1,212		2,012
Dividend income	21	15	129	8	149		322
Net insurance premium income	10,543	1,375	6	16			11,940
Other operating income/(expense)	544	621	670	(239)	6,761	(5,725)	2,632
Total operating income	38,847	17,910	19,179	2,476	5,651	(5,726)	78,337
Net insurance claims <sup>56</sup>	(12,107)	(1,545)	(3)	(37)			(13,692)
Net operating income <sup>4</sup>	26,740	16,365	19,176	2,439	5,651	(5,726)	64,645
Loan impairment charges and other credit risk provisions	(3,227)	(2,384)	(207)	(31)			(5,849)
Net operating income	23,513	13,981	18,969	2,408	5,651	(5,726)	58,796
Employee expenses <sup>57</sup>	(5,219)	(2,327)	(3,549)	(776)	(7,325)		(19,196)
Other operating expenses	(12,029)	(4,722)	(6,411)	(1,453)	(471)	5,726	(19,360)
Total operating expenses	(17,248)	(7,049)	(9,960)	(2,229)	(7,796)	5,726	(38,556)
Operating profit/(loss)	6,265	6,932	9,009	179	(2,145)		20,240
Share of profit/(loss) in associates and joint ventures	384	1,509	432	14	(14)		2,325
Profit/(loss) before tax	6,649	8,441	9,441	193	(2,159)		22,565
	%	%	%	%	%		%
Share of HSBC's profit before tax	29.5	37.4	41.8	0.9	(9.6)		100.0
Cost efficiency ratio	64.5	43.1	51.9	91.4	138.0		59.6
<i>Balance sheet data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	375,086	297,852	272,473	44,224	2,454		992,089

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Total assets	517,085	360,623	1,975,509	97,655	171,812	(451,366)	2,671,318
Customer accounts <sup>27</sup>	579,994	354,298	328,800	96,770	1,435		1,361,297

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

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

	2012						Total
	Retail Banking and Wealth Management	Commercial Banking	Global Banking and Markets	Global Private Banking	Other <sup>38</sup>	Inter segment elimination <sup>55</sup>	
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Profit/(loss) before tax							
Net interest income/(expense)	20,298	10,361	6,960	1,294	(730)	(511)	37,672
Net fee income	7,205	4,470	3,329	1,232	194		16,430
Trading income/(expense) excluding net interest income	276	617	3,588	476	(549)		4,408
Net interest income on trading activities	28	16	2,102	14	12	511	2,683
Net trading income/(expense) <sup>49</sup>	304	633	5,690	490	(537)	511	7,091
Changes in fair value of long-term debt issued and related derivatives					(4,327)		(4,327)
Net income/(expense) from other financial instruments designated at fair value	1,893	250	1,094		(1,136)		2,101
Net income/(expense)	1,893	250	1,094		(5,463)		(2,226)

from financial instruments designated at fair value							
Gains less losses from financial investments	96	22	730	(3)	344		1,189
Dividend income	24	18	148	6	25		221
Net insurance premium income	11,191	1,786	25	42			13,044
Gains on disposal of US branch network, US cards business and Ping An	3,735	277			3,012		7,024
Other operating income	1,472	536	313	151	5,487	(5,859)	2,100
<b>Total operating income</b>	46,218	18,353	18,289	3,212	2,332	(5,859)	82,545
Net insurance claims <sup>56</sup>	(12,357)	(1,802)	(16)	(40)			(14,215)
<b>Net operating income<sup>1</sup></b>	33,861	16,551	18,273	3,172	2,332	(5,859)	68,330
Loan impairment charges and other credit risk provisions	(5,515)	(2,099)	(670)	(27)			(8,311)
<b>Net operating income</b>	28,346	14,452	17,603	3,145	2,332	(5,859)	60,019
Employee expenses <sup>57</sup>	(5,532)	(2,247)	(3,764)	(915)	(8,033)		(20,491)
Other operating expenses	(14,237)	(5,351)	(6,143)	(1,228)	(1,336)	5,859	(22,436)
Total operating expenses	(19,769)	(7,598)	(9,907)	(2,143)	(9,369)	5,859	(42,927)
<b>Operating profit/(loss)</b>	8,577	6,854	7,696	1,002	(7,037)		17,092
Share of profit in associates and joint ventures	998	1,681	824	7	47		3,557
<b>Profit/(loss) before tax</b>	9,575	8,535	8,520	1,009	(6,990)		20,649
	%	%	%	%	%		%
Share of HSBC's profit before tax	46.4	41.3	41.3	4.9	(33.9)		100.0
Cost efficiency ratio	58.4	45.9	54.2	67.6			62.8

*Balance sheet data*<sup>40</sup>



Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	378,022	288,033	249,209	45,213	2,495		962,972
Total assets	536,244	363,659	1,942,470	118,440	201,741	(470,016)	2,692,538
Customer accounts <sup>27</sup>	562,151	338,405	303,561	105,708	1,571		1,311,396

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

77a

**Table of Contents****Report of the Directors: Financial Review (continued)****Geographical regions**

<b><u>Summary</u></b>	78
<b><u>Europe</u></b>	79
<b><u>Asia</u></b>	84
<b><u>Middle East and North Africa</u></b>	91
<b><u>North America</u></b>	96
<b><u>Latin America</u></b>	101

**Summary**

Additional information on results in 2014 may be found in the **Financial Summary** on pages 40 to 62.

In the analysis of profit and loss by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US\$2,972m (2013: US\$2,628m; 2012: US\$2,684m).

From 1 January 2014, the geographical region **Asia** replaced the geographical regions previously reported as **Hong Kong** and **Rest of Asia-Pacific**. This aligns with changes made in the financial information used internally to manage the business. Comparative data have been represented accordingly.

All commentaries are on an adjusted basis (page 40) unless otherwise stated, while tables are on a reported basis unless otherwise stated.

*Profit/(loss) before tax*

	2014		2013		2012	
	US\$m	%	US\$m	%	US\$m	%
Europe	596	3.2	1,825	8.1	(3,414)	(16.5)
Asia <sup>8</sup>	14,625	78.3	15,853	70.3	18,030	87.3
Middle East and North Africa	1,826	9.8	1,694	7.5	1,350	6.5
North America	1,417	7.6	1,221	5.4	2,299	11.1
Latin America	216	1.1	1,972	8.7	2,384	11.6
<b>Year ended 31 December</b>	<b>18,680</b>	<b>100.0</b>	<b>22,565</b>	<b>100.0</b>	<b>20,649</b>	<b>100.0</b>

*Total assets*<sup>40</sup>

	2014		2013	
	US\$m	%	US\$m	%
Europe	1,290,926	49.0	1,392,959	52.1
Asia <sup>8</sup>	878,723	33.4	831,791	31.1
Middle East and North Africa	62,417	2.4	60,810	2.3
North America	436,859	16.6	432,035	16.2
Latin America	115,354	4.4	113,999	4.3
Intra-HSBC items	(150,140)	(5.8)	(160,276)	(6.0)
<b>At 31 December</b>	<b>2,634,139</b>	<b>100.0</b>	<b>2,671,318</b>	<b>100.0</b>

*Risk-weighted assets*<sup>58</sup>

	2014		2013	
	US\$bn	%	US\$bn	%
<b>At 31 December</b>	<b>1,219.8</b>	<b>100.0</b>	<b>1,092.7</b>	<b>100.0</b>
Europe	375.4	30.1	300.1	27.1
Asia <sup>8</sup>	499.8	40.0	430.7	38.9
Middle East and North Africa	63.0	5.0	62.5	5.7
North America	221.4	17.8	223.8	20.2
Latin America	88.8	7.1	89.5	8.1

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Europe**

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

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net interest income	<b>10,611</b>	10,693	10,394
Net fee income	<b>6,042</b>	6,032	6,169
Net trading income	<b>2,534</b>	4,423	2,707
Other income/(expense)	<b>2,384</b>	(181)	(1,662)
<b>Net operating income<sup>4</sup></b>	<b>21,571</b>	20,967	17,608
LICs <sup>43</sup>	<b>(764)</b>	(1,530)	(1,921)
<b>Net operating income</b>	<b>20,807</b>	19,437	15,687
Total operating expenses	<b>(20,217)</b>	(17,613)	(19,095)
<b>Operating profit/(loss)</b>	<b>590</b>	1,824	(3,408)
Income/(expense) from associates <sup>44</sup>	<b>6</b>	1	(6)
<b>Profit/(loss) before tax</b>	<b>596</b>	1,825	(3,414)
Cost efficiency ratio	<b>93.7%</b>	84.0%	108.4%
RoRWA <sup>36</sup>	<b>0.2%</b>	0.6%	(1.0%)
Year-end staff numbers	<b>69,363</b>	68,334	70,061

***Best Debt House in Western Europe***

for the second consecutive year

*(Euromoney Awards)*

**UK No1 Trade Bank**

*(Global Finance Magazine)*

**US\$3.1bn**

**of regulatory fines, provisions,**

**penalties and UK customer redress**

*For footnotes, see page 109.*

## **Economic background**

The **UK** recovery continued through the second half of 2014, though the pace of expansion moderated towards the end of the year. Preliminary estimates indicate that the annual rate of growth of real Gross Domestic Product ( **GDP** ) was 2.6%. The unemployment rate fell to 5.7% in the three months to December and wage growth accelerated slightly from a very low level. The annual Consumer Price Index ( **CPI** ) measure of inflation reached a 14-year low of 0.5% in December. After a period of rapid activity in 2013 and the early months of 2014, there were signs that both economic activity and price inflation in the housing market were moderating as the year ended. The Bank of England kept the Bank Rate steady at 0.5%.

The recovery in **eurozone** economic activity in 2014 was slow and uneven across member states. Real GDP in the region as a whole grew by 0.9% in the year. The German and Spanish economies grew by 1.6% and 1.5%, respectively, while French GDP grew by a more modest 0.4%. Eurozone inflation fell to minus 0.2% in December, prompting fears that the region could move towards a sustained period of deflation. The likelihood that low growth and inflation could persist for an extended period prompted the European Central Bank ( **ECB** ) to cut the main refinancing rate and the deposit rate to 0.05% and minus 0.2%, respectively, in September and embark on a policy of balance sheet expansion starting with purchases of covered bonds and asset-backed securities.

## **Financial overview**

### *Profit before tax (US\$m)*

Our European operations reported a profit before tax of US\$596m in 2014 compared with US\$1.8bn in 2013. The decrease in reported profit before tax was driven by a number of significant items and increased operating expenses, partly offset by reduced LICs. The former included charges relating to UK customer redress of US\$1.3bn, settlements and provisions in relation to regulatory investigations into foreign exchange of US\$1.2bn, of which US\$809m was recorded in the fourth quarter of 2014, and provisions arising from the on-going review of compliance with the CCA in the UK of US\$632m. For further details of all significant items, see page 42.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Profit/(loss) before tax by country within global businesses*

	<b>Retail Banking and Wealth Management</b>	<b>Commercial Banking</b>	<b>Global Banking and Markets</b>	<b>Global Private Banking</b>	<b>Other</b>	<b>Total</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>
UK	<b>589</b>	<b>2,193</b>	<b>(801)</b>	<b>191</b>	<b>(2,228)</b>	<b>(56)</b>
France <sup>35</sup>	<b>(181)</b>	<b>240</b>	<b>354</b>		<b>(199)</b>	<b>214</b>
Germany	<b>28</b>	<b>71</b>	<b>162</b>	<b>27</b>	<b>(10)</b>	<b>278</b>
Switzerland		<b>5</b>	<b>2</b>	<b>38</b>	<b>(3)</b>	<b>42</b>
Turkey	<b>(155)</b>	<b>5</b>	<b>92</b>		<b>(6)</b>	<b>(64)</b>
Other	<b>33</b>	<b>34</b>	<b>240</b>	<b>59</b>	<b>(184)</b>	<b>182</b>
<b>Year ended 31 December 2014</b>	<b>314</b>	<b>2,548</b>	<b>49</b>	<b>315</b>	<b>(2,630)</b>	<b>596</b>
UK	1,471	1,684	1,246	252	(3,493)	1,160
France <sup>35</sup>	285	255	351	21	(162)	750
Germany	30	70	183	44	(25)	302
Switzerland		2	2	(291)		(287)
Turkey	(74)	36	108	(1)	1	70
Other	41	41	(89)	(190)	27	(170)
<b>Year ended 31 December 2013</b>	<b>1,753</b>	<b>2,088</b>	<b>1,801</b>	<b>(165)</b>	<b>(3,652)</b>	<b>1,825</b>
UK	343	832	(111)	235	(6,355)	(5,056)
France <sup>35</sup>	135	203	514	(11)	(263)	578
Germany	29	64	283	40	(72)	344
Switzerland		2	1	133		136
Turkey	(32)	71	104		1	144
Other	34	36	195	102	73	440
<b>Year ended 31 December 2012</b>	<b>509</b>	<b>1,208</b>	<b>986</b>	<b>499</b>	<b>(6,616)</b>	<b>(3,414)</b>

*For footnote, see page 109.*

Adjusted profit before tax decreased by US\$396m, primarily reflecting an increase in costs which was partly offset by a reduction in LICs; revenue was broadly in line with 2013.

## Country business highlights

In the **UK**, overall CMB lending increased by 7% compared with 2013, with new lending and re-financing before attrition and amortisation increasing by 38% and over 85% of small business loan applications approved. In addition, Business Banking launched a campaign to offer further support and lending to SME customers. As part of this, £5.8bn (US\$9.9bn) of future lending was made available to help finance growth across the UK. Lending in Global Trade and Receivables Finance also grew by 3% as we built on our position in the market in Trade Finance and reduced attrition from our existing clients in Receivables Finance.

In RBWM, we approved £11.4bn (US\$18.8bn) of new mortgage lending to over 118,000 customers, including £3.5bn (US\$5.8bn) to over 27,500 first-time buyers. However, our aggregate amount of mortgage balances drawn down decreased marginally. The loan-to-value ( LTV ) ratio on new lending was 60% compared with an average of 43.7% for the total mortgage portfolio. In October 2014, we expanded our mortgage distribution channels to include an intermediary in order to reach the growing proportion of the mortgage market in the UK that wishes to source its finance that way.

As part of the re-shaping of the GB&M business in 2013, we brought together all our financing businesses into Capital Financing, including lending, debt capital markets and equity capital markets. We increased our sector expertise and

enhanced our geographical spread by appointing two new co-heads of UK Banking. In 2014, the advisory and equity capital markets businesses within Capital Financing experienced volume growth that outstripped the market.

In **France**, in GB&M, we acted as sole advisor on one of the largest mergers and acquisitions ( M&A ) transactions in Europe. In CMB, our Payments and Cash Management business implemented the Single Euro Payments Area platform ( SEPA ) for euro-denominated credit transfer and direct debit payments across our European locations. This allows our clients to make and receive payments in euros from their HSBC accounts in the 34 countries that have implemented SEPA, all governed by a consistent set of standards, rules and conditions. In addition, in CMB, we allocated a further 1.5bn (US\$2.0bn) to the SME fund and approved over 2.0bn (US\$2.7bn) of lending in 2014. In RBWM, we experienced strong growth in home loans.

In **Germany**, as part of our growth initiative, we opened three branches in Dortmund, Mannheim and Cologne, increased the number of relationship managers by 26% and held a number of roadshows in countries including France, mainland China and the UK to reinforce Germany as a key international hub. In GPB, we disposed of our HSBC Trinkaus & Burkhardt AG business in Luxembourg.

In **Turkey**, the regulator imposed interest rate caps on credit cards and overdrafts which affected revenue. Despite this, in September 2014 CMB launched a TRL2bn (US\$914m) international fund in order to provide sustainable support and global connectivity for international business, of which TRL1.1bn (US\$519m) was drawn down.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

In **Switzerland**, we continued to reposition the GPB business and focused on growth through the high net worth client segment. Client assets, which include funds under management and cash deposits, decreased due to this repositioning, as well as the sale of a portfolio of client assets.

In November 2014, we sold the Kazakhstan business in line with the Group strategy.

**Review of adjusted performance<sup>45</sup>**

**Revenue** increased by US\$76m, primarily in the UK, partly offset by reductions elsewhere, including France, Switzerland and Turkey.

*Revenue (US\$m)**Country view of adjusted revenue*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
UK	<b>16,080</b>	15,365
France	<b>2,937</b>	3,097
Germany	<b>945</b>	960
Switzerland	<b>736</b>	831
Turkey	<b>791</b>	827
Other	<b>790</b>	1,123
<b>Year ended 31 December</b>	<b>22,279</b>	22,203

In the *UK*, revenue increased by US\$715m. This was driven by favourable fair value movements of US\$222m from interest and exchange rate ineffectiveness in the hedging of long-term debt issued principally by HSBC Holdings in 2014, compared with adverse movements of US\$480m in 2013, and a gain arising from external hedging of an intra-Group financing transaction.

Revenue also rose in CMB due to growth in deposit volumes in Payments and Cash Management and net interest income improved due to wider spreads in term lending. In addition, net fee income grew, partly reflecting increased volumes of new business lending in the Large Corporate and Mid-Market segments.

By contrast, GB&M revenue decreased compared with 2013, primarily driven by Markets. This included the introduction of the FFVA on certain derivative contracts which resulted in a charge affecting Rates and Credit. Revenue also fell in Foreign Exchange, reflecting lower volatility and reduced client flows. Furthermore, revenue



decreased in Equities, as 2013 benefited from higher revaluation gains, which more than offset the increase in revenue from increased client flows and higher derivative income.

RBWM revenue reduced marginally due to spread compression, primarily on mortgages. In addition, fee income fell as a result of higher fees payable under partnership agreements and lower fee income from investment products and overdrafts. These factors were partly offset by improved spreads on savings products and higher current account balances.

In *the rest of Europe*, revenue decreased in France, Switzerland and Turkey. Revenue in France fell principally in RBWM in the Insurance business due to adverse movements of US\$203m in the PVIF asset, reflecting a fall in long-term yields which increased the cost of guarantees on the savings business, compared with favourable movements of US\$48m in 2013. This was coupled with a fall in GB&M in Rates, due to lower volatility and levels of market activity. In Switzerland, the fall in revenue reflected the repositioning of the GPB business and a reduction in client assets. Revenue also decreased in Turkey, principally in RBWM due to interest rate caps on cards and overdrafts imposed by the local regulator, partly offset by an increase in card fees.

LICs reduced, primarily in the UK and, to a lesser extent, in Spain. In the UK in CMB, individually assessed provisions fell, reflecting the quality of the portfolio and improved economic conditions. GB&M also recorded reduced loan impairment charges due to lower individually assessed provisions, and higher net releases of credit risk provisions on available-for-sale ABSs. This was partly offset by an increase due to a revision in certain estimates in our corporate collective loan impairment calculation. Loan impairment charges in RBWM decreased as a result of lower delinquency levels in the improved economic environment and as customers continued to reduce outstanding credit card and loan balances. Loan impairment charges in Spain decreased due to lower individually assessed provisions.

The decreases in the UK and Spain were partly offset by increases in Turkey and France. Loan impairment charges increased in Turkey due to growth in card delinquency rates following regulatory changes. Loan impairment charges in France increased, predominantly in GB&M and CMB due to higher individually assessed provisions.

*Operating expenses (US\$m)*

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

**Operating expenses** rose by US\$1.3bn, mainly in the UK, reflecting growth in Regulatory Programmes and Compliance costs in all businesses and increased staff costs. In addition, the UK bank levy charge of US\$1.1bn in respect of 2014 was US\$0.2bn higher than in 2013, primarily due to an increase in the rate of the levy. Expenses also increased due to the timing of the recognition of the Financial Services Compensation Scheme levy in the UK. These increases were partly offset by sustainable cost savings of over US\$330m.

**2013 compared with 2012****Economic background**

**UK** Gross Domestic Product ( GDP ) growth rose to 1.9% in 2013, higher than in previous years, though the level of real GDP remained below the level seen prior to the recession. The recovery was driven in part by stronger household consumption. The Bank of England policy rate remained at 0.5% and the Asset Purchase Scheme came to a halt. The Bank of England announced a forward guidance policy in August in which it indicated Bank Rate would not rise until unemployment had fallen towards 7%. Labour market conditions improved more rapidly than expected and the headline unemployment rate fell to 7.1% in December. The annual rate of Consumer Prices Index (CPI) inflation fell in December to 2.0%, the lowest level of inflation in almost four years.

The **eurozone** emerged from recession in the second quarter of 2013 with the improvement early in the year driven by Germany and France. However, activity failed to gain momentum since quarterly GDP growth averaged just 2.0% in the second half of the year. Domestic demand improved on the back of improving real wage growth and a slower pace of austerity but recovery remained heavily dependent on external demand. Given the weakness of the economy in early 2013, the ECB cut its refinancing rate from 0.75% to 0.5% in May and then in July adopted a forward guidance policy under which it committed to keep rates at present or lower levels for an extended period. Despite the return to growth, CPI inflation dropped to 0.7% in October 2013 prompting the ECB to cut the refinancing rate by a further 0.25% in November. A combination of improving growth and the ECB's Outright Monetary Transactions programme, which enables it to buy eurozone government bonds in time of market stress, helped alleviate the sovereign crisis evident in former years and bond yields in Italy and Spain fell to their lowest levels since 2010.

**Review of performance**

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. For comparison, adjusted profit before tax would have been US\$4.1bn and US\$3.5bn for 2013 and 2012 respectively as compared with constant currency profit before tax of US\$1.8bn and a loss before tax of US\$3.4bn for 2013 and 2012 respectively. Constant currency, underlying and adjusted are reconciled on pages 105(b) to 105(au).

Our European operations reported a profit before tax of US\$1.8bn in 2013 compared with a loss of US\$3.4bn in 2012 (US\$3.3bn on a constant currency basis). On an underlying basis, excluding fair value movements on own debt, the effects of foreign currency translation and acquisitions and disposals, profit before tax increased by US\$2.1bn. This was due to significantly lower operating expenses, driven by a decrease in charges relating to UK customer redress programmes, an accounting gain of US\$430m relating to changes in delivering ill-health benefits to certain employees

in the UK and sustainable cost savings in 2013.

In the UK, we continued to support the housing market during 2013, approving £14.4bn (US\$22.5bn) of new mortgage lending to over 135,000 customers. This included £3.8bn (US\$6.0bn) to over 30,000 first time buyers. The loan-to-value ratio on new lending was 59.5% compared with an average of 48.3% for the total mortgage portfolio. In addition, we implemented the Global Wealth Incentive Plan to better align customer and business interests.

CMB repositioned its Business Banking segment towards international and internationally aspirant customers while streamlining and re-engineering core processes, which enabled it to obtain efficiencies in a number of areas and supported its continued investment in corporate banking and Global Trade and Receivables Finance. Following the success of the 2012 International SME fund, CMB launched a further fund in 2013, continuing its support for UK businesses that trade or aspire to trade internationally with approved lending of £4.8bn (US\$7.5bn), including the renewal of overdraft and other lending facilities. In addition, CMB won awards for Best Service from a Business Bank and Best Online Banking Provider at the *Business Moneyfacts* awards. GB&M's debt capital markets activity in the Credit and Capital Financing businesses was successful in capturing growth in issuance demand, which resulted in leading market positions and increased market share in the sterling markets. We were ranked first by Bloomberg for primary debt capital market issuances in 2013.

In France, CMB launched a similar SME fund to that in the UK, targeted at international trade customers, approving 1.5bn (US\$2.0bn) of lending in 2013. GB&M acted as joint book runner of a 6.2bn (US\$8.2bn) hybrid bond for a premier French corporate client, demonstrating our ability to deliver large and complex transactions. In RBWM, we increased our market share in the highly competitive home loans market.

In Turkey, unsecured lending grew in RBWM, notably in the credit card business due to new product features and channel capabilities including mobile banking. We launched a similar SME fund to those in the UK and France targeted at international trade customers, approving Turkish lira 1.1bn (US\$0.6bn) of lending in 2013.

We continued to support the programme of renminbi internationalisation during the year with flagship client events taking place in the UK, France and Germany.

HSBC HOLDINGS PLC

81a

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

In Switzerland we continued to address legacy issues and reposition the customer base.

*Net interest income* increased by 3%, primarily in the UK. In GB&M, Balance Sheet Management net interest income was higher, reflecting both portfolio growth from rising deposit balances and reduced funding costs. In addition, net interest income increased due to higher lending spreads in Capital Financing and a rise in legacy credit. In RBWM net interest income increased, driven by growth in residential mortgage balances and improved lending spreads. RBWM customer account balances also increased as customers held balances in readily accessible current and savings accounts, although the benefit was restricted by deposit spread compression. In CMB, net interest income in the UK rose as a result of growth in term lending revenue from higher spreads on new and renewed business, as well as deposit growth in Payments and Cash Management. The spreads resulted in increased portfolio margins overall.

In France, net interest income increased due to improved spreads and growth in home loan balances.

These factors were partly offset by a decline, mainly in Switzerland in GPB, as higher yielding positions matured and opportunities for reinvestment were limited by lower prevailing yields. Narrower lending and deposit spreads and reduced average deposit balances also contributed to a fall in net interest income in Switzerland.

*Net fee income* decreased by US\$138m, mainly in Switzerland in GPB with lower brokerage fees due to a reduction in client transaction volumes, in part reflecting decreased market volatility and fewer large deals.

In the UK, net fee income decreased in RBWM due to higher fees payable under partnership agreements and lower creditor insurance fees. In GB&M, net fee income fell because of higher fees paid to other regions relating to increased foreign exchange trading activities. This was partly offset by increased issuance demand in debt capital markets and event-driven fee income in equity underwriting from increased deal volumes. In addition, we experienced a rise in lending fees in CMB.

In Turkey, net fee income rose due to the growth in card revenue as the business expanded.

*Net trading income* increased by US\$1.7bn to US\$4.4bn. This was primarily in the UK, driven in part by lower adverse foreign exchange movements on assets held as economic hedges of foreign currency debt designated at fair value, with the offset reported in *Net income from financial instruments designated at fair value*. In addition, there was a foreign exchange gain on sterling debt issued by HSBC Holdings and increased favourable fair value movements on non-qualifying hedges compared with 2012.

In GB&M, net trading income included a favourable DVA of US\$65m in 2013. 2012 included a net charge of US\$312m as a result of a change in estimation methodology in respect of CVAs of US\$615m and DVAs of US\$303m, reflecting evolving market practices.

Also in GB&M, Foreign Exchange income rose following increased customer activity, although the rise was offset in part by margin compression and reduced market volatility in the second half of 2013. Net trading income was also higher in the Equities business due to increased deal volumes and revaluation gains. Rates revenue declined due to the benefit in 2012 from tightening spreads following the ECB liquidity intervention, despite new client mandates and

increased market participation, particularly in European government bonds. We also experienced lower adverse fair value movements from own credit spreads on structured liabilities.

In France, trading income on non-qualifying hedges increased as long-term interest rates rose.

*Net income from financial instruments designated at fair value* was US\$0.4bn compared with net expense of US\$2.2bn in 2012. In the UK, we reported lower adverse movements on the fair value of our own debt of US\$1.0bn, compared with adverse movements of US\$4.1bn in 2012. Excluding this, net income declined, driven by lower favourable foreign exchange movements on foreign currency debt than in 2012, with the offset reported in *Net trading income*. In addition, there were higher adverse fair value movements from interest and exchange rate ineffectiveness in the hedging of long-term debt issued principally by HSBC Holdings and its European subsidiaries than in 2012.

By contrast, in the UK and France, we recognised higher net investment gains on the fair value of assets held to meet liabilities under insurance and investment contracts than in 2012, as market conditions improved.

*Gains less losses from financial investments* increased by US\$19m as in the UK we reported gains in RBWM in the Asset Management Group. In GB&M, higher disposal gains and lower impairments on available-for-sale equity securities in Principal Investments were more than offset by lower net gains on the disposal of available-for-sale debt securities in Balance Sheet Management, as part of structural interest rate risk management of the balance sheet.

*Net earned insurance premiums* decreased by 15%, mainly in RBWM in France reflecting lower sales of investment contracts with DPF and the run-off of business from independent financial adviser channels in 2013.

*Other operating income* decreased by US\$600m due to a loss recognised in GPB following the write-off of goodwill relating to our Monaco business and a loss on sale in RBWM on the disposal of an HFC Bank UK secured loan portfolio.

*Net insurance claims incurred and movement in liabilities to policyholders* was broadly in line with 2012. Lower reserves established for new business, reflecting the decline in net premium income in France, were partly offset by higher net investment gains on the fair value of assets held to support policyholder contracts in 2013 than in 2012.

HSBC HOLDINGS PLC

81b

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

*LICs* decreased by 20% to US\$1.5bn. In the UK, GB&M recorded net releases of credit risk provisions on available-for-sale ABSs compared with impairment charges in 2012, offset in part by higher individually assessed provisions. In addition, loan impairment charges in CMB fell due to lower collectively and individually assessed provisions, and in RBWM due to lower collectively assessed provisions reflecting recoveries from debt sales.

In other countries in Europe, lower individually assessed impairment provisions in Greece were partly offset by increases in Turkey, where there was growth in unsecured lending in RBWM, and a rise in Spain, where the challenging economic conditions continued to affect the market.

*Operating expenses* decreased by 7%, driven by lower charges relating to UK customer redress programmes, with US\$1.2bn reported in 2013 compared with US\$2.3bn (US\$2.3bn as reported) in 2012. The charges in 2013 included additional estimated redress for possible mis-selling in previous years of US\$756m in respect of PPI compared with US\$1.7bn in 2012, US\$261m in respect of interest rate protection products compared with US\$586m in 2012 and US\$149m in respect of

Wealth Management products in 2013. Restructuring costs also fell by US\$78m from 2012. In addition, 2012 included a charge relating to the US OFAC investigation of US\$375m in HSBC Holdings which did not recur.

Excluding these items, operating expenses were broadly unchanged compared with 2012. We benefited from sustainable cost savings of over US\$650m as we continued to streamline the business, and a decline in performance-related costs, notably in GB&M. In addition, we reported an accounting gain of US\$430m relating to changes in delivering ill-health benefits to certain employees in the UK. These factors were partially offset by the higher UK bank levy charge of US\$904m in respect of 2013 compared with a charge of US\$571m in 2012, mainly due to an increase in its rate. In addition, operating expenses in both years included adjustments relating to the prior year charge (2013: US\$12m adverse adjustment; 2012: US\$99m favourable adjustment). In other countries in the region, we experienced higher Madoff-related litigation charges in GB&M in Ireland and a provision in respect of regulatory investigations in GPB in Switzerland.

HSBC HOLDINGS PLC

81c

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

	2014						Total
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	US\$m
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	5,196	3,616	1,956	594	(654)	(97)	10,611
Net fee income/(expense)	2,456	1,900	1,087	626	(27)		6,042
Trading income/(expense) excluding net interest income	(260)	33	1,943	140	(92)		1,764
Net interest income/(expense) on trading activities	14	2	660	(4)	1	97	770
Net trading income/(expense) <sup>50</sup>	(246)	35	2,603	136	(91)	97	2,534
Changes in fair value of long-term debt issued and related derivatives					614		614
Net income/(expense) from other financial instruments designated at fair value	616	119	14	(1)	(11)		737
Net income/(expense) from financial instruments designated at fair	616	119	14	(1)	603		1,351

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Value							
Gains less losses from financial investments	12	10	730	9	11		772
Dividend income	3	7	50	2	3		65
Net insurance premium income/(expense)	2,741	217		50			3,008
Other operating income/(expense)	(127)	45	(3)	29	1,249	(186)	1,007
<b>Total operating income</b>	<b>10,651</b>	<b>5,949</b>	<b>6,437</b>	<b>1,445</b>	<b>1,094</b>	<b>(186)</b>	<b>25,390</b>
Net insurance claims <sup>56</sup>	(3,450)	(306)		(63)			(3,819)
<b>Net operating income<sup>4</sup></b>	<b>7,201</b>	<b>5,643</b>	<b>6,437</b>	<b>1,382</b>	<b>1,094</b>	<b>(186)</b>	<b>21,571</b>
Loan impairment charges)/ recoveries and other credit risk provisions	(268)	(502)		4	2		(764)
<b>Net operating income</b>	<b>6,933</b>	<b>5,141</b>	<b>6,437</b>	<b>1,386</b>	<b>1,096</b>	<b>(186)</b>	<b>20,807</b>
Total operating expenses	(6,621)	(2,594)	(6,391)	(1,071)	(3,726)	186	(20,217)
<b>Operating profit/(loss)</b>	<b>312</b>	<b>2,547</b>	<b>46</b>	<b>315</b>	<b>(2,630)</b>		<b>590</b>
Share of profit in associates and joint ventures	2	1	3				6
<b>Profit/(loss) before tax</b>	<b>314</b>	<b>2,548</b>	<b>49</b>	<b>315</b>	<b>(2,630)</b>		<b>596</b>
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.7	13.6	0.3	1.7	(14.1)		3.2
Cost efficiency ratio	91.9	46.0	99.3	77.5	340.6		93.7

*Balance sheet data*<sup>40</sup>

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net) <sup>27</sup>	165,112	106,342	113,136	24,766	377		409,733
Total assets	221,679	120,819	948,951	64,676	64,182	(129,381)	1,290,926
Customer accounts <sup>27</sup>	202,413	135,837	166,075	41,380	254		545,959

HSBC HOLDINGS PLC





**Table of Contents****Report of the Directors: Financial Review** (continued)

	2013							Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m		
<i>Profit/(loss) before tax</i>								
Net interest income/(expense)	5,600	3,353	1,774	722	(694)	(62)		10,693
Net fee income/(expense)	2,545	1,789	957	744	(3)			6,032
Trading income excluding net interest income	206	30	2,181	192	698			3,307
Net interest income on trading activities	2	5	1,013	4	30	62		1,116
Net trading income <sup>50</sup>	208	35	3,194	196	728	62		4,423
Changes in fair value of long-term debt issued and related derivatives					(936)			(936)
Net income/(expense) from other financial instruments designated at fair value	1,059	271	591	4	(570)	(1)		1,354
Net income/(expense) from financial instruments designated at fair value	1,059	271	591	4	(1,506)	(1)		418
Gains less losses from financial	52		344	(17)				379

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

investments							
Dividend income	4	2	65	4			75
Net insurance premium income/(expense)	2,782	361	(1)	16			3,158
Other operating income/(expense)	(103)	9	110	(253)	766		529
Total operating income/(expense)	12,147	5,820	7,034	1,416	(709)	(1)	25,707
Net insurance claims <sup>56</sup>	(4,136)	(567)		(37)			(4,740)
Net operating income/(expense) <sup>4</sup>	8,011	5,253	7,034	1,379	(709)	(1)	20,967
Loan impairment charges and other credit risk provisions	(329)	(935)	(242)	(24)			(1,530)
Net operating income/(expense)	7,682	4,318	6,792	1,355	(709)	(1)	19,437
Total operating expenses	(5,934)	(2,231)	(4,987)	(1,519)	(2,943)	1	(17,613)
Operating profit/(loss)	1,748	2,087	1,805	(164)	(3,652)		1,824
Share of profit/(loss) in associates and joint ventures	5	1	(4)	(1)			1
Profit/(loss) before tax	1,753	2,088	1,801	(165)	(3,652)		1,825
	%	%	%	%	%		%
Share of HSBC's profit before tax	7.8	9.2	8.0	(0.7)	(16.2)		8.1
Cost efficiency ratio	74.1	42.5	70.9	110.2	(415.1)		84.0
<i>Balance sheet data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	177,357	105,498	145,136	27,289	830		456,110
Total assets	238,499	124,242	1,054,506	75,718	72,174	(172,180)	1,392,959
Customer accounts <sup>27</sup>	205,288	134,120	191,715	49,789	1,021		581,933

For footnotes, see page 109.



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

	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	2012 Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	Total US\$m
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	5,437	3,228	1,409	820	(543)	43	10,394
Net fee income	2,622	1,658	1,032	848	9		6,169
Trading income excluding net interest income	67	26	848	216	25		1,182
Net interest income on trading activities	7	14	1,500	14	33	(43)	1,525
Net trading income <sup>49</sup>	74	40	2,348	230	58	(43)	2,707
Changes in fair value of long-term debt issued and related derivatives					(3,091)		(3,091)
Net income/(expense) from other financial instruments designated at fair value	770	139	1,073		(1,106)		876
Net income/(expense) from financial instruments designated at fair value	770	139	1,073		(4,197)		(2,215)

value							
Gains less losses from financial investments	(5)	(1)	375	(3)	(2)		364
Dividend income		1	104	3	3		111
Net insurance premium income	3,150	438		42			3,630
Other operating income	84	58	88	61	796	(9)	1,078
Total operating income/(expense)	12,132	5,561	6,429	2,001	(3,876)	(9)	22,238
Net insurance claims <sup>56</sup>	(4,054)	(536)		(40)			(4,630)
Net operating income/(expense) <sup>1</sup>	8,078	5,025	6,429	1,961	(3,876)	(9)	17,608
Loan impairment charges and other credit risk provisions	(347)	(1,109)	(436)	(29)			(1,921)
Net operating income/(expense)	7,731	3,916	5,993	1,932	(3,876)	(9)	15,687
Total operating expenses	(7,225)	(2,708)	(4,999)	(1,431)	(2,741)	9	(19,095)
Operating profit/(loss)	506	1,208	994	501	(6,617)		(3,408)
Share of profit/(loss) in associates and joint ventures	3		(8)	(2)	1		(6)
Profit/(loss) before tax	509	1,208	986	499	(6,616)		(3,414)
	%	%	%	%	%		%
Share of HSBC's profit before tax	2.5	5.9	4.8	2.4	(32.0)		(16.5)
Cost efficiency ratio	89.4	53.9	77.8	73.0	(70.7)		108.4
<i>Balance sheet data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	170,002	105,796	129,499	29,963	881		436,141
Total assets	240,744	132,718	1,044,507	76,145	75,513	(180,387)	1,389,240
Customer accounts <sup>27</sup>	191,024	121,648	164,743	57,061	739		535,215

For footnotes, see page 109.

HSBC HOLDINGS PLC

83a

**Table of Contents****Report of the Directors: Financial Review** (continued)**Asia**<sup>7</sup>

**HSBC's principal banking subsidiaries in Hong Kong are The Hongkong and Shanghai Banking Corporation Limited and Hang Seng Bank Limited. The former is the largest bank incorporated in Hong Kong and is our flagship bank in Asia.**

**We offer a wide range of banking and financial services in mainland China, through our local subsidiaries HSBC Bank (China) Company Limited and Hang Seng Bank (China) Limited. We also participate indirectly in mainland China through our associate, Bank of Communications.**

**Outside Hong Kong and mainland China, we conduct business in 18 countries and territories in Asia, with particularly strong coverage in Australia, India, Indonesia, Malaysia and Singapore.**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net interest income	<b>12,273</b>	11,432	10,707
Net fee income	<b>5,910</b>	5,936	5,418
Net trading income	<b>2,622</b>	2,026	2,516
Other income	<b>2,872</b>	5,038	6,691
<b>Net operating income</b> <sup>4</sup>	<b>23,677</b>	24,432	25,332
LICs <sup>43</sup>	<b>(647)</b>	(498)	(510)
<b>Net operating income</b>	<b>23,030</b>	23,934	24,822
Total operating expenses	<b>(10,427)</b>	(9,936)	(9,980)
<b>Operating profit</b>	<b>12,603</b>	13,998	14,842
Income from associates <sup>44</sup>	<b>2,022</b>	1,855	3,188
<b>Profit before tax</b>	<b>14,625</b>	15,853	18,030
Cost efficiency ratio	<b>44.0%</b>	40.7%	39.4%
RoRWA <sup>36</sup>	<b>3.1%</b>	3.8%	4.4%
Year-end staff numbers	<b>118,322</b>	113,701	112,766

10%

**Growth in customer lending balances**

excluding the effect of currency translation



**Market leader for  
Asia ex-Japan Bonds**

*(Bloomberg)*

**Best Bank in Asia**

*(The Euromoney Awards of Excellence 2014)*

*For footnotes, see page 109.*

**Economic background**

**Hong Kong**’s real GDP growth slowed in 2014 relative to 2013 due to weaker domestic demand, partly attributable to the slowdown in the annual growth of retail sales. Labour market conditions softened with unemployment rising, albeit from historically low levels. Tourism arrivals to Hong Kong held up overall, up by 16% in the year compared with 2013, driven by the growth of visitors from mainland China. Headline CPI inflation averaged just over 4% for 2014, with a number of expiring government subsidies offsetting lower inflation in fuel and food prices.

In mainland **China**, real GDP growth slowed from 7.7% in 2013 to 7.4% in 2014, largely due to a slowdown in activity in construction and manufacturing investment which was only partially offset by resilient infrastructure investment. Headline annual CPI inflation fell steadily to 1.5% in December, significantly below the government’s target of 3.5%. The People’s Bank of China eased monetary policy in November by cutting policy interest rates for the first time since July 2012. The one-year deposit rate was lowered by 25bps to 2.75% and the one-year lending rate by 40bps to 5.6%. Further measures were announced in December to support bank lending and spur economic activity.

**Japan** experienced significant economic volatility during 2014 from the imposition of a 3 percentage point consumption tax increase, which took effect on 1 April. The economy recorded annualised GDP growth of 5.8% in the first quarter of 2014, but growth slowed sharply after the tax rise, as government stimuli and exports were unable to offset the decline in private consumption. GDP grew at an annualised rate of 2.2% in the fourth quarter after falls of 6.7% and 1.9% in the preceding quarters. The Bank of Japan announced another round of quantitative easing on 31 October 2014, prompting further depreciation of the yen.

In **India**, a new government with a strong mandate for reform boosted market sentiment regarding the long-term prospects for the country’s economy. However, the recovery remained constrained in 2014 with many infrastructure projects delayed pending government clearance. The steep decline in international commodity prices during the second half of the year helped push down goods price inflation and reduce the current account deficit. Following an interest rate rise early in 2014, the central bank kept monetary policy stable throughout the year.

The downward trend in global commodity prices permitted **Indonesia** and **Malaysia** to cut costly fuel subsidies, which is expected to reduce external imbalances and improve their fiscal position. Domestic demand in these countries remained relatively robust throughout 2014, supporting economic growth. In **Singapore**, GDP growth slowed in 2014 from weaker export growth and domestic economic restructuring. The Monetary Authority maintained its policy of gradual currency appreciation.



**Table of Contents****Report of the Directors: Financial Review** (continued)*Profit/(loss) before tax by country within global businesses*

	<b>Retail Banking and Wealth Management</b>		<b>Global Commercial Banking and Markets</b>	<b>Global Private Banking</b>	<b>Other</b>	<b>Total</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>
Hong Kong	3,727	2,264	1,807	146	198	8,142
Australia	78	126	232		(4)	432
India	4	121	442	11	122	700
Indonesia	10	53	110		25	198
Mainland China	292	1,533	954	(3)	175	2,951
Malaysia	156	122	190		28	496
Singapore	129	168	243	57	(8)	589
Taiwan	19	35	166		1	221
Other	57	320	432		87	896
<b>Year ended 31 December 2014</b>	<b>4,472</b>	<b>4,742</b>	<b>4,576</b>	<b>211</b>	<b>624</b>	<b>14,625</b>
Hong Kong	3,742	2,110	1,971	208	58	8,089
Australia	100	131	189		26	446
India	(21)	113	418	7	136	653
Indonesia	12	106	126		36	280
Mainland China	223	1,536	842	(4)	1,644	4,241
Malaysia	148	105	236		25	514
Singapore	147	120	262	74	22	625
Taiwan	7	30	158		5	200
Other	61	207	473	(1)	65	805
<b>Year ended 31 December 2013</b>	<b>4,419</b>	<b>4,458</b>	<b>4,675</b>	<b>284</b>	<b>2,017</b>	<b>15,853</b>
Hong Kong	3,694	2,188	1,518	249	(67)	7,582
Australia	97	38	184		(44)	275
India	41	89	497	7	175	809
Indonesia	29	124	146		7	306
Mainland China	838	1,724	1,257	(4)	2,525	6,340
Malaysia	183	131	242		8	564
Singapore	201	139	296	97	(65)	668
Taiwan	62	36	136			234

Other	66	321	567	59	239	1,252
Year ended 31 December 2012	5,211	4,790	4,843	408	2,778	18,030

In **Australia**, real GDP growth rose to an annual rate of around 2.8% in 2014 and unemployment remained roughly unchanged at 6.1%. Mining investment fell sharply and was only partly offset by an improvement in other sectors of the economy. Low interest rates continued to drive an increase in housing market activity and credit growth picked up modestly. The Australian dollar weakened during the year but remained well above its long-run average level.

In **Taiwan**, economic activity accelerated with the level of GDP in 2014 rising 3.5% in the year as a whole. This was the strongest annual rate of growth since 2011 and an improvement on the 2.1% growth seen in 2013. Growth was driven by a combination of strong exports and domestic consumption thanks to low unemployment and rising wage growth. The central bank in Taiwan kept its key policy rate unchanged throughout 2014 at 1.875%, which is the level it has been since 2011.

## Financial overview

### *Profit before tax (US\$m)*

Our operations in Asia reported a profit before tax of US\$14.6bn in 2014 compared with US\$15.9bn in 2013, a decrease of 8%. The reduction reflected a decrease in revenue and an increase in costs and LICs, partly offset by a higher share of profits from associates. Revenue included the effect of a number of significant items, notably in 2013, an accounting gain arising from the reclassification of Industrial Bank as a financial investment (US\$1.1bn) and the net gain on completion of the Ping An disposal (US\$553m).

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Analysis of mainland China profit/(loss) before tax*

	<b>Retail Banking and Wealth Management</b>	<b>Commercial Banking</b>	<b>Global Banking and Markets</b>	<b>Global Private Banking</b>	<b>Other</b>	<b>Total</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>
BoCom and other associates	255	1,421	296		1	1,973
Mainland China operations	37	112	658	(3)	174	978
Industrial Bank						
Ping An						
<b>Year ended 31 December 2014</b>	<b>292</b>	<b>1,533</b>	<b>954</b>	<b>(3)</b>	<b>175</b>	<b>2,951</b>
BoCom and other associates	247	1,360	284		(38)	1,853
Mainland China operations	(24)	176	558	(4)	40	746
Industrial Bank					1,089	1,089
Ping An					553	553
Year ended 31 December 2013	223	1,536	842	(4)	1,644	4,241
BoCom and other associates	214	1,193	248			1,655
Mainland China operations	(52)	176	606	(4)	66	792
Industrial Bank	54	273	343			670
Ping An	622	82	60		2,459	3,223
Year ended 31 December 2012	838	1,724	1,257	(4)	2,525	6,340

In 2014, significant items included the gain on sale of our investment in Bank of Shanghai (US\$428m) and an impairment of our investment in Industrial Bank (US\$271m). See page 42 for further details of significant items.

On an adjusted basis, profit before tax rose by US\$326m or 2%, driven by higher revenue partly offset by increased operating expenses and LICs.

**Country business highlights**

We continued to focus on our strategic priorities for Asia, using our international network to drive organic growth and connect customers across borders. We completed the sale of our investment in Bank of Shanghai and implemented a

discretionary incentive framework that removes the formulaic link between product sales and remuneration. We also saw continued adoption of our mobile banking applications, extended the contact-less payment systems to Android phones and enhanced our digital banking capabilities.

In **Hong Kong**, average mortgage balances in RBWM increased by 7%, with average LTV ratios of 47% on new mortgage drawdowns and an estimated 29% on the portfolio as a whole. In November 2014, to coincide with the launch of the Hong Kong-Shanghai Stock Connect platform, we rolled out new services allowing retail customers to trade and invest in eligible shares that are listed on the Shanghai Stock Exchange. We strengthened our cards offering with the launch of the Visa Signature card product in Hong Kong and continued building new merchant partnerships across the region. We also re-launched our Advance offering to emerging affluent customers in Hong Kong and nine other regional markets. We were awarded International Retail Bank of the Year by *Asian Banking and Finance*.

In CMB, we were one of the first foreign banks to announce renminbi cross-border pooling capability in the Shanghai Free Trade Zone. The collaboration between CMB and GB&M continued throughout the year, as a

consequence of which 157 primary markets transactions were completed in 2014, up from 122 in 2013, primarily for debt capital market issuances and leveraged asset finance mandates. In addition, we were named Best Commercial Bank by *FinanceAsia Achievement Awards 2014*.

In GB&M, we maintained our market leadership in Asia ex-Japan G3 currency and investment grade bonds, and led the market in Hong Kong dollar bond issuances. We were involved in three of the five largest equity capital market transactions during 2014, as well as the first Sukuk sovereign bond issuance in Hong Kong. Furthermore, we continued to lead the market in offshore renminbi bond issuance in Hong Kong, becoming one of the Hong Kong Monetary Authority's primary liquidity providers for offshore renminbi. We also acted as a joint book runner for an offshore preference share issuance for a mainland Chinese bank, the first mainland Chinese Basel III compliant additional tier-1 capital offering. We remain well-positioned to service our institutional investors using Stock Connect through our integrated Custody Plus platform.

In **mainland China**, we continued to develop our branch network, which comprised 173 HSBC outlets, 25 HSBC rural bank outlets and 50 Hang Seng Bank outlets at the end of the year. In RBWM, we were one of the first foreign banks to launch renminbi derivative products linked to the US dollar/renminbi rate and were awarded Best Foreign Retail Bank by *The Asian Banker* for the sixth consecutive year. During 2014, we were the first foreign custodian bank to service renminbi qualified foreign institutional investors based in Singapore and South Korea. We also became a member of the Shanghai Gold Exchange's international board, a newly established trading platform connecting mainland China's gold market to global investors. In addition, we received regulatory approval to be one of the first market makers to directly trade renminbi, euro and Singaporean dollars in mainland China's interbank foreign exchange market.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

In Payments and Cash Management, we launched the Global Payments System which supports all cross-border payments in and out of mainland China in all currencies, including renminbi. In Global Trade and Receivables Finance, we launched trade link initiatives to connect mainland China with the rest of Asia, Germany and the US, to enhance international connectivity and promote activity between key trade routes. In mergers and acquisitions ( M&A ), we were adviser to a number of state owned enterprises on significant overseas investments and acquisitions.

Elsewhere in Asia, in **India**, we continued to grow our balance sheet in CMB, including term lending and Payments and Cash Management deposits, particularly helping UK corporations to invest in India. In GB&M, we were adviser on two of the largest M&A transactions in 2014, and in Wealth Management we launched Managed Solutions, a multi-asset fund series. In **Australia**, we were a mandated lead arranger for the largest mining project financing deal and for the largest transport infrastructure project during 2014. In CMB, we also announced an A\$250m (US\$225m) International Growth Fund, providing credit facilities to local SMEs to explore business opportunities abroad.

**Review of adjusted performance**<sup>45</sup>*Revenue (US\$m)*

**Revenue** was US\$1.2bn or 5% higher, driven by Hong Kong and mainland China, mainly in CMB and RBWM from balance sheet growth, as well as in GB&M from portfolio growth in Balance Sheet Management and increased term lending. Revenue was also higher in India and Australia.

*Country view of adjusted revenue*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Hong Kong	<b>13,725</b>	13,211
Australia	<b>975</b>	898
India	<b>1,826</b>	1,666
Indonesia	<b>561</b>	559
Mainland China	<b>2,463</b>	1,948
Malaysia	<b>1,066</b>	1,063
Singapore	<b>1,339</b>	1,319
Taiwan	<b>491</b>	501
Other	<b>1,183</b>	<b>1,289</b>
<b>Year ended 31 December</b>	<b>23,629</b>	<b>22,454</b>

In *Hong Kong*, revenue increased by 4%, primarily in CMB and RBWM and, to a lesser extent, in GB&M. Higher revenue in CMB was due to increased net interest income from growth in term lending across a range of sectors, higher average Payments and Cash Management deposit balances and higher fees from remittance volumes, as well as improved lending spreads.

In RBWM, revenue growth was driven by higher net interest income from increased average lending balances, mainly credit cards and other personal lending, and from growth in average deposit balances, though the benefit of higher volumes was partly offset by spread compression. Net fee income also increased, principally from volume growth in unit trusts, credit card transactions and securities brokerage. In our insurance operations, revenue growth reflected higher premium income, which also contributed to growth in the debt securities portfolio, although this was partly offset by less favourable movements in the PVIF asset from annual actuarial assumption updates.

Revenue in GB&M also increased, mainly in Balance Sheet Management due to portfolio growth, and in Capital Financing from higher average term lending balances. This was partly offset by lower net fee income in Markets due to reduced client flows and in Capital Financing reflecting fee compression.

In *mainland China*, revenue increased by 26% compared with 2013. In GB&M, we reported greater net interest income from Balance Sheet Management due to portfolio growth and higher reinvestment rates, and a rise in average term lending balances. Additionally, trading income improved in Rates from higher interest income on debt securities and revaluation gains on trading bonds as yields fell, and in Foreign Exchange from increased client flows. Revenue in RBWM increased, mainly from wider deposit spreads as market interest rates rose in the first half of 2014, while in CMB revenue growth was driven by higher average deposit and lending balances.

*Elsewhere in Asia*, revenue in India rose by 10%, primarily in GB&M from higher Rates trading income due to favourable credit valuation adjustments (CVA's) on derivatives, coupled with higher net interest income from portfolio growth in Balance Sheet Management. In Australia, we reported an increase in revenue of 9%, predominantly in GB&M from higher trading income in Rates and Foreign Exchange. This was partly offset by lower revenue in South Korea following the run-off of our RBWM operations in 2013.

LICs rose by US\$167m or 35%, principally in GB&M and CMB from a rise in a small number of individually assessed impairment charges in Hong Kong and mainland China. This was partly offset by a reduction in individually assessed impairment charges in CMB in New Zealand, Malaysia and Vietnam.

HSBC HOLDINGS PLC



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

*Operating expenses (US\$m)*

**Operating expenses** rose by US\$753m following investment in the region, notably in Regulatory Programmes and Compliance, and increased use of our Global Services Centres across the Group. Cost growth also reflected wage inflation and additional headcount, notably in Hong Kong and mainland China to support business growth, mainly in CMB, as well as increased marketing activity. These factors were partly offset by around US\$270m of sustainable cost savings achieved in 2014.

**Share of profit from associates and joint ventures** rose by US\$71m, mainly from BoCom, reflecting higher revenue from balance sheet growth and trading income, partly offset by increases in operating expenses and LICs.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**2013 compared with 2012****Economic background**

**Hong Kong**'s GDP grew at a faster pace in 2013 than in 2012. This was driven mainly by domestic demand, which offset an ongoing weakness in external orders. Labour market conditions remained resilient and strong nominal wage growth continued to support private consumption. Measures announced in February 2013 by the government and the Hong Kong Monetary Authority to dampen demand in the property market led to a softening in prices and some moderation of demand in the third quarter of the year. Headline CPI inflation fell in the fourth quarter, largely due to lower food prices and housing costs. Underlying inflation averaged 4% in 2013, lower than it was in 2012.

In **mainland China**, the annual pace of GDP growth was unchanged at 7.7% in 2013, above the official GDP growth target of 7.5%. The rebound in activity in the second half of the year was mainly due to measures announced by the government during the summer. Export growth remained moderate through most of 2013, only accelerating in the final months. Annual growth in fixed asset investment remained steady at an annual rate of nearly 20% and consumer spending remained resilient. Headline annual CPI inflation rose modestly to 2.6%, remaining below the government's target of 3.5%. The People's Bank of China maintained a relatively restrictive credit policy but overall liquidity conditions remained loose as the M2 measure of money growth expanded by 13.6% on the year.

Economic activity in **Japan** picked up considerably in 2013, thanks to large-scale stimuli from both the government and the Bank of Japan. Annualised growth slowed to just over 1% in the third quarter although it accelerated in the final months of the year as consumer spending rose in advance of the sales tax increase due in April 2014.

**Singapore**'s economic recovery also gathered pace, led by net external demand.

During the course of the summer, there were concerns in financial markets that global liquidity may become more expensive and less abundant as the US Federal Reserve Board indicated it may begin to taper its purchases of financial assets. Interest rates on US Treasuries rose, attracting global capital back to developed markets. Some emerging economies suffered considerable capital outflows with large declines in the value of their currencies against the US dollar and central banks were forced to raise interest rates to attract capital. This in turn led to a slowdown in activity.

In Asia, India and Indonesia were most affected. The current account positions of both economies had significantly deteriorated in recent years, leaving them vulnerable to changes in external financing conditions. In **India**, structural constraints on growth, including infrastructure bottlenecks, also contributed to a slowdown in activity. The central bank tightened monetary policy during the second half of 2013 in

response to concerns over inflation.

Similar constraints in **Indonesia** saw GDP growth slow in 2013. However, concerted measures to reduce fuel subsidies and narrow the current account deficit should make the economy more resilient to any tightening in monetary conditions in the West. Economic activity also reduced in **Malaysia** as the boost to growth in 2012 from public spending abated.

**Taiwan**'s trade-dependent economy was weak in the first half of 2013, but strengthened in the second half as global trade improved.

**Australian** GDP growth slowed to an annual rate of around 2.5% in 2013 and unemployment rose to 5.7% towards the end of the year. This reflected a slowdown in mining investment after years of strong growth. To stimulate growth elsewhere, the Reserve Bank of Australia cut its cash rate from 3.0% to 2.5% during the year. Low interest rates drove a strong rise in housing prices. The Australian dollar remained well above its long run average levels in 2013, but fell towards the end of the year.

### Review of performance

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. Adjusted profit before tax would have been US\$14.3bn and US\$13.1bn for 2013 and 2012, respectively, as compared with constant currency profit before tax of US\$15.9bn and US\$17.8bn for 2013 and 2012, respectively. Constant currency, underlying and adjusted are reconciled on pages 105(b) to 105(au).

Our operations in Asia reported a pre-tax profit of US\$15.9bn compared with US\$18.0bn in 2012, a decrease of 12%. The reduction reflected a 2012 gain following the disposal of our shareholding in Ping An of US\$3.0bn, together with a reduction in our share of profit from associates of US\$1.4bn as a result of this disposal and the effect of the reclassification of Industrial Bank as a financial investment following its issue of share capital to third parties. These items were partly offset by an accounting gain of US\$1.1bn in 2013 on the reclassification of Industrial Bank.

On an underlying basis, which excludes the items above as well as other disposals and the results of disposed-of operations, profit before tax increased by 16% due to the net gain of US\$553m on completion of the sale of our investment in Ping An in 2013, compared with adverse fair value movements of US\$553m on the Ping An contingent forward sale contract recorded in 2012. Excluding these items, underlying profit before tax increased by 7%, driven by higher net interest income and net fee income in Hong Kong.

The implementation of our strategy to reduce fragmentation across the region continued, leading to the disposal of non-core insurance businesses in Vietnam, South Korea, Taiwan and Singapore, and we announced the closure of a retail brokerage in India and our retail banking operations in South Korea. We also completed the sale of our investment in Ping An in mainland China.

HSBC HOLDINGS PLC

88a

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

In Hong Kong, we grew our average mortgage balances by 8% with average loan-to-value ratios of 44% on new mortgage drawdowns and an estimated 32% on the portfolio as a whole. We continued to develop our digital capabilities and launched our mobile banking application in Hong Kong. We also developed our wealth management capabilities, growing revenue by over 10%. In addition, we enhanced our wealth management systems, simplified the product range and implemented the Global Wealth Incentive Plan to better align customer and business interests.

We further strengthened the collaboration between CMB and GB&M, raising financing for our clients of over US\$14bn from debt capital markets and nearly US\$4bn from equity capital markets, including the largest IPO in Hong Kong for a mainland Chinese consumer company. In addition, we were awarded Best Trade Finance Bank in Hong Kong by *Global Finance*.

In GB&M, we continued to lead the market in Hong Kong dollar bond issuance and are now one of the top five houses for both equity capital markets and mergers and acquisitions in Hong Kong. We were voted Best Debt House in Hong Kong in the *Euromoney* 2013 Awards for Excellence and were involved in seven of the ten largest IPOs in Hong Kong this year.

We led the market in offshore renminbi ( RMB ) bond issuance in Hong Kong, including the RMB3bn (US\$491m) government bond issue in December 2013 by mainland China's Ministry of Finance, and were voted Best provider of offshore renminbi products and services for the second year running by *Asiamoney*. We also won the award for RMB House of the Year from *Asia Risk*.

We announced the sale of our shareholding in Bank of Shanghai in 2013, a transaction which is expected to complete in the first half of 2014.

In mainland China, where we continued to expand our branch network, we had 162 HSBC outlets, 23 HSBC rural bank outlets and 48 Hang Seng Bank outlets at the end of the year. We were also one of the first foreign banks to be approved to distribute domestic funds to retail investors. In addition, we were the market leader in mainland China's state-owned enterprise bond issuances and we were awarded Best Foreign Commercial Bank in China by *FinanceAsia*.

We continued to promote the internationalisation of the renminbi as regulations developed. We were the first foreign bank in mainland China to implement a customised renminbi cross-border centralised settlement solution and were also the first foreign bank to complete a two-way cross-border renminbi lending transaction.

In India, we revised our Wealth Management product offering to ensure customers' needs were being met and to improve customer satisfaction levels. In Payments and Cash Management, we were awarded the Best Domestic Cash Management Bank in 2013 by *Euromoney*. Our strength in debt capital markets ( DCM ) continued, acting as a joint lead manager and bookrunner for the

largest US dollar-denominated single tranche bond issuance by an Indian corporate in 2013.

In Singapore, we led the market in foreign currency DCM issuance, continuing to demonstrate our ability to structure DCM transactions. In CMB, we began to offer a renminbi settlement service.

We continued to develop our Payments and Cash Management product offering across the region and were awarded the Best Cash Management House in Asia by *Euromoney*. We also strengthened our Project and Export Finance capabilities and were named the Best Project Finance House in Asia by *Euromoney* for the third consecutive year. Our strength in DCM continued, and we were the No.1 bookrunner in Asia-ex Japan bonds. We were awarded the Domestic Bond House of the Year by *IFR Asia*.

*Net interest income* rose by US\$839m, primarily in Hong Kong, led by RBWM and supported by GB&M and CMB. The increase was mainly due to higher average lending balances, wider spreads on mortgages in RBWM reflecting lower funding costs, and growth in the insurance debt securities portfolio. Mortgage lending in RBWM in Hong Kong increased, although the rate of growth began to slow during 2013 as transaction volumes in the property market reduced.

Average residential mortgage balances also grew in mainland China and Australia, as we focused on secured lending, and in Singapore reflecting growth in 2012.

In addition, there was strong loan growth in both CMB and GB&M, driven by trade-related lending in the first half of 2013 and an increase in commercial real estate and other property-related lending in the second half of the year, though the benefit of this growth was partly offset by spread compression reflecting competition and increased liquidity in the markets.

Average deposit balances increased, in part reflecting new Premier customers in RBWM and increased Payments and Cash Management balances in CMB, though the benefit of this growth was more than offset by narrower deposit spreads due to a fall in short-term interbank interest rates.

*Net fee income* rose by US\$595m in 2013, led by RBWM in Hong Kong as strong customer demand and favourable market sentiment led to higher fees from unit trusts and increased brokerage income. Fee income also increased due to a rise in debt and equity underwriting and corporate finance activity compared with 2012, in part reflecting collaboration between GB&M and CMB. In CMB, fee income growth reflected an increase in trade and Payments and Cash Management volumes.

*Net trading income* was US\$434m lower, in part from further adverse fair value movements in mainland China on the Ping An contingent forward sale contract of US\$682m, compared with US\$553m in 2012. In addition, in GB&M, net trading income included a favourable DVA of US\$40m in 2013, while 2012 included a favourable DVA of US\$136m, arising from a change in estimation methodology reflecting evolving market practices. Rates revenues decreased, largely from reduced bond holdings

HSBC HOLDINGS PLC

88b

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

in a number of countries and revaluation losses as bond yields rose, notably in mainland China. Foreign Exchange revenues also fell as market conditions in 2012 were not repeated. This was partly offset by favourable movements on the CVA in 2013, compared with adverse movements in 2012 arising from the change in estimation methodology as noted above.

*Net income from financial instruments designated at fair value* was US\$314m compared with US\$554m in 2012, primarily due to lower net investment returns on assets held by the insurance business reflecting weaker equity markets and falling bond prices. To the extent that these investment returns were attributed to policyholders holding unit-linked insurance policies and insurance contracts with DPF, there was a corresponding movement in *Net insurance claims incurred and movement in liabilities to policyholders*.

*Gains less losses from financial investments* were US\$936m higher, primarily in mainland China due to the gain on completion of disposal of our investment in Ping An of US\$1.2bn, which was partly offset by the adverse fair value movement of US\$682m on the contingent forward sale contract included in *Net trading income* leading to a net gain of US\$553m. *Gains less losses from financial investments* were also partly offset by the non-recurrence of the gain on sale of our shares in four Indian banks in 2012.

We reported a *gain on disposal of Ping An* of US\$3.0bn in 2012.

*Dividend income* was US\$153m compared with US\$26m in 2012, mainly due to the dividend from Industrial Bank following its reclassification as a financial investment during the year.

*Net earned insurance premiums* grew by 2%, driven by Hong Kong, due to increased renewals of deferred annuity and unit-linked insurance contracts, partly offset by the absence of non-life insurance premiums following the disposal of the HSBC and Hang Seng Bank general insurance businesses in 2012, and lower new business premiums. The growth in premiums resulted in a corresponding increase in *Net insurance claims incurred and movement in liabilities to policyholders*.

*Other operating income* increased by US\$812m. We recorded an accounting gain of US\$1.1bn on the reclassification of Industrial Bank as a financial investment following its issue of additional share capital to third parties, and a gain on the disposal of our investment in Bao Viet Holdings of US\$104m. In 2012, we recorded gains totalling US\$305m on a reported basis following the sales of our RBWM business in Thailand, our GPB business in Japan and our interest in a property company in the Philippines.

*LICs* were in line with 2012 as higher charges in Hong Kong due to a revision to the assumptions used in our collective assessment models in RBWM and a rise in individual impairment charges in CMB, were broadly offset by the non-recurrence of a large individually assessed impairment of a corporate exposure in Australia and a credit risk provision on an available-for-sale debt security in GB&M.

*Operating expenses* rose by US\$139m in 2013, primarily in Hong Kong, reflecting higher marketing expenditure, costs relating to the introduction of updated payment cards and information technology platforms, as well as increased property rental and maintenance costs. In addition, staff costs increased as a result of changes to the recognition of

pension costs. Costs rose in India from increased use of the service centres and in mainland China from wage inflation, higher staff numbers and branch expansion. These increases were offset by the partial write back of a litigation provision in Singapore and Australia compared with a charge in 2012.

*Share of profit from associates and joint ventures* reduced by US\$1.4bn following the disposal of Ping An, the reclassification of Industrial Bank as a financial investment and an impairment charge of US\$106m on our banking associate in Vietnam. Excluding these factors, income from associates rose, primarily in BoCom as a result of balance sheet growth and increased fee income, partly offset by higher operating expenses and a rise in loan impairment charges.

HSBC HOLDINGS PLC

88c

**Table of Contents****Report of the Directors: Financial Review** (continued)*Profit before tax and balance sheet data Asia*

	2014						
<b>Retail Banking and Wealth Management US\$m</b>	<b>Commercial Banking US\$m</b>	<b>Global Banking and Markets US\$m</b>	<b>Global Private Banking US\$m</b>	<b>Other US\$m</b>	<b>Inter- segment elimination<sup>55</sup> US\$m</b>	<b>Total US\$m</b>	

*Profit before tax*

Net interest income/(expense)	5,003	3,439	3,579	177	(16)	91	12,273
Net fee income	2,792	1,529	1,311	272	6		5,910
Trading income/(expense) excluding net interest income	216	382	1,220	142	(5)		1,955
Net interest income/(expense) on trading activities	(13)	(9)	771		9	(91)	667
Net trading income <sup>50</sup>	203	373	1,991	142	4	(91)	2,622
Changes in fair value of long-term debt issued and related derivatives					(4)		(4)
Net income/(expense) from other financial instruments designated at fair value	543	(6)	(2)		2		537
Net income/(expense) from financial instruments	543	(6)	(2)		(2)		533



## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

designated at fair value							
Gains less losses from financial investments	1	5	46		148		200
Dividend income	1		1		177		179
Net insurance premium income	6,596	794					7,390
Other operating income	516	95	141	3	2,734	(1,158)	2,331
<b>Total operating income</b>	<b>15,655</b>	<b>6,229</b>	<b>7,067</b>	<b>594</b>	<b>3,051</b>	<b>(1,158)</b>	<b>31,438</b>
Net insurance claims <sup>56</sup>	(6,979)	(782)					(7,761)
<b>Net operating income<sup>4</sup></b>	<b>8,676</b>	<b>5,447</b>	<b>7,067</b>	<b>594</b>	<b>3,051</b>	<b>(1,158)</b>	<b>23,677</b>
Loan impairment (charges)/ recoveries and other credit risk provisions	(317)	(228)	(103)	1			(647)
<b>Net operating income</b>	<b>8,359</b>	<b>5,219</b>	<b>6,964</b>	<b>595</b>	<b>3,051</b>	<b>(1,158)</b>	<b>23,030</b>
Total operating expenses	(4,191)	(1,897)	(2,686)	(384)	(2,427)	1,158	(10,427)
<b>Operating profit</b>	<b>4,168</b>	<b>3,322</b>	<b>4,278</b>	<b>211</b>	<b>624</b>		<b>12,603</b>
Share of profit in associates and joint ventures	304	1,420	298				2,022
<b>Profit before tax</b>	<b>4,472</b>	<b>4,742</b>	<b>4,576</b>	<b>211</b>	<b>624</b>		<b>14,625</b>
	%	%	%	%	%		%
Share of HSBC s profit before tax	23.9	25.4	24.5	1.1	3.4		78.3
Cost efficiency ratio	48.3	34.8	38.0	64.6	79.5		44.0

*Balance sheet data<sup>40</sup>*

	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	115,643	132,509	99,934	12,894	1,975		362,955
Total assets	166,577	158,747	548,865	14,905	79,477	(89,848)	878,723
Customer accounts <sup>27</sup>	286,670	155,608	104,896	29,847	470		577,491

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)

	2013						Total
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	US\$m
<i>Profit before tax</i>							
Net interest income/(expense)	4,895	3,103	3,245	205	(124)	108	11,432
Net fee income/(expense)	2,758	1,518	1,419	249	(8)		5,936
Trading income/(expense) excluding net interest income	238	377	1,483	175	(739)		1,534
Net interest income/(expense) on trading activities	(16)	(6)	608		14	(108)	492
Net trading income/(expense) <sup>50</sup>	222	371	2,091	175	(725)	(108)	2,026
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	315		7		(7)		315
Net income/(expense) from financial instruments designated at fair value	315		7		(8)		314
Gains less losses from financial investments	(1)		58	14	1,204		1,275
Dividend income		1	6		145		152

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Net insurance premium income	6,263	654	1				6,918
Other operating income	764	97	163	12	3,871	(1,232)	3,675
Total operating income	15,216	5,744	6,990	655	4,355	(1,232)	31,728
Net insurance claims <sup>56</sup>	(6,609)	(687)					(7,296)
Net operating income <sup>4</sup>	8,607	5,057	6,990	655	4,355	(1,232)	24,432
Loan impairment charges and other credit risk provisions	(347)	(144)	(3)	(4)			(498)
Net operating income	8,260	4,913	6,987	651	4,355	(1,232)	23,934
Total operating expenses	(4,138)	(1,786)	(2,560)	(367)	(2,317)	1,232	(9,936)
Operating profit	4,122	3,127	4,427	284	2,038		13,998
Share of profit/(loss) in associates and joint ventures	297	1,331	248		(21)		1,855
Profit before tax	4,419	4,458	4,675	284	2,017		15,853
	%	%	%	%	%		%
Share of HSBC's profit before tax	19.6	19.8	20.7	1.3	8.9		70.3
Cost efficiency ratio	48.1	35.3	36.6	56.0	53.2		40.7

*Balance sheet data*<sup>40</sup>

	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	111,769	122,882	89,722	10,904	1,620		336,897
Total assets	158,456	146,898	515,023	12,994	82,453	(84,033)	831,791
Customer accounts <sup>27</sup>	278,392	141,958	96,546	31,250	337		548,483

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Profit before tax and balance sheet data Asia (continued)*

	2012						Total
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	US\$m
<i>Profit before tax</i>							
Net interest income/(expense)	4,638	3,025	3,243	251	(345)	(105)	10,707
Net fee income	2,623	1,349	1,214	226	6		5,418
Trading income/(expense) excluding net interest income	272	351	1,668	237	(594)		1,934
Net interest income/(expense) on trading activities	4	(1)	452		22	105	582
Net trading income/(expense) <sup>49</sup>	276	350	2,120	237	(572)	105	2,516
Changes in fair value of long-term debt issued and related derivatives					(4)		(4)
Net income/(expense) from other financial instruments designated at fair value	620	(52)	20		(31)		557
Net income/(expense) from financial instruments designated at fair value	620 (1)	(52) 2	20 (8)	7	(35) 338		553 338

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Gains less losses from financial investments							
Dividend income		1	6		22		29
Net insurance premium income	5,863	898	8				6,769
Gain on disposal of Ping An					3,012		3,012
Other operating income	922	317	159	81	2,723	(1,128)	3,074
Total operating income	14,941	5,890	6,762	802	5,149	(1,128)	32,416
Net insurance claims <sup>56</sup>	(6,280)	(797)	(7)				(7,084)
Net operating income <sup>1</sup>	8,661	5,093	6,755	802	5,149	(1,128)	25,332
Loan impairment (charges)/ recoveries and other credit risk provisions	(331)	(151)	(31)	3			(510)
Net operating income	8,330	4,942	6,724	805	5,149	(1,128)	24,822
Total operating expenses	(4,057)	(1,712)	(2,542)	(397)	(2,400)	1,128	(9,980)
Operating profit	4,273	3,230	4,182	408	2,749		14,842
Share of profit/(loss) in associates and joint ventures	938	1,560	661		29		3,188
Profit before tax	5,211	4,790	4,843	408	2,778		18,030
	%	%	%	%	%		%
Share of HSBC's profit before tax	25.2	23.2	23.5	2.0	13.4		87.3
Cost efficiency ratio	46.8	33.6	37.6	49.5	46.6		39.4
<i>Balance sheet data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	108,542	106,912	83,895	9,702	1,614		310,665
Total assets	151,694	131,179	458,069	32,847	105,619	(74,699)	804,709
Customer accounts <sup>27</sup>	264,879	135,017	98,488	30,661	709		529,754

For footnotes, see page 109.

HSBC HOLDINGS PLC

90a

**Table of Contents****Report of the Directors: Financial Review** (continued)**Middle East and North Africa**

**The network of branches of HSBC Bank Middle East Limited, together with HSBC's subsidiaries and associates, gives us wide coverage in the region. Our associate in Saudi Arabia, The Saudi British Bank (40% owned), is the Kingdom's sixth largest bank by total assets.**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net interest income	<b>1,519</b>	1,486	1,470
Net fee income	<b>650</b>	622	595
Net trading income	<b>314</b>	357	390
Other income	<b>65</b>	38	(25)
<b>Net operating income<sup>4</sup></b>	<b>2,548</b>	2,503	2,430
LICs <sup>43</sup>	<b>6</b>	42	(286)
<b>Net operating income</b>	<b>2,554</b>	2,545	2,144
Total operating expenses	<b>(1,216)</b>	(1,289)	(1,166)
<b>Operating profit</b>	<b>1,338</b>	1,256	978
Income from associates <sup>44</sup>	<b>488</b>	438	372
<b>Profit before tax</b>	<b>1,826</b>	1,694	1,350
Cost efficiency ratio	<b>47.7%</b>	51.5%	48.0%
RoRWA <sup>36</sup>	<b>2.9%</b>	2.7%	2.2%
Year-end staff numbers	<b>8,305</b>	8,618	8,765

**Best Investment Bank in the**

**Middle East**

*(Euromoney 2014)*

**Record reported profit before tax of**

**US\$1.8bn**

**Completed disposal of our operations in**

**Jordan and Pakistan**

**in line with the Group's**



**six filters investment criteria**

**For footnotes, see page 109.**

*For footnotes, see page 109.*

**Economic background**

Economic activity across the Middle East and North Africa remained strong during 2014, despite heightened geopolitical uncertainties and weaker global oil prices towards the end of the year. The region's energy exporters fared particularly well, buoyed by an oil-funded fiscal stimulus and an expansionary monetary stance. **Saudi Arabia**, the Middle East's largest oil exporter, grew strongly as the Kingdom pushed ahead with its infrastructure and industrial expansion programme. The **United Arab Emirates ( UAE )**, however, showed the most significant gains in momentum, boosted by growth in both its export-orientated non-oil sector and an increasingly expansionary fiscal stance. Though showing some gains as growth picked up speed, inflation remained muted at under 5% across the Gulf.

**Egypt** showed further signs of stabilisation in 2014. Although still below the trend levels that prevailed prior to the 2011 revolution, some momentum in growth was achieved in the second half of the year, boosted by the receipt of further concessional funding and an improvement in political order and policy making following the May presidential election. Inflation rose and the budget deficit remained high, recording a third successive double-digit deficit as a percentage of GDP. International reserves fell in the latter months of the year, highlighting ongoing pressure on the currency which remained subject to significant controls.

**Financial overview**

*Profit before tax (US\$m)*

Our operations in the Middle East and North Africa reported a profit before tax of US\$1.8bn, an increase of 8% on a reported basis, despite the effects of business disposals, including the loss on sale of our Pakistan business. See page 42 for further details of our significant items.

On an adjusted basis, profit before tax grew by 11% driven by higher revenue and increased income from our associate, The Saudi British Bank.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Profit/(loss) before tax by country within global businesses*

	<b>Retail Banking and Wealth Management</b>	<b>Commercial Banking</b>	<b>Global Banking and Markets</b>	<b>Global Private Banking</b>	<b>Other</b>	<b>Total</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>
Egypt	64	94	177			335
United Arab Emirates	154	190	364		(46)	662
Saudi Arabia	91	168	203	19	5	486
Other	14	152	182		(5)	343
<b>Year ended 31 December 2014</b>	<b>323</b>	<b>604</b>	<b>926</b>	<b>19</b>	<b>(46)</b>	<b>1,826</b>
Egypt	31	37	166		(29)	205
United Arab Emirates	142	290	275	1	(72)	636
Saudi Arabia	82	146	188	15	7	438
Other	3	172	240			415
Year ended 31 December 2013	258	645	869	16	(94)	1,694
Egypt	67	71	157		(5)	290
United Arab Emirates	143	235	141	1	(56)	464
Saudi Arabia	60	120	170	9	18	377
Other	(18)	161	113		(37)	219
Year ended 31 December 2012	252	587	581	10	(80)	1,350

**Country business highlights**

In the UAE, we made significant progress in executing the strategic plan we announced in 2013. In RBWM, we expanded our range of products in Wealth Management, including the launch of the International Bonds and Portfolio Advisory Service to widen our offering for Premier clients. The introduction of a financial health check to better understand customer needs coupled with the opening of a Customer Service Unit in Abu Dhabi illustrated our focus on putting the customer first.

In CMB, we enhanced our services to customers that trade internationally by completing the implementation of our International Subsidiary Business model across the region in order to better meet their cross-border banking requirements and cement our strategic relationships. We also launched a second tranche of the International Growth

Fund for AED1bn (US\$272m). We continued to invest in our Payments and Cash Management business including recruiting client-facing and specialised staff and won the Best Regional Cash Management Provider in the Middle East award.

In GB&M, we advised a major regional airline on its investment in a European air carrier and a large investment company in Dubai on its inaugural US\$1bn bond issue. In addition, we increased our collaboration with CMB, particularly in Capital Financing, focusing on existing clients and taking advantage of our connectivity with other regions.

The drop in oil prices did not have a material impact on our financial performance in the UAE.

In **Egypt**, in RBWM, we expanded our product offering with enhanced features and reduced pricing for credit cards, and were ranked number one in the customer recommendation index. In GB&M, we acted as the global coordinator, structuring bank, mandated lead arranger and facility agent for a government entity. This reflected our commitment to supporting the Egyptian

government's plan for the development of the country's infrastructure.

In **Saudi Arabia**, through our associates, The Saudi British Bank and HSBC Saudi Arabia Limited, we acted as joint financial advisor, joint lead manager and a receiving bank on the US\$6bn National Commercial Bank initial public offering (IPO). This was the Middle East's largest ever IPO and the world's second largest in 2014.

### Review of adjusted performance<sup>45</sup>

#### Revenue (US\$m)

**Revenue** increased in the majority of our markets, most notably in Egypt in all global businesses and in the UAE.

#### Country view of adjusted revenue

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
UAE	<b>1,448</b>	1,401
Egypt	<b>531</b>	451
Rest of MENA	<b>566</b>	550
Year ended 31 December	<b>2,545</b>	2,402

In *Egypt*, revenue increased by US\$80m, reflecting higher net interest income in RBWM due to improved deposit spreads as a result of re-pricing, and the non-recurrence of losses on disposal of available-for-sale debt securities

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

in GB&M in 2013. In addition, the Central Bank resumed interest payments on overnight placements during 2014, which contributed to the rise in revenue in all global businesses.

In the *UAE*, revenue increased by US\$47m, primarily in GB&M reflecting a rise in Capital Financing due to increased advisory mandates in Project and Export Finance and a gain on restructuring a specific loan in Credit and Lending. In addition, revenue rose in our Equities and Securities Services businesses from increased customer flows, which in part reflected the upgrade of the UAE to emerging markets status in the MSCI Index. In RBWM, revenue increased, but to a lesser extent, reflecting higher net interest income as mortgage balances rose and deposit spreads improved due to re-pricing initiatives. This was partially offset by reduced revenue in CMB from lower spreads on lending balances, reflecting a highly liquid and competitive market coupled with lower charges on foreign exchange transactions in Payments and Cash Management.

In the rest of the region, revenue was higher with increases in *Oman* and *Qatar* partly offset by a reduction in *Algeria*. Higher revenue in Oman in part reflected growth in customer advances in CMB. The increase in Qatar was driven by fees in GB&M reflecting increased customer flows in our Securities Services business, which in part reflected the upgrade of Qatar to emerging markets status in the MSCI Index. The reduction in Algeria reflected regulatory restrictions on foreign exchange spreads charged on corporate customer transactions.

**Net loan impairment** releases were lower by US\$44m, primarily driven by lower impairment releases for a particular UAE-related exposure in GB&M.

***Operating expenses (US\$m)***

**Operating expenses** of US\$1,183m decreased by US\$31m, mainly due to reductions in Egypt and the UAE. In Egypt, expenses fell following charges recorded in 2013 relating to changes in the interpretation of tax regulations. In the UAE, expenses reduced due to the non-recurrence of charges incurred in 2013 on customer redress programmes in RBWM relating to fees charged on overseas credit card transactions. This was partly offset by wage inflation, investment in Regulatory Programmes and Compliance, growth in customer-facing staff in RBWM and increased service and product support staff in CMB.

**Share of profits from associates and joint ventures** increased by 12%, mainly from The Saudi British Bank. This was driven by higher revenue resulting from strong balance sheet growth.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**2013 compared with 2012****Economic background**

Real GDP in the Middle East and North Africa grew by an estimated 4.0% in 2013, led by the Gulf Cooperation Council ( GCC ) and Saudi Arabia 's expansionary fiscal policy and infrastructure investment programme. With oil prices steady in the US\$100-110 per barrel range throughout the year, revenues were more than sufficient to fund this spending, and the region ended 2013 with both current and fiscal accounts amply in surplus. The UAE saw an accelerating recovery in 2013 led by real estate and services, but boosted towards the end of the year by an increasingly expansionary fiscal policy. Despite strong demand and loose fiscal policy, inflation remained very subdued across the region throughout 2013, apart from UAE real estate.

For **Egypt**, political uncertainty gave rise to a third year of sub-par growth and rising unemployment. Real GDP grew by 2.2% in the 2012/13 fiscal year, while the budget deficit widened to 14% of GDP. The country 's external position improved substantially in July, following the receipt of concessionary financing from the GCC. However, while reserves and the currency stabilised, stringent exchange rate and capital controls were still in place at the end of December 2013.

**Review of performance**

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. For comparison, adjusted profit before tax would have been US\$1.7bn and US\$1.4bn for 2013 and 2012 respectively as compared with constant currency profit before tax of US\$1.7bn and US\$1.3bn for 2013 and 2012 respectively. Constant currency, underlying and adjusted are reconciled on pages 105(b) to 105(au).

Our operations in the Middle East and North Africa reported a profit before tax of US\$1.7bn, an increase of 25% compared with 2012. On a constant currency basis, pre-tax profits increased by 29%.

Our reported results in 2013 included adverse movements of US\$4m on our own debt designated at fair value resulting from tightening of credit spreads. Our reported results in 2012 included an investment loss on a subsidiary of US\$85m and adverse movements of US\$12m on our own debt designated at fair value resulting from tightening credit spreads, partly offset by gains recognised on acquisitions totalling US\$21m. On an underlying basis, excluding the items noted above and the results of a deconsolidated subsidiary and the Private Equity business disposed of in 2012, profit before tax increased by 26%, mainly due to lower loan impairment charges and higher income from our associate, The Saudi British Bank.

In the UAE, we inaugurated a new strategic plan for growth with investment committed across all businesses, and with commensurate investment in the risk management functions including Regulatory and Financial Crime Compliance. In RBWM, we focused on

improving our retail customer experience through the new 'Customer at the Heart' campaign and were ranked number one in the Customer Recommendation Index for banks in the UAE. We also invested in mobile and digital

technologies to enhance our Wealth Management offering and to grow our retail foreign exchange revenues.

In CMB, our fourth international trade fund for SMEs of AED1bn (US\$272m) was launched to support new and existing customers with cross-border trading requirements or with aspirations to grow internationally.

In GB&M, there was a focus on cross-border connectivity and CMB collaboration, with tailored risk management solutions. We supported sovereign wealth funds and government-related entities and won several *Euromoney* awards including The Best Investment Bank in Middle East , The Best Risk Advisor in Middle East , Best Cash Management House in the Middle East and No 1 Debt House for MENA and GCC issuer bonds .

We were awarded the Best Trade Bank in the MENA region by *GTR Leaders in Trade 2013* and we enhanced Global Trade and Receivables Finance by investing in sales staff and giving priority to commodity structured trade finance and receivables finance. The level of service provided by our Payments and Cash Management business was reflected in our fifth consecutive *Euromoney* award.

In Egypt, we continued to manage risk in the uncertain political and economic environment. Surplus liquidity levels in Egyptian pounds, which arose following the introduction of foreign currency restrictions at the end of 2012, were managed through the downward re-pricing of deposits. Despite these difficult operating conditions, we continued to invest in the business, through the deployment of new automated teller machines ( ATMs ) and the launch of a new mobile banking application. Our RBWM business was ranked number 1 in the Customer Recommendation Index while our CMB business launched an Egypt SME Fund for EGP300m (US\$44m) targeting international SME growth and trade customers.

We renewed our primary dealer licence for trading in Government of Egypt treasury bills and bonds, ranking as one of the largest primary dealers in the Egyptian market.

In Oman, following the completion of the merger in June 2012 with OIB, we completed the conversion to HSBC systems of our merged operation. We made a number of improvements to our mobile banking and internet banking applications, introducing enhanced security features including the HSBC secure key for internet banking. We also upgraded our e-platform for cash management services for our corporate banking customers. HSBC Bank Oman won *Euromoney* s Best Domestic Cash Management Bank in Oman award for the second consecutive year.

In Saudi Arabia, our associate, The Saudi British Bank, won *The Banker* magazine s award as The Best Bank in Saudi Arabia, 2013 and achieved a record net profit before tax exceeding US\$1bn.

HSBC HOLDINGS PLC

93a

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

In line with our commitment to drive growth and improve returns in businesses that do not meet our six filters criteria (see page 15), we entered into an agreement to sell our operation in Jordan. The transaction is expected to complete in 2014.

*Net interest income* rose by 4%, mainly in Egypt in GB&M, driven by higher yields and balances on available-for-sale investment portfolios and higher balances on corporate deposits as more liquid assets were held in the volatile political environment. In Oman, net interest income increased, notably in RBWM, following the merger with OIB in June 2012. The higher net interest income in the UAE from growth in GB&M in the Credit and Lending portfolio and in RBWM from the Lloyds business acquired in 2012, was more than offset by a decline in CMB, where the business was repositioned to lower risk segments.

*Net fee income* increased by 7%, primarily in the UAE in GB&M due to an increase in advisory mandates in Capital Financing and higher institutional equities fee income from increased deal volumes, partially offset by lower fees from reduced volumes on Global Trade and Receivables Finance products in CMB. In Egypt, net fee income increased, notably in RBWM from cards and consumer loan fees.

*Net trading income* decreased by 6%, notably in Egypt from lower foreign exchange revenues, reflecting the political instability, and lower Rates trading income driven by a reduction in deal volumes. The decrease in trading income also reflected the deconsolidation of a subsidiary in 2012. These factors were partly offset by CVA releases on trading positions relating to a small number of exposures in the UAE in GB&M, compared with charges in 2012.

*Gains less losses from financial investments* decreased by US\$27m, driven by losses on the disposal of the available-for-sale debt securities in Egypt in the first half of 2013 as we adjusted our risk positions.

Other operating income increased by US\$76m, due to the non-recurrence of an US\$85m investment loss on a subsidiary in 2012.

A net *loan impairment release* of US\$42m was recorded in 2013 compared with a charge of US\$282m in 2012. There were provision releases, mainly in GB&M, for a small number of UAE related exposures, reflecting an overall improvement in the loan portfolio compared with charges in 2012. In addition, loan impairment charges declined, due to lower individually assessed loan impairments in the UAE in CMB and lower provisions in RBWM on residential mortgages following a repositioning of the book towards higher quality lending and improved property prices.

*Operating expenses* increased by 13%, mainly in the UAE from the Lloyds business acquired in 2012, expenses for regulatory projects, operational losses and charges from a customer redress programme in RBWM relating to fees charged on overseas credit card transactions. Expenses also increased in Egypt from changes in the interpretation of tax regulations and in Oman following the merger with OIB. These factors were partly offset by approximately US\$40m of sustainable savings from our organisational effectiveness programmes.

*Share of profits from associates and joint ventures* increased by 18%, mainly from The Saudi British Bank. This was driven by higher revenue resulting from strong balance sheet growth, and the effective management of costs.

HSBC HOLDINGS PLC

93b



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

*Profit/(loss) before tax and balance sheet data Middle East and North Africa*

	2014						
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	Total US\$m
<i>Profit/(loss) before</i>							
net interest income	615	467	410		3	24	1,519
net fee							
income/(expense)	152	268	240		(10)		650
including							
income/(expense)							
including net							
interest income	58	68	207		(5)		328
net interest income							
from trading activities			10			(24)	(14)
net trading							
income/(expense) <sup>50</sup>	58	68	217		(5)	(24)	314
net expense from							
financial instruments							
designated at fair							
value					(3)		(3)
gains less losses							
from financial							
investments	1	1	20				22
dividend income	1	1	12				14
other operating							
income	8		27		108	(111)	32
<b>total operating</b>	<b>835</b>	<b>805</b>	<b>926</b>		<b>93</b>	<b>(111)</b>	<b>2,549</b>
net insurance							
premiums <sup>56</sup>							
	835	805	926		93	(111)	2,549

<b>Net operating income<sup>4</sup></b>							
an impairment charges)/recoveries and other credit risk provisions	(26)	(21)	53				
<b>Net operating income</b>	<b>809</b>	<b>784</b>	<b>979</b>		<b>93</b>	<b>(111)</b>	<b>2,55</b>
Net operating expenses	(578)	(348)	(256)		(145)	111	(1,21
<b>Operating profit/(loss)</b>	<b>231</b>	<b>436</b>	<b>723</b>		<b>(52)</b>		<b>1,33</b>
Share of profit in associates and joint ventures	92	168	203	19	6		48
<b>Profit/(loss) before tax</b>	<b>323</b>	<b>604</b>	<b>926</b>	<b>19</b>	<b>(46)</b>		<b>1,82</b>
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.7	3.2	5.0	0.1	(0.2)		9.
Cost efficiency ratio	69.2	43.2	27.6		155.9		47.

*Balance sheet data<sup>40</sup>*

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net) <sup>27</sup>	6,318	13,104	9,641				29,06
Total assets	7,073	14,911	39,229	77	2,900	(1,773)	62,41
Customer accounts <sup>27</sup>	18,024	11,809	9,630		257		39,72

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	2013						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	585	486	390		4	21	1,486
Net fee income/(expense)	161	269	197		(5)		622
Trading income excluding net interest income	59	85	220				364
Net interest income on trading activities			14			(21)	(7)
Net trading income <sup>50</sup>	59	85	234			(21)	357
Net expense from financial instruments designated at fair value					(2)		(2)
Gains less losses from financial investments			(18)				(18)
Dividend income			9				9
Other operating income	25	30	15		99	(120)	49
Total operating income	830	870	827		96	(120)	2,503
Net insurance claims <sup>56</sup>							
Net operating income <sup>4</sup>	830	870	827		96	(120)	2,503
	(49)	(20)	110	1			42

Loan impairment (charges)/ recoveries and other credit risk provisions							
Net operating income	781	850	937	1	96	(120)	2,545
Total operating expenses	(606)	(350)	(256)		(197)	120	(1,289)
Operating profit/(loss)	175	500	681	1	(101)		1,256
Share of profit in associates and joint ventures	83	145	188	15	7		438
Profit/(loss) before tax	258	645	869	16	(94)		1,694
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.1	2.9	3.8	0.1	(0.4)		7.5
Cost efficiency ratio	73.0	40.2	31.0		205.2		51.5
<i>Balance sheet data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	6,152	11,814	9,241		4		27,211
Total assets	7,016	13,776	39,302	64	3,340	(2,688)	60,810
Customer accounts <sup>27</sup>	18,771	12,402	7,432	1	77		38,683

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Profit/(loss) before tax and balance sheet data Middle East and North Africa (continued)*

	2012						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	597	492	367	1	42	(29)	1,470
Net fee income/(expense)	164	279	160	1	(9)		595
Trading income excluding net interest	68	94	208		3		373
Net interest income/(expense) from trading activities		2	30		(44)	29	17
Net trading income/(expense) <sup>50</sup>	68	96	238		(41)	29	390
Net income from financial instruments designated at fair value					(12)		(12)
Gains less losses from financial investments			9				9
Dividend income			5				5
Other operating income/(expense)	(16)	21	14	1	47	(94)	(27)
Total operating income	813	888	793	3	27	(94)	2,430
Net insurance claims <sup>56</sup>	813	888	793	3	27	(94)	2,430

Net operating income <sup>1</sup>							
Loan impairment charges and other credit risk provisions	(55)	(110)	(119)	(2)			(286)
Net operating income	758	778	674	1	27	(94)	2,144
Total operating expenses	(561)	(311)	(264)		(124)	94	(1,166)
Operating profit/(loss)	197	467	410	1	(97)		978
Share of profit in associates and joint ventures	55	120	171	9	17		372
Profit/(loss) before tax	252	587	581	10	(80)		1,350
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.2	2.8	2.8		(0.3)		6.5
Cost efficiency ratio	69.0	35.0	33.3		459.3		48.0

<i>Balance sheet data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	5,828	13,559	8,699				28,086
Total assets	6,562	15,651	36,582	50	6,840	(3,080)	62,605
Customer accounts <sup>27</sup>	19,802	12,826	6,880	3	72		39,583

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

95a

**Table of Contents****Report of the Directors: Financial Review** (continued)**North America**

**Our principal North American businesses are located in the US and Canada. Operations in the US are primarily conducted through HSBC Bank USA, N.A., and HSBC Finance, a national consumer finance company. HSBC Markets (USA) Inc. is the intermediate holding company of, *inter alia*, HSBC Securities (USA) Inc. Canadian operations are conducted through HSBC Bank Canada.**

	2014	2013	2012
	US\$m	US\$m	US\$m
Net interest income	5,015	5,742	8,117
Net fee income	1,940	2,143	2,513
Net trading income	411	948	507
Gains on disposals of US branch network and cards business			4,012
Other income/(expense)	786	(30)	(456)
<b>Net operating income<sup>4</sup></b>	<b>8,152</b>	8,803	14,693
LICs <sup>43</sup>	(322)	(1,197)	(3,457)
<b>Net operating income</b>	<b>7,830</b>	7,606	11,236
Total operating expenses	(6,429)	(6,416)	(8,940)
<b>Operating profit</b>	<b>1,401</b>	1,190	2,296
Income from associates <sup>44</sup>	16	31	3
<b>Profit before tax</b>	<b>1,417</b>	1,221	2,299
Cost efficiency ratio	78.9%	72.9%	60.8%
RoRWA <sup>36</sup>	0.6%	0.5%	0.8%
Year-end staff numbers	20,412	20,871	22,443

**Best Export Finance Arranger in**

**North America**

(Trade Finance Awards for Excellence 2014)

**11%**

**increase in**

**CMB customer lending balances**

on a reported basis

**73%**

**decrease in**

**loan impairment charges**

on a reported basis

*For footnotes, see page 109.*

### **Economic background**

In the US, real GDP rose by 2.4% in 2014, after 2.2% growth in 2013. Both consumer spending and business fixed investment increased at a moderate pace in 2014, climbing 2.5% and 5.2%, respectively. Growth in residential investment slowed markedly, however, to 1.8% in 2014, from 11.9% in 2013. Government expenditure fell by 0.2% in 2014, as a decline in federal government spending more than offset an increase in state and local government expenditure. The unemployment rate fell from 6.7% at the end of 2013 to 5.6% at the end of 2014. CPI inflation averaged 1.6% in 2014, after averaging 1.5% in 2013. The Federal Reserve continued to pursue a highly accommodative monetary policy in 2014, keeping the federal funds rate in a 0.00% to 0.25% range. It gradually reduced its monthly purchases of longer-term Treasury securities and agency mortgage-backed securities during the first ten months of the year, bringing its asset purchase programme to a conclusion at the end of October.

**Canadian** real GDP grew at a 2.4% annual rate through the first three quarters of 2014, an improvement on the 1.8% increase observed during the comparable period in 2013. Exports were supported by US economic growth and rising oil production. Business investment was largely unchanged in 2014. The annual rate of CPI inflation rose to a peak of 2.4% in late 2013 and early 2014. However, as the oil price fell late in the year, fuel prices declined and the annual rate of inflation dropped to 1.5% in December, below the Bank of Canada's 2% inflation target. Monetary policy remained accommodative with the Bank of Canada keeping its policy rate at 1% throughout 2014, where it has been since September 2010.

### **Financial overview**

#### *Profit before tax (US\$m)*

Our operations in North America reported a profit before tax of US\$1.4bn in 2014 compared with US\$1.2bn in 2013. The increase of US\$196m primarily reflected lower LICs, mainly in the US CML portfolio. This was partly offset by lower revenue, primarily reflecting continued CML run-off and a reduction in GB&M in the US. Costs were broadly unchanged as portfolio run-off broadly offset a US\$550m charge in relation to a settlement with the Federal Housing Finance Authority.

*See page 42 for further details of significant items.*





**Table of Contents****Report of the Directors: Financial Review** (continued)*Profit/(loss) before tax by country within global businesses*

	<b>Retail Banking and Wealth Management</b>	<b>Commercial Banking</b>	<b>Global Banking and Markets</b>	<b>Global Private Banking</b>	<b>Other</b>	<b>Total</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>
US	513	400	(403)	82	(60)	532
Canada	96	514	242		(23)	829
Other	23	(1)	49	3	(18)	56
<b>Year ended 31 December 2014</b>	<b>632</b>	<b>913</b>	<b>(112)</b>	<b>85</b>	<b>(101)</b>	<b>1,417</b>
US	(358)	296	633	53	(350)	274
Canada	131	506	280		(3)	914
Other	20	(16)	16	4	9	33
Year ended 31 December 2013	(207)	786	929	57	(344)	1,221
US	2,746	637	661	72	(2,901)	1,215
Canada	207	577	314	(1)	(16)	1,081
Other	42	(15)	(18)	1	(7)	3
Year ended 31 December 2012	2,995	1,199	957	72	(2,924)	2,299

Adjusted profit before tax was US\$63m higher, reflecting a reduction in LICs and operating expenses, partially offset by a decrease in revenue.

**Country business highlights**

In the US, CMB added US\$4.0bn in 2014 to its SME fund which supports businesses that trade or aspire to trade internationally, raising the programme's total available funding to US\$5.0bn. Of this, US\$3.7bn was utilised at 31 December 2014. Corporate lending balances rose as we continued to be successful in our markets targeted for expansion, with balances in both the Midwest and the West Coast increasing by more than 25% year on year.

In RBWM, we continued to optimise the mortgage origination process to improve the customer experience and expanded our digital channel capabilities. The re-launch of our Global Premier programme along with other related campaigns led to approximately 22,000 new Premier customers being added in 2014, an increase of 25%.

Despite lower revenue in GB&M, we continued to execute our growth strategy utilising GB&M's unique client franchise, its geographical network and product capabilities to connect our markets. In addition collaboration with CMB resulted in revenue from its clients rising by 19%.

In **Canada**, CMB continued to focus on the acquisition of new clients, to whom advances reached over US\$1.3bn. We created a dedicated International Subsidiary Banking team to manage and support our international clients on a consistent basis. GB&M focused on increasing its multinational client base, and the Project and Export Finance business continued to reflect growth. Our focus in RBWM continued to be on developing the Premier customer base, building mortgage, credit card, and deposit balances and growing assets under management.

We continued to make progress in our strategy to accelerate the run-off and sale of our US CML portfolio. We completed the sale of several tranches of real estate secured accounts with an aggregate unpaid principal

balance of US\$2.9bn during 2014 and recognised a cumulative gain on sale of US\$168m. Gross lending balances in the CML portfolio, including loans held for sale, were US\$25bn at 31 December 2014, a decline of US\$5.8bn from 2013.

## Review of adjusted performance<sup>45</sup>

### Revenue (US\$m)

**Revenue** fell in the US in RBWM, partly reflecting continued CML run-off, and in GB&M. Revenue also reduced in Canada, mainly reflecting the continued run-off of the Consumer Finance business.

### Country view of adjusted revenue

	2014	2013
	US\$m	US\$m
US	6,083	7,071
Canada	1,921	1,975
Other	264	293
<b>Year ended 31 December</b>	<b>8,268</b>	<b>9,339</b>

In the US, revenue decreased by US\$988m, mainly in RBWM where lower average lending balances driven by the continued run-off and loan sales of the CML portfolio led to lower net interest income. In addition, loan yields fell, partly reflecting the sale of our higher yielding CML non-real estate personal loan portfolio, which resulted in a significant shift in product mix towards increased levels of lower yielding first lien real estate loans. Revenue also declined due to lower deposit volumes and narrower deposit spreads. The fall in revenue was partly offset by releases of mortgage loan repurchase obligations related to loans previously sold, which compared with provisions in 2013.



---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Revenue decreased in GB&M, driven by a reduction in Balance Sheet Management income due to lower reported gains on sales of available-for-sale debt securities as a result of our ongoing portfolio repositioning for risk management purposes, and the adverse performance of economic hedges used to manage interest rate risk. Credit revenue also reduced, primarily in our legacy credit portfolio partly reflecting net adverse fair value movements on the portfolio.

By contrast, revenue increased in CMB, mainly reflecting increased lending balances in markets targeted for expansion and higher income in GB&M from increased collaboration in acquisition financing activity.

In *Canada*, revenue decreased by US\$54m, mainly in RBWM reflecting a fall in net interest income due to lower average lending balances from the continued run-off of the Consumer Finance business. Excluding this, RBWM revenues rose, driven by higher fees partly reflecting increased sales of wealth management products. In CMB, revenues also increased, largely because of the non-recurrence of a reduction in the fair value of an investment property held for sale and recognised in 2013. By contrast, GB&M revenue decreased, reflecting lower trading income from foreign exchange and a reduction in reported gains on sales of available-for-sale debt securities.

**LICs** fell, mainly in the CML portfolio reflecting reduced levels of delinquency, new impaired loans and lower lending balances from the continued run-off and loan sales. This was partly offset by less favourable market value adjustments to underlying property prices because improvements in housing market conditions were less pronounced in 2014 than in 2013. LICs also fell in Principal RBWM, mainly reflecting lower levels of delinquency, and in Canada in CMB from lower individually and collectively assessed impairment charges.

***Operating expenses (US\$m)***

**Operating expenses** decreased by US\$285m, primarily in the US, reflecting lower divestiture costs as our former Cards business reached the end of the data separation process, and lower average staff numbers and costs resulting from the continued run-off and sales of tranches of our CML portfolio. In addition, we also achieved over US\$185m of sustainable cost savings, primarily reflecting organisational effectiveness initiatives. Partly offsetting the lower operating expenses were higher legal costs and the growth in costs associated with Regulatory Programmes and Compliance, reflecting our continued investment in Global Standards.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**2013 compared with 2012****Economic background**

In the **US**, real GDP rose by 1.9% in 2013, after 2.8% growth in 2012. Both consumer spending and business fixed investment grew at a moderate pace in 2013. Residential investment rose by 12.1% in 2013, following 12.9% growth in 2012. Sales of new and existing homes increased in 2013, and average national home prices rose over the course of the year. Export growth slowed to 2.8% in 2013 from 3.5% in 2012. Budgetary caps on federal spending contributed to a 5.1% decline in federal government expenditure in 2013, in real terms. State and local government expenditure also contracted, though by less than in 2012. The unemployment rate fell during the year reaching 6.7% in December although, in part, this reflected the long-term unemployed leaving the labour market rather than job creation. Both headline and core CPI inflation moderated in 2013 as subdued growth in hourly wages continued to constrain labour costs. A lack of consensus between the main political parties about how best to reduce the US fiscal deficit led to a government shutdown on 1 October. An agreement was finally reached on 16 October which allowed the US debt ceiling to be raised and ended the shutdown. The Federal Reserve Board continued to pursue a highly accommodative monetary policy in 2013, keeping the Federal Funds rate in a zero to 0.25% range. It continued with monthly purchases of longer-term treasury securities and agency mortgage-backed securities but announced in December that it would begin to taper asset purchases from January 2014.

The **Canadian** economy grew by 1.6% during the first three quarters of 2013, down from 1.9% in the comparable period in 2012. Led by auto sales, consumer spending rose by 1.8%, contributing 1.2 percentage points to the expansion in 2013. Exports grew by 1.0% in 2013, which was well below the 3% export growth in 2012. Housing starts fell by 14% in 2013 though the level of activity improved during the year after a very weak start. The annual rate of CPI inflation remained close to 1% throughout the year, well below the Bank of Canada's 2% inflation target. The Bank of Canada's policy rate has remained at 1% since September 2010.

**Review of performance**

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. For comparison, adjusted profit before tax would have been US\$2.1bn and US\$0.5bn for 2013 and 2012 respectively as compared with constant currency profit before tax of US\$1.2bn and US\$2.3bn for 2013 and 2012 respectively and underlying profit before tax of US\$1.6bn and US\$(1.5)bn for 2013 and 2012 respectively. Constant currency, underlying currency and adjusted are reconciled on pages 105(b) to 105(au).

Our operations in North America reported a profit before tax of US\$1.2bn in 2013, compared with US\$2.3bn in 2012 on both a reported and constant currency basis.

Reported profits in both years included gains and losses on disposal of businesses not aligned to our long-term strategy, notably gains in the US of US\$3.1bn and US\$864m following the sales of the CRS business and 195 non-strategic retail branches, respectively, in 2012.

On an underlying basis, pre-tax profit was US\$1.6bn in 2013 compared with a pre-tax loss of US\$1.5bn in 2012. This was mainly due to a decline in loan impairment charges in 2013 in the US, primarily in the CML portfolio, and a reduction in operating expenses, as 2012 included a US\$1.5bn expense as part of the settlement of investigations into inadequate compliance with AML laws in the past. These were partly offset by losses on certain portfolio disposals described further below.

Underlying profit before tax in Canada reduced due to the closure to new business in 2012 of the Canadian consumer finance company and lower revenues, reflecting spread compression due to the low interest rate environment and competitive market. These were partly offset by lower costs following cost control and sustainable savings from organisational effectiveness initiatives.

We continued to make progress in our strategy to accelerate the run-off and sales of our CML portfolio, and simplify operations. We completed the sale of the CML non-real estate personal loan portfolio with an unpaid principal balance of US\$3.7bn on 1 April 2013 and recognised a loss on sale of US\$271m. We completed the sales of several tranches of real estate secured accounts with an aggregate unpaid principal balance of US\$5.7bn during 2013 and recognised a cumulative loss on sale of US\$153m. Gross lending balances in the CML portfolio, including loans held for sale, at 31 December 2013 were US\$30.4bn, a decline of US\$12.3bn from 31 December 2012.

We identified real estate secured loan balances with unpaid principal of US\$3.5bn that we plan to actively market in multiple transactions over the next 15 months. The carrying value of these loans was approximately US\$230m greater than their estimated fair value at 31 December 2013.

In the US, we made progress on re-engineering our processes, such as account opening and customer information management, creating standardisation and alignment with our target business and operating models and a simpler relationship experience for our customers. The US has been at the forefront of foundational work to implement Global Standards. We also launched a US\$1bn SME fund in CMB to support those businesses that trade or aspire to trade internationally.

In Canada, we continued to deliver internationally oriented organic business growth and streamlined processes and procedures. In CMB, we focused on positioning ourselves as the leading international trade and business bank, and deployed several new Global Trade products to assist international clients with working capital management. In GB&M, we launched Project and Export Financing and had a strong pipeline of business going into 2014. In RBWM, we continued to work on increasing the Premier customer base, resulting in 3% growth.

HSBC HOLDINGS PLC

98a

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

*Net interest income* decreased by 29% to US\$5.7bn, primarily due to the sale of the CRS business and retail branches, lower average lending balances from the continued run-off of the CML portfolio and other portfolio disposals during the year, lower reinvestment rates in Balance Sheet Management and the closure of the Canada consumer finance company to new business in 2012.

*Net fee income* decreased by 14% to US\$2.1bn, primarily due to the sale of the CRS business and the retail branches in 2012 and the expiry of the majority of the Transition Servicing Agreements with the buyer of the CRS business. This was partly offset by favourable adjustments to mortgage servicing rights valuations as a result of interest rate increases in 2013.

*Net trading income* was US\$948m, an increase of 89%, primarily due to favourable fair value movements on non-qualifying hedges in HSBC Finance of US\$315m in 2013 due to a rise in interest rates (compared with adverse movements of US\$227m in 2012) and lower provisions for mortgage loan repurchase obligations related to loans previously sold. The increase was partly offset by a loss of US\$199m arising from the early termination of qualifying accounting hedges in 2013 as a result of expected changes in funding.

Net trading income increased in GB&M as a result of favourable fair value movements on structured liabilities, in addition to higher Credit trading revenue from revaluation gains on securities, monoline reserve releases in the legacy portfolio and reduced losses from credit default swaps. Net trading income also benefited from the performance of economic hedges used to manage interest rate risk, which was positively affected by favourable interest rate movements. This was partly offset by lower Foreign Exchange revenue as a result of reduced trading volumes, and lower Rates trading revenue due to a decline in trading activities.

*Net expense from financial instruments designated at fair value* was US\$288m compared with US\$1.2bn in 2012. The increase was due to lower adverse fair value movements on our own debt designated at fair value as credit spreads tightened to a lesser extent in 2013 than in 2012.

*Gains less losses from financial investments* increased by 18% as Balance Sheet Management recognised higher gains on sales of available-for-sale debt securities as a result of the continued re-balancing of the portfolio for risk management purposes in the low interest rate environment.

*Net earned insurance premiums* decreased by US\$159m due to the sale of our US insurance business. The reduction in net earned insurance premiums resulted in a corresponding decrease in *Net insurance claims incurred and movement in liabilities to policyholders*.

*Other operating expense* was US\$108m in 2013 compared with income of US\$408m in 2012. This was primarily due to the loss of US\$424m on the sales of the CML non-real estate personal loan portfolio and several tranches of real estate secured loans. In addition, the decrease reflected the sale of our US insurance business and the non-recurrence of the gain on sale of the full service retail brokerage business in Canada in 2012.



*LICs* decreased by US\$2.3bn to US\$1.2bn, mainly in the US due in part to improvements in housing market conditions. In addition, the decrease reflected lower lending balances from continued run-off and loan sales, and reduced levels of new impaired loans and delinquency in the CML portfolio. US\$322m of the decline in loan impairment charges was due to the sale of the CRS business in 2012. These factors were partly offset by an increase of US\$130m relating to a rise in the estimated average period of time from a loss event occurring to writing off real estate loans to 12 months (previously a period of 10 months was used). In CMB, loan impairment charges increased by US\$77m, reflecting higher collectively assessed charges in the US as a result of increased lending balances in key growth markets and higher individually assessed impairments on a small number of exposures mainly in Canada.

*Operating expenses* were US\$2.5bn, 28% lower than in 2012, primarily due to the non-recurrence of a US\$1.5bn settlement of investigations into inadequate compliance with AML laws in the past, lower average staff numbers and costs following business disposals in the US and Canada, and a reduction in litigation provisions and consultancy expenses in relation to US mortgage foreclosure servicing matters. Resources working on the independent foreclosure review were no longer required following the February 2013 Independent Foreclosure Review Settlement Agreement. We also achieved over US\$330m of sustainable cost savings, primarily reflecting organisational effectiveness initiatives.

## HSBC HOLDINGS PLC

98b

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

	2014						
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	Total US\$m
<i>Profit/(loss) before tax</i>							
Net interest income	2,645	1,455	587	204	157	(33)	5,015
Net fee income/(expense)	497	572	775	130	(34)		1,940
Trading income/(expense) excluding net interest income	(165)	34	302	13	3		187
Net interest income/(expense) on trading activities	7	1	183			33	224
Net trading income/(expense) <sup>50</sup>	(158)	35	485	13	3	33	411
Changes in fair value of long-term debt issued and related derivatives					(99)		(99)
Net income from other financial instruments designated at fair value							
Net expense from financial instruments designated at fair value					(99)		(99)
Gains less losses from financial investments		15	237		5		257

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Dividend income	13	8	16	3	4		44
Net insurance premium income							
Other operating income	268	61	101	1	1,872	(1,719)	584
<b>Total operating income</b>	<b>3,265</b>	<b>2,146</b>	<b>2,201</b>	<b>351</b>	<b>1,908</b>	<b>(1,719)</b>	<b>8,152</b>
Net insurance claims <sup>56</sup>							
<b>Net operating income<sup>4</sup></b>	<b>3,265</b>	<b>2,146</b>	<b>2,201</b>	<b>351</b>	<b>1,908</b>	<b>(1,719)</b>	<b>8,152</b>
Loan impairment (charges)/recoveries and other credit risk provisions	(117)	(148)	(63)	8	(2)		(322)
<b>Net operating income</b>	<b>3,148</b>	<b>1,998</b>	<b>2,138</b>	<b>359</b>	<b>1,906</b>	<b>(1,719)</b>	<b>7,830</b>
Total operating expenses	(2,516)	(1,101)	(2,250)	(274)	(2,007)	1,719	(6,429)
<b>Operating profit/(loss)</b>	<b>632</b>	<b>897</b>	<b>(112)</b>	<b>85</b>	<b>(101)</b>		<b>1,401</b>
Share of profit in associates and joint ventures		16					16
<b>Profit/(loss) before tax</b>	<b>632</b>	<b>913</b>	<b>(112)</b>	<b>85</b>	<b>(101)</b>		<b>1,417</b>
	%	%	%	%	%		%
Share of HSBC s profit before tax	3.4	4.9	(0.6)	0.5	(0.5)		7.6
Cost efficiency ratio	77.1	51.3	102.2	78.1	105.2		78.9

*Balance sheet data*<sup>40</sup>

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net) <sup>27</sup>	60,365	41,966	21,110	6,346		129,787
Total assets	74,680	48,411	319,819	8,386	16,823	436,859
Customer accounts <sup>27</sup>	51,258	45,275	30,301	12,050		138,884

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	2013						
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	Total US\$m
<i>Profit/(loss) before tax</i>							
Net interest income	3,483	1,430	582	195	89	(37)	5,742
Net fee income	605	593	741	125	79		2,143
Trading income excluding net interest income	48	40	613	19	7		727
Net interest income on trading activities	11	1	172			37	221
Net trading income <sup>50</sup>	59	41	785	19	7	37	948
Changes in fair value of long-term debt issued and related derivatives						(288)	(288)
Net income from other financial instruments designated at fair value							
Net expense from financial instruments designated at fair value						(288)	(288)
Gains less losses from financial investments	4		282		8		294
Dividend income	12	9	48	4	4		77
Net insurance premium income	34						34

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Other operating income/(expense)	(454)		229	1	1,829	(1,713)	(108)
Total operating income	3,743	2,073	2,667	344	1,728	(1,713)	8,842
Net insurance claims <sup>56</sup>	(39)						(39)
Net operating income <sup>4</sup>	3,704	2,073	2,667	344	1,728	(1,713)	8,803
Loan impairment charges and other credit risk provisions	(950)	(223)	(20)	(4)			(1,197)
Net operating income	2,754	1,850	2,647	340	1,728	(1,713)	7,606
Total operating expenses	(2,960)	(1,096)	(1,718)	(283)	(2,072)	1,713	(6,416)
Operating profit/(loss)	(206)	754	929	57	(344)		1,190
Share of profit/(loss) in associates and joint ventures	(1)	32					31
Profit/(loss) before tax	(207)	786	929	57	(344)		1,221
	%	%	%	%	%		%
Share of HSBC's profit before tax	(0.9)	3.5	4.1	0.3	(1.6)		5.4
Cost efficiency ratio	79.9	52.9	64.4	82.3	119.9		72.9
<i>Balance sheet data<sup>40</sup></i>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	66,192	37,735	18,070	5,956			127,953
Total assets	82,530	45,706	313,701	8,542	13,211	(31,655)	432,035
Customer accounts <sup>27</sup>	53,600	49,225	24,113	13,871			140,809

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

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

	2012						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking <sup>68</sup> US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income	5,481	1,443	948	192	118	(65)	8,117
Net fee income	923	562	716	124	188		2,513
Trading income/(expense) excluding net interest income	(216)	47	466	20	16		333
Net interest income on trading activities	17	1	91			65	174
Net trading income/(expense) <sup>50</sup>	(199)	48	557	20	16	65	507
Changes in fair value of long-term debt issued and related derivatives					(1,219)		(1,219)
Net income from other financial instruments designated at fair value							
Net expense from financial instruments designated at fair value					(1,219)		(1,219)
Gains less losses from financial investments	27		223	(7)	8		251
Dividend income	15	11	32	3			61

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Net insurance premium income	193						193
Gains on disposal of US branch network and cards business	3,735	277					4,012
Other operating income	173	149	191	5	1,787	(1,899)	406
Total operating income	10,348	2,490	2,667	337	898	(1,899)	14,841
Net insurance claims <sup>56</sup>	(148)						(148)
Net operating income <sup>1</sup>	10,200	2,490	2,667	337	898	(1,899)	14,693
Loan impairment (charges)/recoveries and other credit risk provisions	(3,241)	(148)	(71)	3			(3,457)
Net operating income	6,959	2,342	2,596	340	898	(1,899)	11,236
Total operating expenses	(3,966)	(1,144)	(1,639)	(268)	(3,822)	1,899	(8,940)
Operating profit/(loss)	2,993	1,198	957	72	(2,924)		2,296
Share of profit in associates and joint ventures	2	1					3
Profit/(loss) before tax	2,995	1,199	957	72	(2,924)		2,299
	%	%	%	%	%		%
Share of HSBC s profit before tax	14.5	5.8	4.6	0.3	(14.2)		11.1
Cost efficiency ratio	38.9	45.9	61.5	79.5	425.6		60.8
<i>Balance sheet data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	76,414	36,387	16,217	5,457			134,475
Total assets	101,103	48,604	345,040	8,828	12,659	(25,987)	490,247
Customer accounts <sup>27</sup>	57,758	48,080	22,258	13,553	51		141,700

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

100a

**Table of Contents****Report of the Directors: Financial Review** (continued)**Latin America**

**Our operations in Latin America principally comprise HSBC Bank Brasil S.A.-Banco Múltiplo, HSBC México, S.A. and HSBC Bank Argentina S.A. In addition to banking services, we operate insurance businesses in Brazil, Mexico and Argentina.**

	<b>2014</b>	2013	2012
	<b>US\$m</b>	US\$m	US\$m
Net interest income	<b>5,310</b>	6,186	6,984
Net fee income	<b>1,415</b>	1,701	1,735
Net trading income	<b>856</b>	936	971
Other income	<b>691</b>	1,745	1,261
<b>Net operating income<sup>4</sup></b>	<b>8,272</b>	10,568	10,951
LICs <sup>43</sup>	<b>(2,124)</b>	(2,666)	(2,137)
<b>Net operating income</b>	<b>6,148</b>	7,902	8,814
Total operating expenses	<b>(5,932)</b>	(5,930)	(6,430)
<b>Operating profit</b>	<b>216</b>	1,972	2,384
Income from associates <sup>44</sup>			
<b>Profit before tax</b>	<b>216</b>	1,972	2,384
Cost efficiency ratio	<b>71.7%</b>	56.1%	58.7%
RoRWA <sup>36</sup>	<b>0.2%</b>	2.0%	2.4%
Year-end staff numbers	<b>41,201</b>	42,542	46,556

**Further progress made in repositioning  
our businesses in Brazil and Mexico**

**Loan House and Bond House of the Year**

*(LatinFinance, 2014)*

**#1**

**in Domestic Cash Management**

**in Argentina and Mexico**

*(Euromoney Cash Management Survey, 2014)*



*For footnotes, see page 109.*

## **Economic background**

Data for the third quarter of 2014 suggested that Latin America may have seen a material slowdown in its average real annual GDP growth in 2014 to nearly 1.0% from 2.6% in 2013.

A slowdown in the **Brazilian** economy explains much of this weakness. The level of economic activity was broadly unchanged in 2014 following growth of 2.5% in 2013, but deteriorating business confidence and the resulting contraction in business investment spending were the main factors behind the economic slowdown. To mitigate inflationary pressures from a weakening currency, the central bank raised the key policy rate by 75bps in the fourth quarter to 11.75%.

**Mexico**'s economic growth accelerated in 2014 after low real GDP growth of only 1.1% in 2013. Consumer spending, the main area of weakness in 2013, accelerated during the year and the improvement in US demand served to boost exports. Inflationary pressures remained muted and the Mexican central bank cut its key policy rate to 3% from 3.5% at the start of the year.

The **Argentinian** economy contracted in 2014 due to falling commodity prices, a stagnant Brazilian economy and a technical default on the dollar-denominated external debt of the country. A significant devaluation of the Argentine peso at the beginning of 2014 fuelled higher inflation.

## **Financial overview**

### *Profit before tax (US\$m)*

Latin America reported a profit before tax of US\$216m in 2014 compared with US\$2.0bn in 2013. The reduction was due to lower revenue, primarily driven by the non-recurrence of the US\$1.1bn gain on sale of our operations in Panama in 2013 partly offset by a decrease in LICs.

Adjusted profit before tax decreased by US\$326m, and included a loss before tax in Brazil. The reduction in profit primarily reflected higher operating expenses, mainly due to inflationary and union-agreed salary increases in Brazil and Argentina, and lower revenue in Mexico and Brazil as we progressed with repositioning our business. These factors were partly offset by an increase in revenue in Argentina and a reduction in LICs, primarily in Mexico.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Profit/(loss) before tax by country within global businesses*

	<b>Retail Banking and Wealth Management</b>	<b>Commercial Banking</b>	<b>Global Banking and Markets</b>	<b>Global Private Banking</b>	<b>Other</b>	<b>Total</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>
Argentina	52	135	219		(22)	384
Brazil	(174)	(153)	115	(2)	(33)	(247)
Mexico	36	(52)	89	(2)	(20)	51
Other	(4)	7	27		(2)	28
<b>Year ended 31 December 2014</b>	<b>(90)</b>	<b>(63)</b>	<b>450</b>	<b>(4)</b>	<b>(77)</b>	<b>216</b>
Argentina	97	142	170		(1)	408
Brazil	(114)	(43)	514	5	(11)	351
Mexico	154	(160)	115	(3)	11	117
Other	289	525	368	(1)	(85)	1,096
Year ended 31 December 2013	426	464	1,167	1	(86)	1,972
Argentina	209	169	174		(46)	506
Brazil	94	359	696	17	(43)	1,123
Mexico	338	176	201	2	(18)	699
Other	(33)	47	82	1	(41)	56
Year ended 31 December 2012	608	751	1,153	20	(148)	2,384

**Country business highlights**

In 2014, in our priority growth markets of Brazil, Mexico and Argentina, we continued to implement strategic initiatives to improve future returns whilst we faced economic and inflationary pressures.

In **Brazil**, we made progress in our efforts to transform the business in order to ensure its long-term sustainability. In RBWM, we are updating our business model by concentrating RMs on specific client segments in order to better serve customer needs. We also updated certain features of our lending products to improve our competitiveness such as increasing the duration of some of our personal loans, and further strengthened our retail credit capabilities to improve the quality of originations. We continued to rationalise our branch network, closing 21 branches in areas with lower growth potential as we concentrated our efforts on city clusters with faster-growing revenue pools, and launching 60 client service units with a focus on sales and automated transactions. In CMB, we increased MME market presence

and in RBWM we grew lending by 4% following contraction in the past two years. In addition, we saw increased client activity in GB&M, mainly in our Rates business.

In **Mexico**, we remained focused on achieving sustainable growth although revenue was subdued. In RBWM we introduced RMs dedicated to our Advance segment to improve productivity and customer experience. We launched a balance transfer campaign, selectively increased credit limits for lower risk customers and saw mortgage balances grow by 5% reflecting competitive pricing. In CMB we improved processes in the Business Banking segment to allow RMs to better support their clients. In GB&M, lending balances rose by 48% as a result of new business initiatives following energy reforms in the second half of 2014. We made strong progress on repositioning our business, which has reduced customer numbers, and continued to focus on streamlining, managing our cost

base and strengthening our risk management and controls.

In **Argentina**, we continued to manage our business conservatively as the economic environment remained challenging. We focused our growth on GB&M and corporate CMB customers and continued to follow cautious lending policies in RBWM and Business Banking. We retained leading market positions in Trade and Foreign Exchange.

### Review of adjusted performance<sup>45</sup>

#### Revenue (US\$m)

**Revenue** was higher in Argentina due to favourable results in GB&M and growth in RBWM and CMB. This was partly offset by reductions in Mexico across all global businesses and in Brazil, primarily in CMB and GB&M.

#### Country view of adjusted revenue

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Argentina	<b>1,070</b>	718
Brazil	<b>4,821</b>	4,932
Mexico	<b>2,304</b>	2,479
Other	<b>58</b>	(54)
<b>Year ended 31 December</b>	<b>8,253</b>	8,075

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

In *Argentina*, revenue increased by US\$352m, primarily in GB&M, together with growth in RBWM and CMB. In GB&M, the increase reflected favourable trading results and higher revenue in Balance Sheet Management, as volumes and spreads related to short-term funds grew in a volatile market.

Revenue increased in RBWM, primarily due to growth in insurance revenue from higher investment income which reflected movements in the bond markets. In addition, revenue rose from increased net interest income, driven by wider spreads due to higher interest rates coupled with growth in average deposit balances. In CMB, revenue increased due to growth in net interest income reflecting wider spreads due to an increase in interest rates, higher average lending balances and growth in Payments and Cash Management deposit balances. Higher balances also led to increased fees from both Payments and Cash Management and Trade products.

In *Mexico*, revenue decreased by US\$175m, mainly in RBWM and, to a lesser extent, in CMB and GB&M.

In RBWM, revenue fell primarily due to lower sales volumes in the insurance business. Revenue was also adversely affected as we continued to progress with repositioning the business. In addition, we experienced narrower liability spreads on current accounts, savings and deposits following a decrease in interest rates although the effect was partly offset by higher mortgage balances.

In CMB, net interest income decreased due to asset spread compression and a reduction in average lending balances. This was notably in Business Banking, where we continued to reposition the business, there were pre-payments by a small number of large corporates and a portion of loans to certain homebuilders were written off. Net interest income was also adversely affected by narrower deposit spreads following a decrease in interest rates. In addition, fee income decreased as a result of lower Account Services and Payments and Cash Management fees reflecting fewer customers, as we continued to reposition the business.

In GB&M, lower revenue was primarily due to market movements which affected counterparty credit spreads resulting in increased CVA charges, and lower gains on disposal of available-for-sale securities.

In *Brazil*, revenue decreased in CMB and GB&M, while RBWM remained broadly unchanged. In CMB, revenue was lower, despite growth in overall lending balances, as the portfolio mix changed to reflect an increase in lower-yielding MMEs.

In GB&M, revenue reduced in Balance Sheet Management, though this was partly offset by growth

in Rates revenue, driven by higher client activity. Revenue in RBWM was broadly unchanged. Insurance revenue increased due to favourable movements in the PVIF asset compared with adverse movements in 2013. This was offset by a decrease in fee income across a number of products, in part reflecting a change in mix by customers towards more secured, lower-yielding assets and strong market competition.

LICs fell, primarily in Mexico and, to a lesser extent, in Brazil.

In Mexico, LICs improved due to lower individually assessed charges in CMB, in particular relating to certain homebuilders following a change in the public housing policy in 2013, and in GB&M due to the non-recurrence of a large specific provision booked in 2013.

In Brazil, the fall was driven by changes to the impairment model and assumption revisions for restructured loan account portfolios which occurred in 2013 in both RBWM and CMB. In addition, collectively assessed impairments reduced in CMB, notably in Business Banking, reflecting improved delinquency rates. This was partly offset by an increase in GB&M driven by an individually assessed impairment and a provision made against a guarantee.

*Operating expenses (US\$m)*

**Operating expenses** increased by US\$796m, primarily in Brazil and Argentina, largely due to union-agreed salary increases and inflationary pressures. In addition, we saw higher transactional taxes in Argentina in line with a growth in revenue and increased infrastructure costs across the region. We also incurred specific costs in Brazil in 2014 relating to an accelerated depreciation charge and an impairment of an intangible asset in RBWM. Despite these factors, our strict cost control continued and we progressed with our strategic focus on streamlining, which resulted in sustainable cost savings of over US\$155m.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**2013 compared with 2012****Economic background**

In Latin America, average GDP growth fell to 2.4% in 2013 from 2.9% in 2012. **Brazil**'s GDP growth accelerated from 1% in 2012 to above 2% by the end of 2013. However, this was the third year of below-trend growth. Brazil's growing current account deficit raised concerns during the summer. The resulting capital flight and decline in the currency served to put further upward pressure on prices, pushing CPI inflation above the mid-point of the central bank's target for the fourth consecutive year.

**Mexico** saw a material slowdown in economic activity in 2013, with GDP growth likely to have slowed to 1.3% from 3.9% in 2012. Inflationary pressures remained subdued and Banco de México cut its key policy rate to 3.5% from 4.5% at the start of the year. However, a significant number of structural reforms should aid the long-term performance of the Mexican economy.

The **Argentinian** economy accelerated in 2013 following a good agricultural harvest and a modest recovery in the Brazilian economy. Structural problems became increasingly evident with high inflation and, eventually, currency weakness.

**Review of performance**

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. For comparison, adjusted profit before tax would have been US\$0.8bn and US\$2.1bn for 2013 and 2012 respectively as compared with constant currency profit before tax of US\$2.0bn and US\$2.2bn for 2013 and 2012 respectively and underlying profit before tax of US\$0.7bn and US\$1.9bn for 2013 and 2012 respectively. Constant currency, underlying currency and adjusted are reconciled on pages 105(b) to 105(au).

In Latin America, reported profit before tax of US\$2.0bn was US\$412m lower than in 2012, and US\$239m lower on a constant currency basis.

On an underlying basis, which excludes the US\$1.1bn gain on the sale of our operations in Panama and the effect of other non-strategic business disposals, pre-tax profits decreased by US\$1.2bn. This was driven by a US\$714m rise in loan impairment charges and a decline in revenue of US\$348m, in part reflecting adverse movements in the PVIF asset compared with 2012.

We made significant progress on repositioning our business in the region, with a particular focus on our priority growth markets of Brazil, Mexico and Argentina. We also completed the disposal of operations in Panama, Peru and Paraguay, along with the sale of a portfolio of our non-life insurance assets and liabilities and a non-strategic business in Mexico. We expect to complete the sale of our operations in Colombia and Uruguay in 2014, subject to regulatory approvals. While our performance was affected by slower economic growth and inflationary pressures, we continued to implement the Group's strategy in our core priority markets in order to reposition

our portfolios. We made significant progress in exiting certain businesses and products, strengthening transaction monitoring and account opening, and investing in improved compliance across the region.

In Brazil, we focused on growing secured lending balances for corporates and Premier customers in order to increase connectivity and reduce our risk exposure. We tightened origination criteria in unsecured lending in RBWM, resulting in slower loan growth, and in Business Banking, where volumes declined. We were awarded Best Debt House in Brazil by *Euromoney*, and received the Best Infrastructure Financing in Brazil award from *LatinFinance* in GB&M.

In Mexico, we increased our market share in personal lending, and launched a successful residential mortgage campaign in RBWM. In CMB, we launched a new US\$1bn SME fund to support businesses that trade or aspire to trade internationally, and approved lending of US\$274m. We grew revenue from collaboration between CMB and GB&M by 11%, were awarded the Best Domestic Cash Manager award by *Euromoney* and won two awards for Infrastructure Financing from *LatinFinance*.

In Argentina, we continued to manage our business conservatively as the economic environment remained challenging. We focused on GB&M and corporate CMB customers, and tightened credit origination criteria and strengthened our collections capabilities in Business Banking and RBWM.

*Net interest income* decreased by US\$358m, driven by the effect of the disposal of non-strategic businesses and a decline in Brazil, partly offset by growth in Argentina.

Net interest income decreased in Brazil due to a shift to lower yielding assets in CMB with reduced lending balances in Business Banking as we focused on growing secured balances for corporates. The reduction in net interest income in RBWM reflected lower average lending balances as a result of more restrictive origination criteria, which included reducing credit limits where appropriate, the rundown of non-strategic portfolios and a change in the product mix towards more secured assets. In addition, spreads were narrower in CMB reflecting competition, notably in working capital products. Net interest income also decreased in Balance Sheet Management due to lower reinvestment rates.

In Argentina, higher net interest income was driven by increased average credit card and personal lending balances, coupled with higher deposits in RBWM and CMB, both reflecting successful sales and marketing campaigns launched during 2013.

In Mexico, net interest income remained broadly unchanged. It decreased in CMB reflecting large prepayments relating to a small number of corporates, and in GB&M as maturing investments were renewed at lower reinvestment rates. These falls were offset by an increase in RBWM as the launch of successful sales campaigns resulted in higher average lending balances, notably in payroll and personal lending.

HSBC HOLDINGS PLC

103a

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

*Net fee income* increased by 4%, mainly in Argentina. This was driven by business growth, notably in Payments and Cash Management, and the sale of the non-life insurance business which resulted in the non-recurrence of sales commissions previously paid to third party distribution channels. In Brazil and Mexico, fees rose, mainly in RBWM, where higher volumes and re-pricing initiatives drove fee increases in current accounts and credit cards.

*Net trading income* increased by US\$39m, primarily reflecting favourable results in GB&M in Argentina and Brazil. This was partly offset by lower average trading assets as maturing investments in Brazil were not renewed.

*Net income from financial instruments designated at fair value* decreased by US\$274m, notably in Brazil, as a result of lower investment gains due to market movements. To the extent that these investment gains were attributed to policyholders there was a corresponding movement in *Net insurance claims incurred and movement in liabilities to policyholders*.

*Gains less losses from financial investments* fell by 62% due to lower gains on disposal of available-for-sale government debt securities in Balance Sheet Management and the non-recurrence of the gain on sale of shares in a non-strategic investment in 2012.

*Net earned insurance premiums* decreased by 19%, driven by lower sales of unit-linked pension products in Brazil. Premiums also fell in Argentina as a result of the sale of the non-life insurance business in 2012. The reduction in net earned insurance premiums resulted in a corresponding decrease in *Net insurance claims incurred and movement in liabilities to policyholders*.

*Other operating income* increased by US\$910m, driven by the US\$1.1bn gain on the sale of our operations in Panama. This was partly offset by a significant reduction in the PVIF asset due to an increase in lapse rates and interest rate movements in Brazil and Mexico, and the non-recurrence of the favourable effect of the recognition of a PVIF asset in Brazil in 2012.

*LICs* increased by US\$693m, primarily in Mexico due to specific impairments in CMB relating to homebuilders from a change in the public housing policy, and higher collective impairments in RBWM as a result of increased volumes and higher delinquency in our unsecured lending portfolio. In Brazil, LICs increased due to changes to the impairment model and assumption revisions for restructured loan account portfolios in RBWM and CMB, following a realignment of local practices to Group standard policy. LICs were also adversely affected by higher specific impairments in CMB across a number of corporate exposures. These factors were partly offset by improvements in credit quality in Brazil following the modification of credit strategies in previous years to mitigate rising delinquency rates.

*Operating expenses* decreased by US\$112m as a result of business disposals, continued strict cost control and progress with our organisational effectiveness programmes which resulted in sustainable cost savings of over US\$200m. The decrease was largely offset by the effect of inflationary pressures, union-agreed salary increases in Brazil and Argentina, and higher compliance and risk costs from the implementation of Global Standards and portfolio repositioning, notably in Mexico.



HSBC HOLDINGS PLC

103b

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

	2014						
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	Total US\$m
<i>Profit/(loss) before tax</i>							
Net interest income	3,323	1,529	490	19	9	(60)	5,310
Net fee income	771	469	147	28			1,415
Trading income/(expense) excluding net interest income	123	103	391	3	(1)		619
Net interest income/(expense) on trading activities	1	4	174		(2)	60	237
Net trading income/(expense) <sup>50</sup>	124	107	565	3	(3)	60	856
Changes in fair value of long-term debt issued and related derivatives							
Net income from other financial instruments designated at fair value	516	175					691
Net income from financial instruments designated at fair value	516	175					691
Gains less losses from financial investments			84				84

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Dividend income	6	2	1				9
Net insurance premium income	1,233	285	5				1,523
Other operating income	54	47	19		213	(184)	149
<b>Total operating income</b>	<b>6,027</b>	<b>2,614</b>	<b>1,311</b>	<b>50</b>	<b>219</b>	<b>(184)</b>	<b>10,037</b>
Net insurance claims <sup>56</sup>	(1,410)	(352)	(3)				(1,765)
<b>Net operating income<sup>4</sup></b>	<b>4,617</b>	<b>2,262</b>	<b>1,308</b>	<b>50</b>	<b>219</b>	<b>(184)</b>	<b>8,272</b>
Loan impairment (charges)/ recoveries and other credit risk provisions	(1,091)	(776)	(252)	(5)			(2,124)
<b>Net operating income</b>	<b>3,526</b>	<b>1,486</b>	<b>1,056</b>	<b>45</b>	<b>219</b>	<b>(184)</b>	<b>6,148</b>
Total operating expenses	(3,616)	(1,549)	(606)	(49)	(296)	184	(5,932)
<b>Operating profit/(loss)</b>	<b>(90)</b>	<b>(63)</b>	<b>450</b>	<b>(4)</b>	<b>(77)</b>		<b>216</b>
Share of profit in associates and joint ventures							
<b>Profit/(loss) before tax</b>	<b>(90)</b>	<b>(63)</b>	<b>450</b>	<b>(4)</b>	<b>(77)</b>		<b>216</b>
	%	%	%	%	%		%
Share of HSBC s profit before tax	(0.5)	(0.3)	2.4		(0.5)		1.1
Cost efficiency ratio	78.3	68.5	46.3	98.0	135.2		71.7

*Balance sheet data<sup>40</sup>*

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Loans and advances to customers (net) <sup>27</sup>	12,306	20,078	10,642	96		43,122
Total assets	29,074	29,851	55,827	298	1,155	115,354
Customer accounts <sup>27</sup>	23,056	15,125	8,219	2,188		48,588

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	2013						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	3,776	1,828	775	24	(12)	(205)	6,186
Net fee income	952	548	168	32	1		1,701
Trading income/(expense) excluding net interest income	138	117	456	4	(4)		711
Net interest income on trading activities			20			205	225
Net trading income/(expense) <sup>50</sup>	138	117	476	4	(4)	205	936
Changes in fair value of long-term debt issued and related derivatives							
Net income from other financial instruments designated at fair value	264	61	1				326
Net income from financial instruments designated at fair value	264	61	1				326
Gains less losses from financial investments		1	81				82
Dividend income	5	3	1				9
Net insurance premium income	1,464	360	6				1,830
	312	485	310	1	196	(189)	1,115
Table of Contents							340

Other operating income							
Total operating income	6,911	3,403	1,818	61	181	(189)	12,185
Net insurance claims <sup>56</sup>	(1,323)	(291)	(3)				(1,617)
Net operating income <sup>4</sup>	5,588	3,112	1,815	61	181	(189)	10,568
Loan impairment charges and other credit risk provisions	(1,552)	(1,062)	(52)				(2,666)
Net operating income	4,036	2,050	1,763	61	181	(189)	7,902
Total operating expenses	(3,610)	(1,586)	(596)	(60)	(267)	189	(5,930)
Operating profit/(loss)	426	464	1,167	1	(86)		1,972
Share of profit in associates and joint ventures							
Profit/(loss) before tax	426	464	1,167	1	(86)		1,972
	%	%	%	%	%		%
Share of HSBC's profit before tax	1.9	2.0	5.2		(0.4)		8.7
Cost efficiency ratio	64.6	51.0	32.8	98.4	147.5		56.1
<i>Balance sheet data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and advances to customers (net) <sup>27</sup>	13,616	19,923	10,304	75			43,918
Total assets	30,584	30,001	52,977	337	634	(534)	113,999
Customer accounts <sup>27</sup>	23,943	16,593	8,994	1,859			51,389

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

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

	2012						Total US\$m
	Retail Banking and Wealth Management US\$m	Commercial Banking US\$m	Global Banking and Markets US\$m	Global Private Banking US\$m	Other US\$m	Inter- segment elimination <sup>55</sup> US\$m	
<i>Profit/(loss) before tax</i>							
Net interest income/(expense)	4,145	2,173	993	30	(2)	(355)	6,984
Net fee income	873	622	207	33			1,735
Trading income excluding net interest income	85	99	398	3	1		586
Net interest income on trading activities			29		1	355	385
Net trading income <sup>50</sup>	85	99	427	3	2	355	971
Changes in fair value of long-term debt issued and related derivatives							
Net income from other financial instruments designated at fair value	503	163	1				667
Net income from financial instruments designated at fair value	503	163	1				667
Gains less losses from financial	75	21	131				227

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

investments							
Dividend income	9	5	1				15
Net insurance							
premium income	1,985	450	17				2,452
Other operating							
income/(expense)	309	(9)	6	3	134	(190)	253
Total operating							
income	7,984	3,524	1,783	69	134	(190)	13,304
Net insurance							
claims <sup>56</sup>	(1,875)	(469)	(9)				(2,353)
Net operating							
income <sup>1</sup>	6,109	3,055	1,774	69	134	(190)	10,951
Loan impairment							
charges and other							
credit risk							
provisions	(1,541)	(581)	(13)	(2)			(2,137)
Net operating							
income	4,568	2,474	1,761	67	134	(190)	8,814
Total operating							
expenses	(3,960)	(1,723)	(608)	(47)	(282)	190	(6,430)
Operating							
profit/(loss)	608	751	1,153	20	(148)		2,384
Share of profit in							
associates and							
joint ventures							
Profit/(loss) before							
tax	608	751	1,153	20	(148)		2,384
	%	%	%	%	%		%
Share of HSBC's							
profit before tax	2.9	3.6	5.6	0.1	(0.7)		11.6
Cost efficiency							
ratio	64.8	56.4	34.3	68.1	210.4		58.7
<i>Balance sheet</i>							
<i>data</i> <sup>40</sup>							
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Loans and							
advances to							
customers (net) <sup>27</sup>	17,236	25,379	10,899	91			53,605
Total assets	36,141	35,507	58,272	570	1,110	(323)	131,277
Customer							
accounts <sup>27</sup>	28,688	20,834	11,192	4,430			65,144
<i>For footnotes, see page 109.</i>							

HSBC HOLDINGS PLC





**Table of Contents****Report of the Directors: Financial Review** (continued)**Reconciliation of reported and adjusted items for 2014****Global businesses****Retail Banking and Wealth Management***Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>24,594</b>	26,740	(8)
Currency translation adjustment <sup>74</sup>		(393)	
Acquisitions, disposals and dilutions	<b>(16)</b>	(572)	
Other significant items	<b>893</b>	477	
Adjusted	<b>25,471</b>	26,252	(3)
LICs			
Reported	<b>(1,819)</b>	(3,227)	44
Currency translation adjustment <sup>74</sup>		152	
Acquisitions, disposals and dilutions	<b>2</b>	65	
Other significant items			
Adjusted	<b>(1,817)</b>	(3,010)	40
Operating expenses			
Reported	<b>(17,522)</b>	(17,248)	(2)
Currency translation adjustment <sup>74</sup>		262	
Acquisitions, disposals and dilutions	<b>21</b>	275	
Other significant items	<b>1,097</b>	1,031	
Adjusted	<b>(16,404)</b>	(15,680)	(5)
Adjusted cost efficiency ratio	<b>64.4%</b>	59.7%	
Share of profit in associates and joint ventures			
Reported	<b>398</b>	384	4
Currency translation adjustment <sup>74</sup>			
Acquisitions, disposals and dilutions		13	

Other significant items			
Adjusted	<b>398</b>	397	
Profit before tax			
Reported	<b>5,651</b>	6,649	(15)
Currency translation adjustment <sup>74</sup>		21	
Acquisitions, disposals and dilutions	<b>7</b>	(219)	
Other significant items	<b>1,990</b>	1,508	
Adjusted	<b>7,648</b>	7,959	(4)

*Reconciliation of reported and adjusted average risk-weighted assets*

	<b>2014</b>	2013	
	<b>US\$bn</b>	US\$bn	
Average RWAs			
Average reported RWAs	<b>220</b>	252	(13)
Currency translation adjustment <sup>77</sup>		(2)	
Acquisitions, disposals and dilutions	<b>(1)</b>	(4)	
Other significant items		(4)	
Average adjusted RWAs	<b>219</b>	242	(10)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105b

**Table of Contents****Report of the Directors: Financial Review** (continued)**Principal RBWM business**

The Principal RBWM business measure excludes the effects of the US run-off portfolio. We believe that looking at the Principal RBWM business without the run-off business allows management to more clearly discuss the cause of material changes from year to year in the

ongoing business and assess the factors and trends in the business which are expected to have a material effect in future years. Tables which reconcile reported RBWM financial measures to Principal RBWM financial measures are provided below.

**Reconciliation of reported and adjusted items***US run-off*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>1,337</b>	1,672	(20)
Currency translation adjustment <sup>74</sup>			
Acquisitions, disposals and dilutions		105	
Other significant items	<b>149</b>	278	
Adjusted	<b>1,486</b>	2,055	(28)
LICs			
Reported	<b>(30)</b>	(705)	96
Currency translation adjustment <sup>74</sup>			
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>(30)</b>	(705)	96
Operating expenses			
Reported	<b>(738)</b>	(1,166)	37
Currency translation adjustment <sup>74</sup>			
Acquisitions, disposals and dilutions		14	
Other significant items	<b>19</b>	113	
Adjusted	<b>(719)</b>	(1,039)	31

Adjusted cost efficiency ratio	<b>48.4%</b>	50.6%	
Profit/(loss) before tax			
Reported	<b>569</b>	(200)	
Currency translation adjustment <sup>74</sup>			
Acquisitions, disposals and dilutions		120	
Other significant items	<b>168</b>	391	
Adjusted	<b>737</b>	311	137

*Reconciliation of reported and adjusted average risk-weighted assets*

*US run-off*

	<b>2014</b>	2013	
	<b>US\$bn</b>	US\$bn	
Average RWAs			
Average reported RWAs	<b>67</b>	92	(27)
Currency translation adjustment <sup>77</sup>			
Acquisitions, disposals and dilutions			
Other significant items		(4)	
Average adjusted RWAs	<b>67</b>	88	(24)

*Card and Retail Services*

	<b>2014</b>	2013	
	<b>US\$bn</b>	US\$bn	
Average RWAs			
Average reported RWAs		4	(100)
Currency translation adjustment <sup>77</sup>			
Acquisitions, disposals and dilutions			
Other significant items			
Average adjusted RWAs		4	(100)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105c

**Table of Contents****Report of the Directors: Financial Review** (continued)**Principal RBWM**<sup>78</sup>

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>23,257</b>	25,068	(7)
Currency translation adjustment <sup>74</sup>		(393)	
Acquisitions, disposals and dilutions	<b>(16)</b>	(677)	
Significant items			
Other significant items	<b>744</b>	199	
Adjusted	<b>23,985</b>	24,197	(1)
LICs			
Reported	<b>(1,789)</b>	(2,522)	29
Currency translation adjustment <sup>74</sup>		152	
Acquisitions, disposals and dilutions	<b>2</b>	65	
Other significant items			
Adjusted	<b>(1,787)</b>	(2,305)	22
Operating expenses			
Reported	<b>(16,784)</b>	(16,082)	(4)
Currency translation adjustment <sup>74</sup>		262	
Acquisitions, disposals and dilutions	<b>21</b>	261	
Other significant items	<b>1,078</b>	918	
Adjusted	<b>(15,685)</b>	(14,641)	(7)
Adjusted cost efficiency ratio	<b>65.4%</b>	60.5%	
Profit before tax			
Reported	<b>5,082</b>	6,849	(26)
Currency translation adjustment <sup>74</sup>		21	
Acquisitions, disposals and dilutions	<b>7</b>	(339)	
Other significant items	<b>1,822</b>	1,117	
Adjusted	<b>6,911</b>	7,648	(10)

*Reconciliation of reported and adjusted average risk-weighted assets*

*Principal RBWM*

	<b>2014</b>	2013	
	<b>US\$bn</b>	US\$bn	
Average RWAs			
Average reported RWAs	<b>152</b>	156	(3)
Currency translation adjustment <sup>77</sup>		(2)	
Acquisitions, disposals and dilutions		(4)	
Other significant items			
Average adjusted RWAs	<b>152</b>	150	1

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105d

**Table of Contents****Report of the Directors: Financial Review** (continued)**Commercial Banking***Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>16,303</b>	16,365	
Currency translation adjustment <sup>74</sup>		(243)	
Acquisitions, disposals and dilutions	<b>(14)</b>	(643)	
Other significant items	<b>23</b>		
Adjusted	<b>16,312</b>	15,479	5
LICs			
Reported	<b>(1,675)</b>	(2,384)	30
Currency translation adjustment <sup>74</sup>		42	
Acquisitions, disposals and dilutions	<b>(2)</b>	2	
Other significant items			
Adjusted	<b>(1,677)</b>	(2,340)	28
Operating expenses			
Reported	<b>(7,489)</b>	(7,049)	(6)
Currency translation adjustment <sup>74</sup>		164	
Acquisitions, disposals and dilutions	<b>14</b>	101	
Other significant items	<b>175</b>	19	
Adjusted	<b>(7,300)</b>	(6,765)	(8)
Adjusted cost efficiency ratio	<b>44.8%</b>	43.7%	
Share of profit in associates and joint ventures			
Reported	<b>1,605</b>	1,509	6
Currency translation adjustment <sup>74</sup>		8	
Acquisitions, disposals and dilutions		19	
Other significant items			
Adjusted	<b>1,605</b>	1,536	4
Profit before tax			
Reported	<b>8,744</b>	8,441	4

Currency translation adjustment <sup>74</sup>		(29)	
Acquisitions, disposals and dilutions	(2)	(521)	
Other significant items	198	19	
Adjusted	8,940	7,910	13

*Reconciliation of reported and adjusted average risk-weighted assets*

	2014	2013	
	US\$bn	US\$bn	
Average RWAs			
Average reported RWAs	419	389	8
Currency translation adjustment <sup>77</sup>		(3)	
Acquisitions, disposals and dilutions	(1)	(11)	
Other significant items			
Average adjusted RWAs	418	375	12

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105e



**Table of Contents****Report of the Directors: Financial Review** (continued)**Global Banking and Markets***Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>17,778</b>	19,176	(7)
Currency translation adjustment <sup>74</sup>		(62)	
Acquisitions, disposals and dilutions	<b>(12)</b>	(494)	
Other significant items	<b>340</b>	(88)	
Adjusted	<b>18,106</b>	18,532	(2)
LICs			
Reported	<b>(365)</b>	(207)	(76)
Currency translation adjustment <sup>74</sup>		(23)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>(365)</b>	(230)	(59)
Operating expenses			
Reported	<b>(12,028)</b>	(9,960)	(21)
Currency translation adjustment <sup>74</sup>		(44)	
Acquisitions, disposals and dilutions	<b>5</b>	78	
Other significant items	<b>1,892</b>	364	
Adjusted	<b>(10,131)</b>	(9,562)	(6)
Adjusted cost efficiency ratio	<b>56.0%</b>	51.6%	
Share of profit in associates and joint ventures			
Reported	<b>504</b>	432	17
Currency translation adjustment <sup>74</sup>		2	
Acquisitions, disposals and dilutions		34	
Other significant items			
Adjusted	<b>504</b>	468	8
Profit before tax			
Reported	<b>5,889</b>	9,441	(38)

Currency translation adjustment <sup>74</sup>		(127)	
Acquisitions, disposals and dilutions	(7)	(382)	
Other significant items	2,232	276	
Adjusted	8,114	9,208	(12)

*Reconciliation of reported and adjusted average risk-weighted assets*

	2014	2013	
	US\$bn	US\$bn	
Average RWAs			
Average reported RWAs	511	417	23
Currency translation adjustment <sup>77</sup>		(3)	
Acquisitions, disposals and dilutions	(1)	(5)	
Other significant items			
Average adjusted RWAs	510	409	25

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105f

**Table of Contents****Report of the Directors: Financial Review** (continued)

## Legacy Credit

*Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>(2)</b>	149	
Currency translation adjustment <sup>74</sup>		(3)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>(2)</b>	146	
LICs			
Reported	<b>349</b>	206	69
Currency translation adjustment <sup>74</sup>		7	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>349</b>	213	64
Operating expenses			
Reported	<b>(708)</b>	(170)	
Currency translation adjustment <sup>74</sup>		(3)	
Acquisitions, disposals and dilutions			
Other significant items	<b>533</b>		
Adjusted	<b>(175)</b>	(173)	(1)
Profit/(loss) before tax			
Reported	<b>(361)</b>	185	
Currency translation adjustment <sup>74</sup>		1	
Acquisitions, disposals and dilutions			
Other significant items	<b>533</b>		
Adjusted	<b>172</b>	186	(8)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105g

**Table of Contents****Report of the Directors: Financial Review** (continued)

## Global Banking and Markets excluding Legacy Credit

*Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>17,780</b>	19,027	(7)
Currency translation adjustment <sup>74</sup>		(59)	
Acquisitions, disposals and dilutions	<b>(12)</b>	(494)	
Other significant items	<b>340</b>	(88)	
Adjusted	<b>18,108</b>	18,386	(2)
LICs			
Reported	<b>(714)</b>	(413)	(73)
Currency translation adjustment <sup>74</sup>		(30)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>(714)</b>	(443)	(61)
Operating expenses			
Reported	<b>(11,320)</b>	(9,790)	(16)
Currency translation adjustment <sup>74</sup>		(41)	
Acquisitions, disposals and dilutions	<b>5</b>	78	
Other significant items	<b>1,359</b>	364	
Adjusted	<b>(9,956)</b>	(9,389)	(6)
Adjusted cost efficiency ratio	<b>55.0%</b>	51.1%	
Profit before tax			
Reported	<b>6,250</b>	9,256	(32)
Currency translation adjustment <sup>74</sup>		(128)	
Acquisitions, disposals and dilutions	<b>(7)</b>	(382)	
Other significant items	<b>1,699</b>	276	
Adjusted	<b>7,942</b>	9,022	(12)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105h

**Table of Contents****Report of the Directors: Financial Review** (continued)

## Global Private Banking

*Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>2,377</b>	2,439	(3)
Currency translation adjustment <sup>74</sup>		12	
Acquisitions, disposals and dilutions		(5)	
Other significant items	<b>41</b>	279	
Adjusted	<b>2,418</b>	2,725	(11)
LICs			
Reported	<b>8</b>	(31)	
Currency translation adjustment <sup>74</sup>		(2)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>8</b>	(33)	
Operating expenses			
Reported	<b>(1,778)</b>	(2,229)	20
Currency translation adjustment <sup>74</sup>		(6)	
Acquisitions, disposals and dilutions		4	
Other significant items	<b>71</b>	425	
Adjusted	<b>(1,707)</b>	(1,806)	5
Adjusted cost efficiency ratio	<b>70.6%</b>	66.3%	
Share of profit in associates and joint ventures			
Reported	<b>19</b>	14	36
Currency translation adjustment <sup>74</sup>			
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>19</b>	14	36
Profit before tax			
Reported	<b>626</b>	193	224

Currency translation adjustment <sup>74</sup>		4	
Acquisitions, disposals and dilutions		(1)	
Other significant items	<b>112</b>	704	
Adjusted	<b>738</b>	900	(18)

*Reconciliation of reported and adjusted average risk-weighted assets*

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
Average RWAs		
Average reported RWAs	<b>22</b>	22
Currency translation adjustment <sup>33</sup>		
Acquisitions, disposals and dilutions		
Other significant items		
Average adjusted RWAs	<b>22</b>	22

*For footnotes, see page 109.*

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Other***Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>6,365</b>	5,651	13
Currency translation adjustment <sup>74</sup>		(60)	
Own credit spread <sup>75</sup>	<b>(417)</b>	1,246	
Acquisitions, disposals and dilutions	<b>33</b>	(1,043)	
Other significant items	<b>(117)</b>	(1,262)	
Adjusted	<b>5,864</b>	4,532	29
Operating expenses			
Reported	<b>(8,601)</b>	(7,796)	(10)
Currency translation adjustment <sup>74</sup>		32	
Acquisitions, disposals and dilutions		30	
Other significant items	<b>120</b>	199	
Adjusted	<b>(8,481)</b>	(7,535)	(13)
Adjusted cost efficiency ratio	<b>144.6%</b>	166.3%	
Loss before tax			
Reported	<b>(2,230)</b>	(2,159)	(3)
Currency translation adjustment <sup>74</sup>		(28)	
Own credit spread <sup>75</sup>	<b>(417)</b>	1,246	
Acquisitions, disposals and dilutions	<b>33</b>	(992)	
Other significant items	<b>3</b>	(1,063)	
Adjusted	<b>(2,611)</b>	(2,996)	13

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105j

**Table of Contents****Report of the Directors: Financial Review** (continued)**Geographical regions****Europe***Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>21,571</b>	20,967	3
Currency translation adjustment <sup>74</sup>		651	
Own credit spread <sup>75</sup>	<b>(393)</b>	1,015	
Acquisitions, disposals and dilutions		(51)	
Other significant items	<b>1,101</b>	(379)	
Adjusted	<b>22,279</b>	22,203	
LICs			
Reported	<b>(764)</b>	(1,530)	50
Currency translation adjustment <sup>74</sup>		(54)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>(764)</b>	(1,584)	52
Operating expenses			
Reported	<b>(20,217)</b>	(17,613)	(15)
Currency translation adjustment <sup>74</sup>		(376)	
Acquisitions, disposals and dilutions		28	
Other significant items	<b>2,601</b>	1,637	
Adjusted	<b>(17,616)</b>	(16,324)	(8)
Adjusted cost efficiency ratio	<b>79.1%</b>	73.5%	
Profit before tax			
Reported	<b>596</b>	1,825	(67)
Currency translation adjustment <sup>74</sup>		221	
Own credit spread <sup>75</sup>	<b>(393)</b>	1,015	

Acquisitions, disposals and dilutions		(18)	
Other significant items	<b>3,702</b>	1,258	
Adjusted	<b>3,905</b>	4,301	(9)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105k

**Table of Contents****Report of the Directors: Financial Review** (continued)**Asia**<sup>76</sup>*Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>23,677</b>	24,432	(3)
Currency translation adjustment <sup>74</sup>		(280)	
Own credit spread <sup>75</sup>	<b>4</b>	2	
Acquisitions, disposal and dilutions	<b>32</b>	(1,139)	
Other significant items	<b>(84)</b>	(561)	
Adjusted	<b>23,629</b>	22,454	5
LICs			
Reported	<b>(647)</b>	(498)	(30)
Currency translation adjustment <sup>74</sup>		18	
Acquisitions, disposal and dilutions			
Other significant items			
Adjusted	<b>(647)</b>	(480)	(35)
Operating expenses			
Reported	<b>(10,427)</b>	(9,936)	(5)
Currency translation adjustment <sup>74</sup>		127	
Acquisitions, disposal and dilutions		72	
Other significant items	<b>58</b>	121	
Adjusted	<b>(10,369)</b>	(9,616)	(8)
Adjusted cost efficiency ratio	<b>43.9%</b>	42.8%	
Share of profit in associates and joint ventures			
Reported	<b>2,022</b>	1,855	9
Currency translation adjustment <sup>74</sup>		14	
Acquisitions, disposal and dilutions		82	
Other significant items			
Adjusted	<b>2,022</b>	1,951	4
Profit before tax			

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Reported	<b>14,625</b>	15,853	(8)
Currency translation adjustment <sup>74</sup>		(121)	
Own credit spread <sup>75</sup>	<b>4</b>	2	
Acquisitions, disposal and dilutions	<b>32</b>	(985)	
Other significant items	<b>(26)</b>	(440)	
Adjusted	<b>14,635</b>	14,309	2

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

1051

**Table of Contents****Report of the Directors: Financial Review** (continued)

## Middle East and North Africa

*Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>2,548</b>	2,503	2
Currency translation adjustment <sup>74</sup>		(13)	
Own credit spread <sup>75</sup>	<b>6</b>	4	
Acquisitions, disposals and dilutions	<b>(14)</b>	(90)	
Other significant items	<b>5</b>	(2)	
Adjusted	<b>2,545</b>	2,402	6
LICs			
Reported	<b>6</b>	42	(86)
Currency translation adjustment <sup>74</sup>		6	
Acquisitions, disposals and dilutions	<b>(2)</b>	6	
Other significant items			
Adjusted	<b>4</b>	48	(92)
Operating expenses			
Reported	<b>(1,216)</b>	(1,289)	6
Currency translation adjustment <sup>74</sup>		6	
Acquisitions, disposals and dilutions	<b>31</b>	65	
Other significant items	<b>2</b>	4	
Adjusted	<b>(1,183)</b>	(1,214)	3
Adjusted cost efficiency ratio	<b>46.5%</b>	50.5%	
Share of profit in associates and joint ventures			
Reported	<b>488</b>	438	11
Currency translation adjustment <sup>74</sup>		(1)	
Acquisitions, disposal and dilutions			
Other significant items			
Adjusted	<b>488</b>	437	12
Profit before tax			
Reported	<b>1,826</b>	1,694	8
Currency translation adjustment <sup>74</sup>		(8)	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Own credit spread <sup>75</sup>	<b>6</b>	4	
Acquisitions, disposals and dilutions	<b>15</b>	(19)	
Other significant items	<b>7</b>	2	
Adjusted	<b>1,854</b>	1,673	11

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105m

**Table of Contents****Report of the Directors: Financial Review** (continued)

## North America

*Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>8,152</b>	8,803	(7)
Currency translation adjustment <sup>74</sup>		(139)	
Own credit spread <sup>75</sup>	<b>(34)</b>	225	
Acquisitions, disposals and dilutions		89	
Other significant items	<b>150</b>	361	
Adjusted	<b>8,268</b>	9,339	(11)
LICs			
Reported	<b>(322)</b>	(1,197)	73
Currency translation adjustment <sup>74</sup>		13	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>(322)</b>	(1,184)	73
Operating expenses			
Reported	<b>(6,429)</b>	(6,416)	
Currency translation adjustment <sup>74</sup>		65	
Acquisitions, disposals and dilutions		14	
Other significant items	<b>578</b>	201	
Adjusted	<b>(5,851)</b>	(6,136)	5
Adjusted cost efficiency ratio	<b>70.8%</b>	65.7%	
Profit before tax			
Reported	<b>1,417</b>	1,221	16
Currency translation adjustment <sup>74</sup>		(63)	
Own credit spread <sup>75</sup>	<b>(34)</b>	225	
Acquisitions, disposals and dilutions		103	
Other significant items	<b>728</b>	562	
Adjusted	<b>2,111</b>	2,048	3

*For footnotes, see page 109.*



HSBC HOLDINGS PLC

105n

**Table of Contents****Report of the Directors: Financial Review** (continued)**Latin America***Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>8,272</b>	10,568	(22)
Currency translation adjustment <sup>74</sup>		(914)	
Own credit spread <sup>75</sup>			
Acquisitions, disposals and dilutions	<b>(27)</b>	(1,566)	
Other significant items	<b>8</b>	(13)	
Adjusted	<b>8,253</b>	8,075	2
LICs			
Reported	<b>(2,124)</b>	(2,666)	20
Currency translation adjustment <sup>74</sup>		191	
Acquisitions, disposals and dilutions	<b>2</b>	61	
Other significant items			
Adjusted	<b>(2,122)</b>	(2,414)	12
Operating expenses			
Reported	<b>(5,932)</b>	(5,930)	
Currency translation adjustment <sup>74</sup>		535	
Acquisitions, disposals and dilutions	<b>9</b>	309	
Other significant items	<b>116</b>	75	
Adjusted	<b>(5,807)</b>	(5,011)	(16)
Adjusted cost efficiency ratio	<b>70.4%</b>	62.1%	
Profit before tax			
Reported	<b>216</b>	1,972	(89)
Currency translation adjustment <sup>74</sup>		(188)	
Acquisitions, disposals and dilutions	<b>(16)</b>	(1,196)	
Other significant items	<b>124</b>	62	
Adjusted	<b>324</b>	650	(50)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105o

**Table of Contents****Report of the Directors: Financial Review** (continued)**Home markets****UK***Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>15,727</b>	14,253	10
Currency translation adjustment <sup>74</sup>		789	
Own credit spread <sup>75</sup>	<b>(474)</b>	1,011	
Acquisitions, disposals and dilutions		(51)	
Other significant items	<b>827</b>	(637)	
Adjusted	<b>16,080</b>	15,365	5
LICs			
Reported	<b>(214)</b>	(1,003)	79
Currency translation adjustment <sup>74</sup>		(83)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>(214)</b>	(1,086)	80
Operating expenses			
Reported	<b>(15,576)</b>	(12,096)	(29)
Currency translation adjustment <sup>74</sup>		(455)	
Acquisitions, disposals and dilutions		28	
Other significant items	<b>2,553</b>	909	
Adjusted	<b>(13,023)</b>	(11,614)	(12)
Adjusted cost efficiency ratio	<b>81.0%</b>	75.6%	
Profit/(loss) before tax			
Reported	<b>(56)</b>	1,160	
Currency translation adjustment <sup>74</sup>		251	
Own credit spread <sup>75</sup>	<b>(474)</b>	1,011	
Acquisitions, disposals and dilutions		(18)	

Other significant items	<b>3,380</b>	272	
Adjusted	<b>2,850</b>	2,676	7

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105p

**Table of Contents****Report of the Directors: Financial Review** (continued)**Hong Kong***Reconciliation of reported and adjusted items*

	<b>2014</b>	2013	Change <sup>72</sup>
	<b>US\$m</b>	US\$m	%
Revenue <sup>73</sup>			
Reported	<b>13,844</b>	13,203	5
Currency translation adjustment <sup>74</sup>		5	
Own credit spread <sup>75</sup>	<b>1</b>	1	
Acquisitions, disposals and dilutions			
Other significant items	<b>(120)</b>	2	
Adjusted	<b>13,725</b>	13,211	4
LICs			
Reported	<b>(320)</b>	(137)	(134)
Currency translation adjustment <sup>74</sup>			
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	<b>(320)</b>	(137)	(134)
Operating expenses			
Reported	<b>(5,424)</b>	(5,045)	(8)
Currency translation adjustment <sup>74</sup>		(1)	
Acquisitions, disposals and dilutions			
Other significant items	<b>56</b>	41	
Adjusted	<b>(5,368)</b>	(5,005)	(7)
Adjusted cost efficiency ratio	<b>39.1%</b>	37.9%	
Profit before tax			
Reported	<b>8,142</b>	8,089	1
Currency translation adjustment <sup>74</sup>		3	
Own credit spread <sup>75</sup>	<b>1</b>	1	
Acquisitions, disposals and dilutions			
Other significant items	<b>(64)</b>	43	
Adjusted	<b>8,079</b>	8,136	(1)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105q

**Table of Contents****Report of the Directors: Financial Review** (continued)*Other significant items affecting adjusted performance*

	2014	
	UK	Hong Kong
Revenue		
Debit valuation adjustment on derivative contracts	203	26
Fair value movements on non-qualifying hedges	(8)	11
Gain on sale of shareholding in Bank of Shanghai		(428)
Impairment on our investment in Industrial Bank		271
Provision arising from the ongoing review of compliance with the Consumer Credit Act in the UK	632	
	827	(120)
Operating expenses		
Settlements and provisions in connection with foreign exchange investigations	1,187	
Restructuring and other related costs	91	7
Regulatory provisions in GBP		49
UK customer redress programmes	1,275	
	2,553	56
	2013	
	UK	Hong Kong
Revenue		
Debit valuation adjustment on derivative contracts	(78)	(12)
Fair value movements on non-qualifying hedges	(263)	14
FX gains relating to sterling debt issued by HSBC Holdings	(442)	
Loss on sale of an HFC Bank UK secured loan portfolio	146	
	(637)	2
Operating expenses		
Accounting gain arising from change in basis of delivering ill-health benefits in the UK	(430)	
Restructuring and other related costs	104	6
Regulatory provisions in GBP		35
UK customer redress programmes	1,235	
	909	41

HSBC HOLDINGS PLC





---

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**2013 compared with 2012**

**Use of non-GAAP financial measures**

Our reported results are prepared in accordance with IFRSs as detailed in the Financial Statements starting on page 334. In measuring our performance, the financial measures that we use include those which have been derived from our reported results in order to eliminate factors which distort year-on-year comparisons. These are considered non-GAAP financial measures. Non-GAAP financial measures that we use throughout our Financial Review and are described below. Other non-GAAP financial measures are described and reconciled to the closest reported financial measure when used.

**Constant currency**

Foreign currency translation differences reflect the movements of the US dollar against most major currencies during 2013. We exclude the translation differences when using constant currency because it allows us to assess balance sheet and income statement performance on a like-for-like basis to better understand the underlying trends in the business.

Constant currency

Constant currency comparatives for 2012 referred to in the commentaries are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

the income statements for 2012 at the average rates of exchange for 2013; and

the balance sheet at 31 December 2012 at the prevailing rates of exchange on 31 December 2013.

No adjustment has been made to the exchange rates used to translate foreign currency denominated assets and liabilities into the functional currencies of any HSBC branches, subsidiaries, joint ventures or associates. When reference is made to constant currency in tables or commentaries, comparative data reported in the functional

currencies of HSBC's operations have been translated at the appropriate exchange rates applied in the current year on the basis described above.

HSBC HOLDINGS PLC

105s

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported and constant currency profit before tax*

	2013 compared with 2012					
	2012 as reported	Currency translation adjustment <sup>74</sup>	at 2013 exchange rates	2013 as reported	Reported change <sup>72</sup>	Constant currency change <sup>72</sup>
	US\$m	US\$m	US\$m	US\$m	%	%
HSBC						
Net interest income	37,672	(682)	36,990	35,539	(6)	(4)
Net fee income	16,430	(203)	16,227	16,434		1
Net trading income	7,091	(164)	6,927	8,690	23	25
Own credit spread <sup>75</sup>	(5,215)	12	(5,203)	(1,246)	76	76
Other income/(expense) from financial instruments	2,989	(53)	2,936	2,014	(33)	(31)
Net income/(expense) from financial instruments designated at fair value	(2,226)	(41)	(2,267)	768		
Gains on disposal of US branch network, US cards business and Ping An	7,024		7,024		(100)	(100)
Gains less losses from financial investments	1,189	(17)	1,172	2,012	69	72
Net earned insurance	13,044	(118)	12,926	11,940	(8)	(8)

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

premiums						
Other operating income	2,321	(200)	2,121	2,954	27	39
Total operating income	82,545	(1,425)	81,120	78,337	(5)	(3)
Net insurance claims <sup>81</sup>	(14,215)	96	(14,119)	(13,692)	(4)	(3)
Net operating income <sup>73</sup>	68,330	(1,329)	67,001	64,645	(5)	(4)
Loan impairment charges and other credit risk provisions	(8,311)	201	(8,110)	(5,849)	30	28
Net operating income	60,019	(1,128)	58,891	58,796	(2)	
Operating expenses	(42,927)	683	(42,244)	(38,556)	10	9
Operating profit	17,092	(445)	16,647	20,240	18	22
Share of profit in associates and joint ventures	3,557	45	3,602	2,325	(35)	(35)
Profit before tax	20,649	(400)	20,249	22,565	9	11
By global business						
Retail Banking and Wealth Management	9,575	(26)	9,549	6,649	(31)	(30)
Commercial Banking	8,535	(96)	8,439	8,441	(1)	
Global Banking and Markets	8,520	(147)	8,373	9,441	11	13
Global Private Banking	1,009	(16)	993	193	(81)	(81)
Other	(6,990)	(115)	(7,105)	(2,159)	69	70
Profit before tax	20,649	(400)	20,249	22,565	9	11
By geographical region						
Europe	(3,414)	65	(3,349)	1,825		
Asia <sup>76</sup>	18,030	(228)	17,802	15,853	(12)	(11)
Middle East and North Africa	1,350	(36)	1,314	1,694	25	29
North America	2,299	(28)	2,271	1,221	(47)	(46)
Latin America	2,384	(173)	2,211	1,972	(17)	(11)
Profit before tax	20,649	(400)	20,249	22,565	9	11

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105t

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

#### **Underlying performance**

To arrive at underlying performance:

we adjust for the year-on-year effects of foreign currency translation;

we eliminate the fair value movements on our long-term debt attributable to credit spread ( own credit spread ) where the net result of such movements will be zero upon maturity of the debt. This does not include fair value changes due to own credit risk in respect of trading liabilities or derivative liabilities; and

we adjust for acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses.

For acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses, we eliminate the gain or loss on disposal or dilution and any associated gain or loss on reclassification or impairment recognised in the year incurred, and remove the operating profit or loss of the acquired, disposed of or diluted subsidiaries, associates, joint ventures and businesses from all the years presented so we can view results on a like-for-like basis. For example, if a disposal was made in the current year, any gain or loss on disposal, any associated gain or loss on reclassification or impairment recognised and the results of the disposed-of business would be removed from the results of the current year and the previous year as if the disposed-of business did not exist in those years. The disposal of investments other than those included in the above definition does not lead to underlying adjustments.

We use underlying performance to explain year-on-year changes when the effect of fair value movements on own debt, acquisitions, disposals or dilution is significant because we consider that this basis more appropriately reflects operating performance.

#### **Adjusted performance**

Adjusted performance is computed by adjusting reported results for the year-on-year effects of foreign currency translation differences and significant items which distort year-on-year comparisons.

In 2013 we used the non-GAAP financial measure of underlying performance , as described above. In 2014, we modified our approach to better align it with the way we view our performance internally and with feedback received from investors. Adjusted performance builds on underlying performance by maintaining the adjustment for currency translation differences and incorporating the adjustments for own credit spread and acquisitions, disposals and dilutions into the definition of significant items. We use the term significant items to collectively describe the group of individual adjustments which are

excluded from reported results when arriving at adjusted performance. Significant items, which are detailed below, are those items which management and investors would ordinarily identify and consider separately when assessing performance in order to better understand the underlying trends in the business.

We believe adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and quantifying items management believe to be significant and providing insight into how management assesses year-on-year performance.

We arrive at adjusted performance by excluding from our reported results:

the year-on-year effects of foreign currency translation differences. This is done by comparing reported results for 2013 with reported results for 2012 retranslated at 2013 exchange rates. The foreign currency translation differences reflect the movements of the US dollar against most major currencies; and

significant items which distort the year-on-year comparison of reported results by obscuring the underlying factors and trends which affect operations. Significant items include adjustments for own credit spread and acquisitions, disposals and dilutions which were previously part of our underlying measure and are as follows for 2013 as compared with 2012.

The following acquisitions, disposals and changes to ownership levels affected the underlying performance:

HSBC HOLDINGS PLC

105u



**Table of Contents****Report of the Directors: Financial Review** (continued)*Disposal gains/(losses) affecting underlying performance*

	Date	Disposal gain/(loss) US\$m
HSBC Bank Canada's disposal of HSBC Securities (Canada) Inc's full service retail brokerage business <sup>70</sup>	Jan 2012	83
The Hongkong and Shanghai Banking Corporation Limited's disposal of RBWM operations in Thailand <sup>70</sup>	Mar 2012	108
HSBC Finance Corporation, HSBC USA Inc. and HSBC Technology and Services (USA) Inc.'s disposal of US Card and Retail Services business <sup>70</sup>	May 2012	3,148
HSBC Bank USA, N.A.'s disposal of 138 non-strategic branches <sup>70</sup>	May 2012	661
HSBC Argentina Holdings S.A.'s disposal of its non-life insurance manufacturing subsidiary <sup>70</sup>	May 2012	102
The Hongkong and Shanghai Banking Corporation Limited's disposal of its private banking business in Japan <sup>70</sup>	Jun 2012	67
The Hongkong and Shanghai Banking Corporation Limited's disposal of its shareholding in a property company in the Philippines <sup>71</sup>	Jun 2012	130
Hang Seng Bank Limited's disposal of its non-life insurance manufacturing subsidiary <sup>70</sup>	Jul 2012	46
HSBC Bank USA, N.A.'s disposal of 57 non-strategic branches <sup>70</sup>	Aug 2012	203
HSBC Asia Holdings B.V.'s investment loss on a subsidiary <sup>70</sup>	Aug 2012	(85)
HSBC Bank plc's disposal of HSBC Securities SA <sup>1</sup>	Aug 2012	(11)
HSBC Europe (Netherlands) B.V.'s disposal of HSBC Credit Zrt <sup>1</sup>	Aug 2012	(2)
HSBC Europe (Netherlands) B.V.'s disposal of HSBC Insurance (Ireland) Limited <sup>71</sup>	Oct 2012	(12)
HSBC Europe (Netherlands) B.V.'s disposal of HSBC Reinsurance Limited <sup>71</sup>	Oct 2012	7
HSBC Private Bank (UK) Limited's disposal of Property Vision Holdings Limited <sup>71</sup>	Oct 2012	(1)
HSBC Investment Bank Holdings Limited's disposal of its stake in Havas Havalimanlari Yer Hizmetleri Yatirim Holding Anonim Sirketi <sup>71</sup>	Oct 2012	18
HSBC Insurance (Asia) Limited's disposal of its non-life insurance portfolio <sup>70</sup>	Nov 2012	117
HSBC Bank plc's disposal of HSBC Shipping Services Limited <sup>71</sup>	Nov 2012	(2)
HSBC Bank (Panama) S.A.'s disposal of its operations in Costa Rica, El Salvador and Honduras <sup>70</sup>	Dec 2012	(62)
HSBC Insurance Holdings Limited and The Hongkong and Shanghai Banking Corporation Limited's disposal of their shares in Ping An <sup>70</sup>	Dec 2012	3,012
The Hongkong and Shanghai Banking Corporation Limited's disposal of its	Dec 2012	212

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

shareholding in Global Payments Asia-Pacific Limited <sup>70</sup>		
Reclassification gain in respect of our holding in Industrial Bank Co., Limited following the issue of additional share capital to third parties <sup>70</sup>	Jan 2013	1,089
HSBC Insurance (Asia-Pacific) Holdings Limited's disposal of its shareholding in Bao Viet Holdings <sup>70</sup>	Mar 2013	104
Household Insurance Group Holding company's disposal of its insurance manufacturing business <sup>70</sup>	Mar 2013	(99)
HSBC Seguros, S.A. de C.V., Grupo Financiero HSBC's disposal of its property and Casualty Insurance business in Mexico <sup>70</sup>	Apr 2013	20
HSBC Bank plc's disposal of its shareholding in HSBC (Hellas) Mutual Funds Management SA <sup>71</sup>	Apr 2013	(7)
HSBC Insurance (Asia-Pacific) Holdings Limited disposal of its shareholding in Hana HSBC Life Insurance Company Limited <sup>70</sup>	May 2013	28
HSBC Bank plc's disposal of HSBC Assurances IARD <sup>70</sup>	May 2013	(4)
The Hongkong and Shanghai Banking Corporation Limited's disposal of HSBC Life (International) Limited's Taiwan branch operation <sup>74</sup>	June 2013	(36)
HSBC Markets (USA) Inc.'s disposal of its subsidiary, Rutland Plastic Technologies <sup>71</sup>	Aug 2013	17
HSBC Insurance (Singapore) Pte Ltd's disposal of its Employee Benefits Insurance business in Singapore <sup>71</sup>	Aug 2013	(8)
HSBC Investment Bank Holdings plc's disposal of its investment in associate FIP Colorado <sup>71</sup>	Aug 2013	(5)
HSBC Investment Bank Holdings plc group's disposal of its investment in subsidiary, Viking Sea Tech <sup>70</sup>	Aug 2013	54
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Panama) S.A. <sup>71</sup>	Oct 2013	1,107
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Peru) S.A. <sup>71</sup>	Nov 2013	(18)
HSBC Latin America Holdings UK Limited's disposal of HSBC Bank (Paraguay) S.A. <sup>71</sup>	Nov 2013	(21)
Reclassification loss in respect of our holding in Yantai Bank Co., Limited following an increase in its registered share capital <sup>70</sup>	Dec 2013	(38)

*For footnotes, see page 109.*

*Acquisition gains/(losses) affecting the underlying performance<sup>71</sup>*

	Date	Fair value gain on acquisition US\$m
Gain on the merger of Oman International Bank S.A.O.G. and the Omani operations of HSBC Bank Middle East Limited	Jun 2012	3
Gain on the acquisition of the onshore retail and commercial banking business of Lloyds Banking Group in the UAE by HSBC Bank Middle East Limited	Oct 2012	18

*For footnote, see page 109.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

The following table reconciles selected reported items for 2013 and 2012 to the underlying basis. For comparison purposes the reconciliations have been updated to additionally reflect the adjusted basis.

The details of other significant items can be found on page 6.

*Reconciliation of reported, underlying and adjusted items*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported	35,539	37,672	(6)
Currency translation adjustment <sup>74</sup>		(682)	
Acquisitions, disposals and dilutions	(273)	(2,015)	
Underlying	35,266	34,975	1
Other significant items			
Adjusted	35,266	34,975	
Other operating income			
Reported	2,632	2,100	25
Currency translation adjustment <sup>74</sup>		(195)	
Acquisitions, disposals and dilutions	(2,234)	(811)	
Underlying	398	1,094	(64)
Other significant items	819		
Adjusted	1,217	1,094	
Revenue <sup>73</sup>			
Reported	64,645	68,330	(5)
Currency translation adjustment <sup>74</sup>		(1,341)	
Own credit spread <sup>75</sup>	1,246	5,215	
Acquisitions, disposals and dilutions	(2,596)	(10,607)	
Underlying	63,295	61,597	3
Other significant items	(594)	17	
Adjusted	62,701	61,614	

LICs

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Reported	(5,849)	(8,311)	30
Currency translation adjustment <sup>74</sup>		201	
Acquisitions, disposals and dilutions	32	376	
Underlying	(5,817)	(7,734)	25
Other significant items			
Adjusted	(5,817)	(7,734)	
Total operating expenses			
Reported	(38,556)	(42,927)	10
Currency translation adjustment <sup>74</sup>		683	
Acquisitions, disposals and dilutions	353	1,490	
Underlying	(38,203)	(40,754)	6
Other significant items	2,038	5,239	
Adjusted	(36,165)	(35,515)	
Underlying cost efficiency ratio	60.4%	66.2%	
Adjusted cost efficiency ratio	57.7%	57.6%	
Share of profit in associates and joint ventures			
Reported	2,325	3,557	(35)
Currency translation adjustment <sup>74</sup>		45	
Acquisitions, disposals and dilutions	(14)	(1,425)	
Underlying	2,311	2,177	6
Other significant items			
Adjusted	2,311	2,177	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105w

**Table of Contents****Report of the Directors: Financial Review** (continued)

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Profit before tax			
Reported	22,565	20,649	9
Currency translation adjustment <sup>74</sup>		(412)	
Own credit spread <sup>75</sup>	1,246	5,215	
Acquisitions, disposals and dilutions	(2,225)	(10,166)	
Underlying	21,586	15,286	41
Other significant items	1,444	5,256	
Adjusted	23,030	20,542	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105x

**Table of Contents****Report of the Directors: Financial Review** (continued)

The following table details the impact of other significant items in 2013 and 2012 for each of our geographical regions and global businesses.

*Other significant items affecting adjusted performance*    *Losses/(gains)*

				2013		
	Europe	Asia <sup>76</sup>	MENA	North	Latin	Total
	US\$m	US\$m	US\$m	America	America	US\$m
				US\$m	US\$m	US\$m
Revenue						
Net gain on completion of Ping An disposal		(553)				(553)
Debit valuation adjustment on derivative contracts	(65)	(40)	(2)	14	(13)	(106)
Fair value movements on non-qualifying hedges	(297)	32		(246)		(511)
FX gains relating to sterling debt issued by HSBC Holdings	(442)					(442)
Write-off of allocated goodwill relating to the GPB Monaco business	279					279
Gain/(loss) on sale of several tranches of real estate secured accounts in the US				123		123
Loss on sale of non-real estate secured accounts in the US				271		271
Loss on early termination of cash flow hedges in the US run-off portfolio				199		199
Loss on sale of an HFC Bank UK secured loan portfolio	146					146
	(379)	(561)	(2)	361	(13)	(594)
Operating expenses						
Restructuring and other related costs	217	86	4	101	75	483
UK customer redress programmes	1,235					1,235
Madoff-related litigation costs	298					298
Regulatory provisions in GPB	317	35				352
US customer remediation provisions relating to CRS				100		100
Accounting gain arising from change in basis of delivering ill-health benefits in the	(430)					(430)

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

UK	1,637	121	4	201	75	2,038
	RBWM US\$m	CMB US\$m	GB&M US\$m	GPB US\$m	Other US\$m	Total US\$m
Revenue						
Net gain on completion of Ping An disposal					(553)	(553)
Revenue						
Debit valuation adjustment on derivative contracts			(106)			(106)
Fair value movements on non-qualifying hedges	(262)		18		(267)	(511)
FX gains relating to sterling debt issued by HSBC Holdings					(442)	(442)
Write-off of allocated goodwill relating to the GPB Monaco business				279		279
Gain/(loss) on sale of several tranches of real estate secured accounts in the US	123					123
Loss on sale of non-real estate secured accounts in the US	271					271
Loss on early termination of cash flow hedges in the US run-off portfolio	199					199
Loss on sale of an HFC Bank UK secured loan portfolio	146					146
	477		(88)	279	(1,262)	(594)
Operating expenses						
Restructuring and other related costs	167	31	13	73	199	483
UK customer redress programmes	953	148	134			1,235
Madoff-related litigation costs			298			298
Regulatory provisions in GPB				352		352
US customer remediation provisions relating to CRS	100					100
Accounting gain arising from change in basis of delivering ill-health benefits in the UK	(189)	(160)	(81)			(430)
	1,031	19	364	425	199	2,038

HSBC HOLDINGS PLC

105y

**Table of Contents****Report of the Directors: Financial Review** (continued)

	2012					
	Europe	Asia <sup>76</sup>	MENA	North	Latin	Total
	US\$m	US\$m	US\$m	America	America	US\$m
				US\$m	US\$m	US\$m
Revenue						
Debit valuation adjustment on derivative contracts	(303)	(136)	(4)	(58)	(17)	(518)
Fair value movements on non-qualifying hedges	51	51		194		296
Gain on sale of our shares in Indian banks		(314)				(314)
Loss on forward contract relating to Ping An sale		553				553
	(252)	154	(4)	136	(17)	17
Operating expenses						
Fines and penalties for inadequate compliance with anti-money laundering and sanction laws	375			1,546		1,921
North America mortgage foreclosure and servicing costs				104		104
Restructuring and related costs	299	162	27	221	167	876
UK customer redress charges	2,338					2,338
	3,012	162	27	1,871	167	5,239
	RBWM	CMB	GB&M	GPB	Other	Total
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Revenue						
Debit valuation adjustment on derivative contracts			(518)			(518)
Fair value movements on non-qualifying hedges	193		42	(4)	65	296
Gain on sale of our shares in Indian banks					(314)	(314)
Loss on forward contract relating to Ping An sale					553	553
	193		(476)	(4)	304	17



Operating expenses						
Fines and penalties for inadequate compliance with anti-money laundering and sanction laws					1,921	1,921
North America mortgage foreclosure and servicing costs	104					104
Restructuring and related costs	266	62	63	58	427	876
UK customer redress charges	1,751	258	331	(2)		2,338
	2,121	320	394	56	2,348	5,239

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105z

**Table of Contents****Report of the Directors: Financial Review** (continued)**Reconciliation of reported to constant currency, underlying and adjusted items for 2013****Global businesses****Retail Banking and Wealth Management***Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	20,298	(368)	19,930	18,339	(10)	(8)
Net fee income	7,205	(113)	7,092	7,021	(3)	(1)
Net trading income	304	(18)	286	686	126	140
Net income from financial instruments designated at fair value	1,893	(26)	1,867	1,638	(13)	(12)
Gains on disposal of US branch network and cards business	3,735		3,735		(100)	(100)
Gains less losses from financial investments	96	(7)	89	55	(43)	(38)
Net insurance premium	11,191	(68)	11,123	10,543	(6)	(5)

income						
Other						
operating						
income						
(including						
dividend						
income)	1,496	(34)	1,462	565	(62)	(61)
Total						
operating						
income	46,218	(634)	45,584	38,847	(16)	(15)
Net insurance						
claims and						
benefits paid						
and						
movement in						
liabilities to						
policyholders	(12,357)	44	(12,313)	(12,107)	2	2
Net operating						
income <sup>73</sup>	33,861	(590)	33,271	26,740	(21)	(20)
LICs	(5,515)	135	(5,380)	(3,227)	41	40
Net operating						
income	28,346	(455)	27,891	23,513	(17)	(16)
Operating						
expenses	(19,769)	415	(19,354)	(17,248)	13	11
Operating						
profit	8,577	(40)	8,537	6,265	(27)	(27)
Share of						
profit from						
associates and						
joint ventures	998	14	1,012	384	(62)	(62)
Profit before						
tax	9,575	(26)	9,549	6,649	(31)	(30)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105aa

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items RBWM*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported net interest income	18,339	20,298	(10)
Currency translation adjustment <sup>74</sup>		(368)	
Acquisitions, disposals and dilutions	(151)	(1,735)	
Underlying	18,188	18,195	
Other significant items			
Adjusted	18,188	18,195	
Other operating income			
Reported other operating income	544	1,472	(63)
Currency translation adjustment <sup>74</sup>		(33)	
Acquisitions, disposals and dilutions	(312)	(395)	
Underlying	232	1,044	(78)
Other significant items	540		
Adjusted	772	1,044	
Revenue <sup>73</sup>			
Reported revenue	26,740	33,861	(21)
Currency translation adjustment <sup>74</sup>		(590)	
Acquisitions, disposals and dilutions	(494)	(6,447)	
Underlying	26,246	26,824	(2)
Other significant items	477	193	
Adjusted	26,723	27,017	
LICs			
Reported LICs	(3,227)	(5,515)	41
Currency translation adjustment <sup>74</sup>		135	
Acquisitions, disposals and dilutions	33	377	
Underlying	(3,194)	(5,003)	36
Other significant items			
Adjusted	(3,194)	(5,003)	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Operating expenses			
Reported operating expenses	(17,248)	(19,769)	13
Currency translation adjustment <sup>74</sup>		415	
Acquisitions, disposals and dilutions	203	1,176	
Underlying	(17,045)	(18,178)	6
Other significant items	1,031	2,121	
Adjusted	(16,014)	(16,057)	
Underlying cost efficiency ratio	64.9%	67.8%	
Adjusted cost efficiency ratio	59.9%	59.4%	
Share of profit in associates and joint ventures			
Reported	384	998	(62)
Currency translation adjustment <sup>74</sup>		14	
Acquisitions, disposals and dilutions	(6)	(670)	
Underlying	378	342	11
Other significant items			
Adjusted	378	342	
Profit before tax			
Reported profit before tax	6,649	9,575	(31)
Currency translation adjustment <sup>74</sup>		(26)	
Acquisitions, disposals and dilutions	(264)	(5,565)	
Underlying	6,385	3,984	60
Other significant items	1,508	2,314	
Adjusted	7,893	6,298	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105ab

**Table of Contents****Report of the Directors: Financial Review** (continued)**Principal Retail Banking and Wealth Management business**<sup>76</sup>*Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	16,468	(368)	16,100	16,278	(1)	1
Net fee income	6,777	(113)	6,664	7,010	3	5
Other income <sup>80</sup>	3,403	(109)	3,294	1,780	(48)	(46)
Net operating income <sup>73</sup>	26,648	(590)	26,058	25,068	(6)	(4)
LICs	(2,624)	135	(2,489)	(2,522)	4	(1)
Net operating income	24,024	(455)	23,569	22,546	(6)	(4)
Total operating expenses	(17,937)	415	(17,522)	(16,082)	10	8
Operating profit	6,087	(40)	6,047	6,464	6	7
Share of profit from associates and joint ventures	996	14	1,010	385	(61)	(62)
Profit	7,083	(26)	7,057	6,849	(3)	(3)

before tax

*For footnotes, see page 109.***Retail Banking and Wealth Management HSBC Finance***Reconciliation of reported, underlying and adjusted items*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Revenue <sup>73</sup>			
Reported revenue	1,672	7,251	(77)
Acquisitions, disposals and dilutions	105	(4,888)	
Underlying	1,777	2,363	(25)
Other significant items	278	227	
Adjusted	2,055	2,590	
Profit/(loss) before tax			
Reported profit/(loss) before tax	(200)	2,443	
Acquisitions, disposals and dilutions	120	(3,889)	
Underlying	(80)	(1,446)	94
Other significant items	391	323	
Adjusted	311	(1,123)	

*For footnote, see page 109.*

HSBC HOLDINGS PLC

105ac

**Table of Contents****Report of the Directors: Financial Review** (continued)**Commercial Banking***Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	10,361	(220)	10,141	10,200	(2)	1
Net fee income	4,470	(69)	4,401	4,717	6	7
Net trading income	633	(15)	618	649	3	5
Net income from financial instruments designated at fair value	250	(17)	233	332	33	42
Gains on disposal of US branch network and cards business	277		277		(100)	(100)
Gains less losses from financial investments	22	(2)	20	1	(95)	(95)
Net insurance premium income	1,786	(49)	1,737	1,375	(23)	(21)
Other operating income (including dividend)	554	(10)	544	636	15	17



income)						
Total operating income	18,353	(382)	17,971	17,910	(2)	
Net insurance claims and benefits paid and movement in liabilities to policyholders	(1,802)	53	(1,749)	(1,545)	15	12
Net operating income <sup>73</sup>	16,551	(329)	16,222	16,365	(1)	1
LICs	(2,099)	59	(2,040)	(2,384)	(14)	(17)
Net operating income	14,452	(270)	14,182	13,981	(3)	(1)
Operating expenses	(7,598)	149	(7,449)	(7,049)	7	5
Operating profit	6,854	(121)	6,733	6,932	1	3
Share of profit from associates and joint ventures	1,681	25	1,706	1,509	(10)	(12)
Profit before tax	8,535	(96)	8,439	8,441	(1)	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105ad

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items* CMB

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported net interest income	10,200	10,361	(2)
Currency translation adjustment <sup>74</sup>		(220)	
Acquisitions, disposals and dilutions	(92)	(211)	
Underlying	10,108	9,930	2
Other significant items			
Adjusted	10,108	9,930	
Other operating income			
Reported other operating income	621	536	16
Currency translation adjustment <sup>74</sup>		(10)	
Acquisitions, disposals and dilutions	(470)	(187)	
Underlying	151	339	(55)
Other significant items			
Adjusted	151	339	
Revenue <sup>73</sup>			
Reported revenue	16,365	16,551	(1)
Currency translation adjustment <sup>74</sup>		(329)	
Acquisitions, disposals and dilutions	(593)	(762)	
Underlying	15,772	15,460	2
Other significant items			
Adjusted	15,772	15,460	
LICs			
Reported LICs	(2,384)	(2,099)	(14)
Currency translation adjustment <sup>74</sup>		59	
Acquisitions, disposals and dilutions	(1)		
Underlying	(2,385)	(2,040)	(17)
Other significant items			
Adjusted	(2,385)	(2,040)	
Operating expenses			

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Reported operating expenses	(7,049)	(7,598)	7
Currency translation adjustment <sup>74</sup>		149	
Acquisitions, disposals and dilutions	63	191	
Underlying	(6,986)	(7,258)	4
Other significant items	19	320	
Adjusted	(6,967)	(6,938)	
Underlying cost efficiency ratio	44.3%	46.9%	
Adjusted cost efficiency ratio	44.2%	44.9%	
Share of profit in associates and joint ventures			
Reported	1,509	1,681	(10)
Currency translation adjustment <sup>74</sup>		25	
Acquisitions, disposals and dilutions	(10)	(351)	
Underlying	1,499	1,355	11
Other significant items			
Adjusted	1,499	1,355	
Profit before tax			
Reported profit before tax	8,441	8,535	(1)
Currency translation adjustment <sup>74</sup>		(96)	
Acquisitions, disposals and dilutions	(541)	(922)	
Underlying	7,900	7,517	5
Other significant items	19	320	
Adjusted	7,919	7,837	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105ae

**Table of Contents****Report of the Directors: Financial Review** (continued)**Global Banking and Markets***Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	6,960	(127)	6,833	6,766	(3)	(1)
Net fee income	3,329	(22)	3,307	3,482	5	5
Net trading income	5,690	(90)	5,600	6,780	19	21
Net income from financial instruments designated at fair value	1,094	(13)	1,081	599	(45)	(45)
Gains less losses from financial investments	730	(8)	722	747	2	3
Net insurance premium income	25	(3)	22	6	(76)	(73)
Other operating income (including dividend income)	461	9	470	799	73	70
Total operating income	18,289	(254)	18,035	19,179	5	6
	(16)	1	(15)	(3)	81	80

Net insurance claims and benefits paid and movement in liabilities to policyholders						
Net operating income <sup>73</sup>	18,273	(253)	18,020	19,176	5	6
LICs	(670)	5	(665)	(207)	69	69
Net operating income	17,603	(248)	17,355	18,969	8	9
Operating expenses	(9,907)	95	(9,812)	(9,960)	(1)	(2)
Operating profit	7,696	(153)	7,543	9,009	17	19
Share of profit from associates and joint ventures	824	6	830	432	(48)	(48)
Profit before tax	8,520	(147)	8,373	9,441	11	13

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105af

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items GB&M*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported net interest income	6,766	6,960	(3)
Currency translation adjustment <sup>74</sup>		(127)	
Acquisitions, disposals and dilutions	(26)	(56)	
Underlying	6,740	6,777	(1)
Other significant items			
Adjusted	6,740	6,777	
Other operating income			
Reported other operating income	670	313	114
Currency translation adjustment <sup>74</sup>		10	
Acquisitions, disposals and dilutions	(407)	(78)	
Underlying	263	245	7
Other significant items			
Adjusted	263	245	
Revenue <sup>73</sup>			
Reported revenue	19,176	18,273	5
Currency translation adjustment <sup>74</sup>		(253)	
Acquisitions, disposals and dilutions	(460)	(219)	
Underlying	18,716	17,801	5
Other significant items	(88)	(476)	
Adjusted	18,628	17,325	
LICs			
Reported LICs	(207)	(670)	69
Currency translation adjustment <sup>74</sup>		5	
Acquisitions, disposals and dilutions			
Underlying	(207)	(665)	69
Other significant items			
Adjusted	(207)	(665)	
Operating expenses			

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Reported operating expenses	(9,960)	(9,907)	(1)
Currency translation adjustment <sup>74</sup>		95	
Acquisitions, disposals and dilutions	54	107	
Underlying	(9,906)	(9,705)	(2)
Other significant items	364	394	
Adjusted	(9,542)	(9,311)	
Underlying cost efficiency ratio	52.9%	54.5%	
Adjusted cost efficiency ratio	51.2%	53.7%	
Share of profit in associates and joint ventures			
Reported	432	824	(48)
Currency translation adjustment <sup>74</sup>		6	
Acquisitions, disposals and dilutions	2	(404)	
Underlying	434	426	2
Other significant items			
Adjusted	434	426	
Profit before tax			
Reported profit before tax	9,441	8,520	11
Currency translation adjustment <sup>74</sup>		(147)	
Acquisitions, disposals and dilutions	(404)	(516)	
Underlying	9,037	7,857	15
Other significant items	276	(82)	
Adjusted	9,313	7,775	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105ag

**Table of Contents****Report of the Directors: Financial Review** (continued)**Global Private Banking***Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	1,294	(6)	1,288	1,146	(11)	(11)
Net fee income	1,232	1	1,233	1,150	(7)	(7)
Net trading income	490	(1)	489	394	(20)	(19)
Net income from financial instruments designated at fair value				4		
Gains less losses from financial investments	(3)		(3)	(3)		
Net insurance premium income	42	2	44	16	(62)	(64)
Other operating income/(expense) (including dividend income)	157	(13)	144	(231)		
Total operating income	3,212	(17)	3,195	2,476	(23)	(23)
Net insurance claims and benefits paid and movement in liabilities to policyholders	(40)	(2)	(42)	(37)	8	12
	3,172	(19)	3,153	2,439	(23)	(23)



Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Net operating income <sup>73</sup>						
LICs	(27)	1	(26)	(31)	(15)	(19)
Net operating income	3,145	(18)	3,127	2,408	(23)	(23)
Operating expenses	(2,143)	2	(2,141)	(2,229)	(4)	(4)
Operating profit	1,002	(16)	986	179	(82)	(82)
Share of profit from associates and joint ventures	7		7	14	100	100
Profit before tax	1,009	(16)	993	193	(81)	(81)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105ah

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items* **GPB**

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported net interest income	1,146	1,294	(11)
Currency translation adjustment <sup>74</sup>		(6)	
Acquisitions, disposals and dilutions	(4)	(13)	
Underlying	1,142	1,275	(10)
Other significant items			
Adjusted	1,142	1,275	
Other operating income			
Reported other operating income	(239)	151	
Currency translation adjustment <sup>74</sup>		(13)	
Acquisitions, disposals and dilutions	(1)	(56)	
Underlying	(240)	82	
Other significant items	279		
Adjusted	39	82	
Revenue <sup>73</sup>			
Reported revenue	2,439	3,172	(23)
Currency translation adjustment <sup>74</sup>		(19)	
Acquisitions, disposals and dilutions	(5)	(72)	
Underlying	2,434	3,081	(21)
Other significant items	279	(4)	
Adjusted	2,713	3,077	
LICs			
Reported LICs	(31)	(27)	(15)
Currency translation adjustment <sup>74</sup>		1	
Acquisitions, disposals and dilutions			
Underlying	(31)	(26)	(19)
Other significant items			
Adjusted	(31)	(26)	
Operating expenses			

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Reported operating expenses	(2,229)	(2,143)	(4)
Currency translation adjustment <sup>74</sup>		2	
Acquisitions, disposals and dilutions	4	15	
Underlying	(2,225)	(2,126)	(5)
Other significant items	425	56	
Adjusted	(1,800)	(2,070)	
Underlying cost efficiency ratio	91.4%	69.0%	
Adjusted cost efficiency ratio	66.3%	67.3%	
Profit before tax			
Reported profit before tax	193	1,009	(81)
Currency translation adjustment <sup>74</sup>		(16)	
Acquisitions, disposals and dilutions	(1)	(57)	
Underlying	192	936	(79)
Other significant items	704	52	
Adjusted	896	988	
<i>For footnotes, see page 109.</i>			

HSBC HOLDINGS PLC

105ai

**Table of Contents****Report of the Directors: Financial Review** (continued)**Other***Reconciliation of reported and constant currency loss before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	(730)	(4)	(734)	(737)	(1)	
Net fee income	194		194	64	(67)	(67)
Net trading income	(537)	(1)	(538)	6		
Own credit spread <sup>75</sup>	(5,215)	12	(5,203)	(1,246)	76	76
Other expense from financial instruments designated at fair value	(248)	7	(241)	(558)	(125)	(132)
Net expense from financial instruments designated at fair value	(5,463)	19	(5,444)	(1,804)	67	67
Gains on disposal of US branch network, US cards business and Ping An	3,012		3,012		(100)	(100)
Gains less losses from financial	344		344	1,212	252	252

investments						
Other						
operating						
income						
(including						
dividend						
income)	5,512	(210)	5,302	6,910	25	30
Total						
operating						
income	2,332	(196)	2,136	5,651	142	165
Net insurance						
claims and						
benefits paid						
and						
movement in						
liabilities to						
policyholders						
Net operating						
income <sup>73</sup>	2,332	(196)	2,136	5,651	142	165
LICs						
Net operating						
income	2,332	(196)	2,136	5,651	142	165
Operating						
expenses	(9,369)	81	(9,288)	(7,796)	17	16
Operating						
loss	(7,037)	(115)	(7,152)	(2,145)	70	70
Share of						
profit/(loss)						
from						
associates and						
joint ventures	47		47	(14)		
Loss before						
tax	(6,990)	(115)	(7,105)	(2,159)	69	70

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105aj

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items*    *Other*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Revenue <sup>73</sup>			
Reported revenue	5,651	2,332	142
Currency translation adjustment <sup>74</sup>		(209)	
Own credit spread <sup>75</sup>	1,246	5,215	
Acquisitions, disposals and dilutions	(1,044)	(3,107)	
Underlying	5,853	4,231	38
Other significant items	(1,262)	304	
Adjusted	4,591	4,535	
Operating expenses			
Reported operating expenses	(7,796)	(9,369)	17
Currency translation adjustment <sup>74</sup>		81	
Acquisitions, disposals and dilutions	29	1	
Underlying	(7,767)	(9,287)	16
Other significant items	199	2,348	
Adjusted	(7,568)	(6,939)	
Underlying cost efficiency ratio	132.7%	219.5%	
Adjusted cost efficiency ratio	164.8%	153.0%	
Loss before tax			
Reported loss before tax	(2,159)	(6,990)	69
Currency translation adjustment <sup>74</sup>		(127)	
Own credit spread <sup>75</sup>	1,246	5,215	
Acquisitions, disposals and dilutions	(1,015)	(3,106)	
Underlying	(1,928)	(5,008)	62
Other significant items	(1,063)	2,652	
Adjusted	(2,991)	(2,356)	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105ak

**Table of Contents****Report of the Directors: Financial Review** (continued)**Geographical regions****Europe***Reconciliation of reported and constant currency profit/(loss) before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	10,394	(38)	10,356	10,693	3	3
Net fee income	6,169	1	6,170	6,032	(2)	(2)
Net trading income	2,707	(19)	2,688	4,423	63	65
Own credit spread <sup>75</sup>	(4,110)	12	(4,098)	(1,015)	75	75
Other income from financial instruments designated at fair value	1,895	12	1,907	1,433	(24)	(25)
Net income/(expense) from financial instruments designated at fair value	(2,215)	24	(2,191)	418		
Gains less losses from financial investments	364	(4)	360	379	4	5
Net earned insurance premiums	3,630	85	3,715	3,158	(13)	(15)

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Other operating income (including dividend income)	1,189	49	1,238	604	(49)	(51)
Total operating income	22,238	98	22,336	25,707	16	15
Net insurance claims and benefits paid and movement in liabilities to policyholders	(4,630)	(121)	(4,751)	(4,740)	(2)	
Net operating income <sup>73</sup>	17,608	(23)	17,585	20,967	19	19
LICs	(1,921)	15	(1,906)	(1,530)	20	20
Net operating income	15,687	(8)	15,679	19,437	24	24
Operating expenses	(19,095)	74	(19,021)	(17,613)	8	7
Operating profit/(loss)	(3,408)	66	(3,342)	1,824		
Share of profit/(loss) from associates and joint ventures	(6)	(1)	(7)	1		
Profit/(loss) before tax	(3,414)	65	(3,349)	1,825		

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105al



**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items Europe*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported	10,693	10,394	3
Currency translation adjustment <sup>74</sup>		(38)	
Acquisitions, disposals and dilutions	17	15	
Underlying	10,710	10,371	3
Other significant items			
Adjusted	10,710	10,371	
Other operating income			
Reported	529	1,080	(51)
Currency translation adjustment <sup>74</sup>		49	
Acquisitions, disposals and dilutions	(69)	(54)	
Underlying	460	1,075	(57)
Other significant items	425		
Adjusted	885	1,075	
Revenue <sup>73</sup>			
Reported	20,967	17,608	19
Currency translation adjustment <sup>74</sup>		(35)	
Own credit spread <sup>75</sup>	1,015	4,110	
Acquisitions, disposals and dilutions	(51)	(36)	
Underlying	21,931	21,647	1
Other significant items	(379)	(252)	
Adjusted	21,552	21,395	
LICs			
Reported	(1,530)	(1,921)	20
Currency translation adjustment <sup>74</sup>		15	
Acquisitions, disposals and dilutions			
Underlying	(1,530)	(1,906)	20
Other significant items			
Adjusted	(1,530)	(1,906)	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Operating expenses			
Reported	(17,613)	(19,095)	8
Currency translation adjustment <sup>74</sup>		74	
Acquisitions, disposals and dilutions	28	46	
Underlying	(17,585)	(18,975)	7
Other significant items	1,637	3,012	
Adjusted	15,948	(15,963)	
Underlying cost efficiency ratio	80.2%	87.7%	
Adjusted cost efficiency ratio	74.0%	74.6%	
Profit/(loss) before tax			
Reported	1,825	(3,414)	
Currency translation adjustment <sup>74</sup>		53	
Own credit spread <sup>75</sup>	1,015	4,110	
Acquisitions, disposals and dilutions	(18)	10	
Underlying	2,822	759	272
Other significant items	1,258	2,760	
Adjusted	4,080	3,519	
<i>For footnotes, see page 109.</i>			

HSBC HOLDINGS PLC

105am

**Table of Contents****Report of the Directors: Financial Review** (continued)**Asia**<sup>76</sup>*Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	10,707	(119)	10,588	11,432	7	8
Net fee income	5,418	(77)	5,341	5,936	10	11
Net trading income	2,516	(56)	2,460	2,026	(19)	(18)
Own credit spread <sup>75</sup>	(3)		(3)	(2)	33	33
Other income from financial instruments designated at fair value	556	2	558	316	(43)	(43)
Net income from financial instruments designated at fair value	553	2	555	314	(43)	(43)
Gains on disposal of Ping An	3,012		3,012		(100)	(100)
Gains less losses from financial investments	338	(1)	337	1,275	277	278
Net insurance premium income	6,769		6,769	6,918	2	2

Other operating income (including dividend income)	3,103	(214)	2,889	3,827	23	32
Total operating income	32,416	(465)	31,951	31,728	(2)	(1)
Net insurance claims and benefits paid and movement in liabilities to policyholders	(7,084)		(7,084)	(7,296)	(3)	(3)
Net operating income <sup>73</sup>	25,332	(465)	24,867	24,432	(4)	(2)
LICs	(510)	12	(498)	(498)	2	
Net operating income	24,822	(453)	24,369	23,934	(4)	(2)
Operating expenses	(9,980)	179	(9,801)	(9,936)		(1)
Operating profit	14,842	(274)	14,568	13,998	(6)	(4)
Share of profit from associates and joint ventures	3,188	46	3,234	1,855	(42)	(43)
Profit before tax	18,030	(228)	17,802	15,853	(12)	(11)

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105an

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items Asia*<sup>76</sup>

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported	11,432	10,707	7
Currency translation adjustment <sup>74</sup>		(119)	
Acquisitions, disposals and dilutions		(31)	
Underlying	11,432	10,557	8
Other significant items			
Adjusted	11,432	10,557	
Other operating income			
Reported	3,675	3,074	20
Currency translation adjustment <sup>74</sup>		(214)	
Acquisitions, disposals and dilutions	(1,139)	(674)	
Underlying	2,536	2,186	16
Other significant items			
Adjusted	2,536	2,186	
Revenue <sup>73</sup>			
Reported	24,432	25,332	(4)
Currency translation adjustment <sup>74</sup>		(465)	
Own credit spread <sup>75</sup>	2	3	
Acquisitions, disposals and dilutions	(1,139)	(3,787)	
Underlying	23,295	21,083	10
Other significant items	(561)	154	
Adjusted	22,734	21,237	
LICs			
Reported	(498)	(510)	2
Currency translation adjustment <sup>74</sup>		12	
Acquisitions, disposals and dilutions		(2)	
Underlying	(498)	(500)	
Other significant items			
Adjusted	(498)	(500)	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Operating expenses			
Reported	(9,936)	(9,980)	
Currency translation adjustment <sup>74</sup>		179	
Acquisitions, disposals and dilutions	72	145	
Underlying	(9,864)	(9,656)	(2)
Other significant items	121	162	
Adjusted	(9,743)	(9,494)	
Underlying cost efficiency ratio	42.3%	45.8%	
Adjusted cost efficiency ratio	42.9%	44.7%	
Share of profit in associates and joint ventures			
Reported	1,855	3,188	(42)
Currency translation adjustment <sup>6</sup>		46	
Acquisitions, disposals and dilutions	(19)	(1,425)	
Underlying	1,836	1,809	1
Other significant items			
Adjusted	1,836	1,809	
Profit before tax			
Reported	15,853	18,030	(12)
Currency translation adjustment <sup>74</sup>		(228)	
Own credit spread <sup>75</sup>	2	3	
Acquisitions, disposals and dilutions	(1,086)	(5,069)	
Underlying	14,769	12,736	16
Other significant items	(440)	316	
Adjusted	14,329	13,052	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105ao

**Table of Contents****Report of the Directors: Financial Review** (continued)**Middle East and North Africa***Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
Net interest income	1,470	(43)	1,427	1,486	1	4
Net fee income	595	(11)	584	622	5	7
Net trading income	390	(9)	381	357	(8)	(6)
Own credit spread <sup>75</sup>	(12)		(12)	(4)	67	67
Other income from financial instruments designated at fair value				2		
Net expense from financial instruments designated at fair value	(12)		(12)	(2)	83	83
Gains less losses from financial investments	9		9	(18)		
Net insurance premium income						
Other operating income/(expense) including dividend income)	(22)		(22)	58		
Total operating income	2,430	(63)	2,367	2,503	3	6

net insurance						
claims and						
benefits paid and						
movement in						
liabilities to						
policyholders						
net operating						
income <sup>73</sup>	2,430	(63)	2,367	2,503	3	6
IFCs	(286)	4	(282)	42		
net operating						
income	2,144	(59)	2,085	2,545	19	22
operating						
expenses	(1,166)	23	(1,143)	(1,289)	(11)	(13)
operating profit	978	(36)	942	1,256	28	33
share of profit						
from associates						
and joint ventures	372		372	438	18	18
profit before tax	1,350	(36)	1,314	1,694	25	29

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105ap



**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items Middle East and North Africa*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported	1,486	1,470	1
Currency translation adjustment <sup>74</sup>		(43)	
Acquisitions, disposals and dilutions		(8)	
Underlying	1,486	1,419	5
Other significant items			
Adjusted	1,486	1,419	
Other operating income			
Reported	49	(27)	
Currency translation adjustment <sup>74</sup>			
Acquisitions, disposals and dilutions		64	
Underlying	49	37	32
Other significant items			
Adjusted	49	37	
Revenue <sup>73</sup>			
Reported	2,503	2,430	3
Currency translation adjustment <sup>74</sup>		(63)	
Own credit spread <sup>75</sup>	4	12	
Acquisitions, disposals and dilutions		3	
Underlying	2,507	2,382	5
Other significant items	(2)	(4)	
Adjusted	2,505	2,378	
LICs			
Reported	42	(286)	
Currency translation adjustment <sup>74</sup>		4	
Acquisitions, disposals and dilutions			
Underlying	42	(282)	
Other significant items			
Adjusted	42	(282)	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Operating expenses			
Reported	(1,289)	(1,166)	(11)
Currency translation adjustment <sup>74</sup>		23	
Acquisitions, disposals and dilutions		15	
Underlying	(1,289)	(1,128)	(14)
Other significant items	4	27	
Adjusted	(1,285)	(1,101)	
Underlying cost efficiency ratio	51.4%	47.4%	
Adjusted cost efficiency ratio	51.3%	46.3%	
Profit before tax			
Reported	1,694	1,350	25
Currency translation adjustment <sup>74</sup>		(36)	
Own credit spread <sup>75</sup>	4	12	
Acquisitions, disposals and dilutions		18	
Underlying	1,698	1,344	26
Other significant items	2	23	
Adjusted	1,700	1,367	
<i>For footnotes, see page 109.</i>			

HSBC HOLDINGS PLC

105aq

**Table of Contents****Report of the Directors: Financial Review** (continued)**North America***Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m	2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>73</sup> %
Net interest						
Income	8,117	(42)	8,075	5,742	(29)	(29)
Net fee income	2,513	(18)	2,495	2,143	(15)	(14)
Net trading						
Income	507	(6)	501	948	87	89
Own credit read <sup>75</sup>	(1,090)		(1,090)	(226)	79	79
Other expense from financial instruments designated at fair value	(129)		(129)	(62)	52	52
Net expense from financial instruments designated at fair value	(1,219)		(1,219)	(288)	76	76
Profits on disposal of US branch network and US wards business	4,012		4,012		(100)	(100)
Profits less losses from financial investments	251	(1)	250	294	17	18
Net insurance premium income	193		193	34	(82)	(82)
Other operating income/(expense)	467	3	470	(31)		

cluding dividend income)						
total operating income	14,841	(64)	14,777	8,842	(40)	(40)
net insurance premiums and benefits paid and movement in liabilities to policyholders	(148)		(148)	(39)	74	74
net operating income <sup>73</sup>	14,693	(64)	14,629	8,803	(40)	(40)
FX losses	(3,457)	6	(3,451)	(1,197)	65	65
net operating income	11,236	(58)	11,178	7,606	(32)	(32)
operating expenses	(8,940)	30	(8,910)	(6,416)	28	28
operating profit	2,296	(28)	2,268	1,190	(48)	(48)
share of profit from associates and joint ventures	3		3	31	933	933
profit before tax	2,299	(28)	2,271	1,221	(47)	(46)

*For footnotes, see page 109.*

## HSBC HOLDINGS PLC

105ar

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items North America*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported	5,742	8,117	(29)
Currency translation adjustment <sup>74</sup>		(42)	
Acquisitions, disposals and dilutions	(14)	(1,433)	
Underlying	5,728	6,642	(14)
Significant items			
Adjusted	5,728	6,642	
Other operating income/(expense)			
Reported	(108)	406	
Currency translation adjustment <sup>74</sup>		3	
Acquisitions, disposals and dilutions	97	(134)	
Underlying	(11)	275	
Significant items	394		
Adjusted	383	275	
Revenue <sup>73</sup>			
Reported	8,803	14,693	(40)
Currency translation adjustment <sup>74</sup>		(64)	
Own credit spread <sup>75</sup>	226	1,090	
Acquisitions, disposals and dilutions	89	(5,982)	
Underlying	9,118	9,737	(6)
Significant items	361	136	
Adjusted	9,479	9,873	
LICs			
Reported	(1,197)	(3,457)	65
Currency translation adjustment <sup>74</sup>		6	
Acquisitions, disposals and dilutions		325	
Underlying	(1,197)	(3,126)	62
Significant items			
Adjusted	(1,197)	(3,126)	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Operating expenses			
Reported	(6,416)	(8,940)	28
Currency translation adjustment <sup>74</sup>		30	
Acquisitions, disposals and dilutions	14	796	
Underlying	(6,402)	(8,114)	21
Significant items	201	1,871	
Adjusted	(6,201)	(6,243)	
Underlying cost efficiency ratio	70.2%	83.3%	
Adjusted cost efficiency ratio	65.4%	63.2%	
Profit/(loss) before tax			
Reported	1,221	2,299	(47)
Currency translation adjustment <sup>74</sup>		(28)	
Own credit spread <sup>75</sup>	226	1,090	
Acquisitions, disposals and dilutions	103	(4,861)	
Underlying	1,550	(1,500)	
Significant items	562	2,007	
Adjusted	2,112	507	

*For footnotes, see page 109.*

HSBC HOLDINGS PLC

105as

**Table of Contents****Report of the Directors: Financial Review** (continued)**Latin America***Reconciliation of reported and constant currency profit before tax*

	2012 as reported US\$m	Currency		2013 as reported US\$m	Reported change <sup>72</sup> %	Constant currency change <sup>72</sup> %
		translation adjustment <sup>74</sup> US\$m	2012 at 2013 exchange rates US\$m			
Net interest income	6,984	(440)	6,544	6,186	(11)	(5)
Net fee income	1,735	(98)	1,637	1,701	(2)	4
Net trading income	971	(74)	897	936	(4)	4
Own credit spread <sup>75</sup>						
Other income from financial instruments designated at fair value	667	(67)	600	326	(51)	(46)
Net income from financial instruments designated at fair value	667	(67)	600	326	(51)	(46)
Gains less losses from financial investments	227	(11)	216	82	(64)	(62)
Net insurance premium income	2,452	(203)	2,249	1,830	(25)	(19)
Other operating income (including	268	(49)	219	1,124	319	413

dividend income)						
Total operating income	13,304	(942)	12,362	12,185	(8)	(1)
Net insurance claims and benefits paid and movement in liabilities to policyholders	(2,353)	217	(2,136)	(1,617)	31	24
Net operating income <sup>73</sup>	10,951	(725)	10,226	10,568	(3)	3
LICs	(2,137)	164	(1,973)	(2,666)	(25)	(35)
Net operating income	8,814	(561)	8,253	7,902	(10)	(4)
Operating expenses	(6,430)	388	(6,042)	(5,930)	8	2
Operating profit	2,384	(173)	2,211	1,972	(17)	(11)
Share of profit from associates and joint ventures						
Profit before tax	2,384	(173)	2,211	1,972	(17)	(11)
<i>For footnotes, see page 109.</i>						

## HSBC HOLDINGS PLC

105at



**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported, underlying and adjusted items Latin America*

	2013 US\$m	2012 US\$m	Change <sup>72</sup> %
Net interest income			
Reported	6,186	6,984	(11)
Currency translation adjustment <sup>74</sup>		(440)	
Acquisitions, disposals and dilutions	(277)	(561)	
Underlying Significant items	5,909	5,983	(1)
Adjusted	5,909	5,983	
Other operating income			
Reported	1,115	253	341
Currency translation adjustment <sup>74</sup>		(48)	
Acquisitions, disposals and dilutions	(1,123)	(14)	
Underlying Significant items	(8)	191	
Adjusted	(8)	191	
Revenue <sup>73</sup>			
Reported	10,568	10,951	(3)
Currency translation adjustment <sup>74</sup>		(725)	
Acquisitions, disposals and dilutions	(1,495)	(805)	
Underlying Significant items	9,073	9,421	(4)
Adjusted	(13)	(17)	
Adjusted	9,060	9,404	
LICs			
Reported	(2,666)	(2,137)	(25)
Currency translation adjustment <sup>74</sup>		164	
Acquisitions, disposals and dilutions	32	53	
Underlying Significant items	(2,634)	(1,920)	(37)
Adjusted	(2,634)	(1,920)	
Operating expenses			

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Reported	(5,930)	(6,430)	8
Currency translation adjustment <sup>74</sup>		388	
Acquisitions, disposals and dilutions	239	488	
Underlying	(5,691)	(5,554)	(2)
Significant items	75	167	
Adjusted	(5,616)	(5,387)	
Underlying cost efficiency ratio	62.7%	59.0%	
Adjusted cost efficiency ratio	62.0%	57.3%	
Profit before tax			
Reported	1,972	2,384	(17)
Currency translation adjustment <sup>74</sup>		(173)	
Acquisitions, disposals and dilutions	(1,224)	(264)	
Underlying	748	1,947	(62)
Significant items	62	150	
Adjusted	810	2,097	
<i>For footnotes, see page 109.</i>			

HSBC HOLDINGS PLC

105au

**Table of Contents**

**Report of the Directors: Financial Review (continued)**

**Other information**

<b><u>Funds under management and assets held in custody</u></b>	<b>106</b>
<b><u>Taxes paid by region and country</u></b>	<b>106</b>
<b><u>Property</u></b>	<b>107</b>
<b><u>Our disclosure philosophy</u></b>	<b>107</b>
<b><u>Disclosures arising from EDTF recommendations</u></b>	<b>108</b>
<b><u>Disclosure controls</u></b>	<b>108a</b>
<b><u>Management's assessment of internal controls over financial reporting</u></b>	<b>108a</b>
<b><u>Change in registrant's certifying accountant</u></b>	<b>108a</b>

**Funds under management and assets held in custody**

**Funds under management<sup>59</sup>**

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
<b>Funds under management</b>		
At 1 January	<b>921</b>	910
Net new money	<b>38</b>	(18)

Value change	40	34
Exchange and other	(45)	(5)
<b>At 31 December</b>	<b>954</b>	921
	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
<b>Funds under management by business</b>		
Global Asset Management	445	420
Global Private Banking	275	282
Affiliates	5	5
Other	229	214
<b>At 31 December</b>	<b>954</b>	921

*For footnote, see page 109.*

Funds under management ( FuM ) at 31 December 2014 amounted to US\$954bn, an increase of 4%, primarily due to favourable market movements and net inflows in the year.

Global Asset Management FuM increased by 6% to US\$445bn as we attracted US\$29bn of net new money, notably in fixed income products from our customers in Europe and Asia, as well as from net inflows into liquidity funds in Europe and North America. In addition, we transferred FuM of US\$18bn which had previously been reported within Other FuM and we benefited from favourable movements in equity and bond markets. These increases were partly offset by adverse foreign exchange movements reflecting the strengthening of the US dollar against all major currencies.

GPB FuM decreased by 3% to US\$275bn due to the ongoing repositioning of our client base, which gave rise to disposals of a portfolio of assets in Switzerland to LGT Bank (Switzerland) Ltd and our HSBC Trinkaus & Burkhardt AG business in Luxembourg with a combined

FuM of US\$8bn, and negative net new money in Europe. In addition, there were unfavourable foreign exchange movements, mainly in Europe. This was partly offset by favourable market movements, also principally in Europe, and from positive net new money in areas targeted for growth.

Other FuM increased by 7% to US\$229bn, primarily due to strong net inflows and favourable market movements. This was partly offset by the transfer of FuM into Global Asset Management noted above.

#### **Assets held in custody<sup>59</sup> and under administration**

Custody is the safekeeping and servicing of securities and other financial assets on behalf of clients. At 31 December 2014, we held assets as custodian of US\$6.4 trillion, 3% higher than the US\$6.2 trillion held at 31 December 2013. This was mainly driven by incremental net asset inflows in Asia and Europe, and notably in Middle East and North Africa, partly offset by adverse foreign exchange movements.

Our assets under administration business, which includes the provision of bond and loan administration services and the valuation of portfolios of securities and other financial assets on behalf of clients, complements the custody business. At 31 December 2014, the value of assets held under administration by the Group amounted to US\$3.2 trillion, which was 6% higher than at 31 December 2013. This was mainly driven by incremental net asset inflows in the Funds business in Europe and Asia, which was partly offset by adverse foreign exchange movements.

#### **Taxes paid by region and country**

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

The following tables reflect a geographical view of HSBC's operations and the basis of preparation is aligned to the Group's approach in meeting its country-by-country reporting obligations as laid out in Article 89 of the EU's CRD IV.

*Breakdown of tax paid by region*<sup>60</sup>

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
<b>Region</b>		
UK	<b>2.4</b>	2.1
Rest of Europe	<b>1.3</b>	1.5
Asia	<b>2.7</b>	2.5
Middle East and North Africa	<b>0.2</b>	0.3
North America	<b>(0.1)</b>	0.4
Latin America	<b>1.4</b>	1.8
<b>Total</b>	<b>7.9</b>	8.6

*For footnote, see page 109.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Taxes paid by country*<sup>60</sup>

	2014 US\$m	2013 US\$m	2012 US\$m
Total taxes paid analysed by regions			
<b>Asia</b>	<b>2,687</b>	2,536	2,639
Home and priority growth markets	<b>2,399</b>	2,185	2,225
Hong Kong	<b>1,273</b>	1,248	974
Mainland China	<b>278</b>	207	276
India	<b>290</b>	318	349
Australia	<b>204</b>	105	209
Malaysia	<b>133</b>	106	193
Indonesia	<b>76</b>	74	113
Singapore	<b>101</b>	88	89
Taiwan	<b>44</b>	39	22
Other markets	<b>288</b>	351	414
<b>Europe</b>	<b>3,709</b>	3,570	3,213
Home and priority growth markets	<b>3,466</b>	3,326	3,021
UK	<b>2,363</b>	2,107	1,906
France	<b>790</b>	844	679
Germany	<b>131</b>	151	200
Switzerland	<b>107</b>	142	160
Turkey	<b>75</b>	82	76
Other markets	<b>243</b>	244	192
<b>Middle East and North Africa</b>	<b>210</b>	251	284
Priority growth markets	<b>162</b>	213	234
UAE	<b>102</b>	98	120
Egypt	<b>60</b>	115	114
Other markets	<b>48</b>	38	50
<b>North America</b>	<b>(108)</b>	414	1,236
Priority growth markets			
US	<b>(377)</b>	125	798
Canada	<b>269</b>	285	434
Other markets		4	4
<b>Latin America</b>	<b>1,384</b>	1,836	1,977
Priority growth markets	<b>1,338</b>	1,645	1,835
Brazil	<b>804</b>	1,002	1,174

Argentina	333	318	391
Mexico	201	325	270
Other markets	46	191	142
<b>Total</b>	<b>7,882</b>	8,607	9,349

*For footnote, see page 109.*

## Property

At 31 December 2014, we operated from some 7,885 operational properties worldwide, of which approximately 1,965 were located in Europe, 2,500 in Asia, 450 in North America, 2,700 in Latin America and 275 in the Middle East and North Africa. These properties had an area of approximately 54.3m square feet (2013: 56.6m square feet).

Our freehold and long leasehold properties, together with all our leasehold land in Hong Kong, were valued in 2014. The value of these properties was US\$10.8bn

(2012: US\$10.3bn) in excess of their carrying amount in the consolidated balance sheet on an historical cost based measure. In addition, properties with a net book value of US\$1.6bn (2013: US\$1.5bn) were held for investment purposes.

Our operational properties are stated at cost, being historical cost or fair value at the date of transition to IFRSs (their deemed cost) less any impairment losses, and are depreciated on a basis calculated to write off the assets over their estimated useful lives. Properties owned as a consequence of an acquisition are recognised initially at fair value.

*Further details are included in Note 23 on the Financial Statements.*

## Our disclosure philosophy

HSBC strives to maintain the highest standards of disclosure in our reporting.

It has long been our policy to provide disclosures that help investors and other stakeholders understand the Group's performance, financial position and changes thereto. In accordance with this policy:

In order to make the financial statements and notes thereon easier to understand, we have undertaken an initiative to provide more focused information and to remove duplication where possible. As a result, we have changed the location and the wording used to describe certain accounting policies within the notes, removed certain immaterial disclosures and changed the order of certain sections. In applying materiality to financial statement disclosures, we consider both the amount and nature of each item. The main changes to the presentation of the financial statements and notes thereon in 2014 are described on pages 346 and 347.

The information provided in the Notes on the Financial Statements and the Report of the Directors goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements and listing rules. In particular, we provide additional disclosures having regard to the recommendations of the Enhanced Disclosures Task Force (EDTF) report Enhancing the Risk Disclosures of Banks issued in October 2012. The report aims to help financial institutions identify areas that investors had highlighted needed better and more transparent information about banks' risks, and how these risks relate to performance measurement and reporting. In addition, we continue to enhance our disclosures in line with good practice recommendations issued by relevant regulators and standard setters and in response to feedback received from users of our financial statements.

HSBC HOLDINGS PLC

107



**Table of Contents****Report of the Directors: Financial Review** (continued)**Disclosures arising from EDTF recommendations**

Type of risk	Recommendation	Disclosure	Page
General	1	The risks to which the business is exposed.	112 to 117
	2	Our risk appetite and stress testing.	117 to 118
	3	Top and emerging risks, and the changes during the reporting period.	118 to 124
	4	Discussion of future regulatory developments affecting our business model and Group profitability, and its implementation in Europe.	119 to 120 and 252 to 256
Risk governance, risk management and business model	5	Group Risk Committee, and their activities.	280 to 281
	6	Risk culture and risk governance and ownership.	111
	7	Diagram of the risk exposure by global business segment.	22
Capital adequacy and risk-weighted assets	8	Stress testing and the underlying assumptions.	117 to 118
	9	Pillar 1 capital requirements. For calculation of Pillar 1 capital requirements, see the <i>Pillar 3 Disclosures 2014</i> document.	258 to 259
	10	Reconciliation of the accounting balance sheet to the regulatory balance sheet.	249
	11	Flow statement of the movements in regulatory capital since the previous reporting period, including changes in the different tiers of	245

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

		regulatory capital.	
	12	Discussion of targeted level of capital, and the plans on how to establish this.	239 and 252 to 258
	13	Analysis of risk-weighted assets by risk type, global business and geographical region, and market risk RWAs.	240
	14	For analysis of the capital requirements for each Basel asset class, see the <i>Pillar 3 Disclosures 2014</i> document.	
	15	For analysis of credit risk for each Basel asset class, see the <i>Pillar 3 Disclosures 2014</i> document.	
	16	Flow statements reconciling the movements in risk-weighted assets for each risk-weighted asset type.	242 to 244
Liquidity	17	For discussion of Basel credit risk model performance, see the <i>Pillar 3 Disclosures 2014</i> document.	
	18	Analysis of the Group's liquid asset buffer.	165 to 166
Funding	19	Encumbered and unencumbered assets analysed by balance sheet category.	171 to 173
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by remaining contractual maturity at the balance sheet date.	426 to 435
Market risk	21	Analysis of the Group's sources of funding and a description of our funding strategy.	168
	22	Relationship between the market risk measures for trading and non-trading portfolios and the balance sheet, by business segment.	179 to 180
	23	Discussion of significant trading and non-trading market risk factors.	176 to 179
	24	VaR assumptions, limitations and validation.	223 to 224
	25	Discussion of stress tests, reverse stress tests and stressed VaR.	224 to 225

Credit risk	26	Analysis of the aggregate credit risk exposures, including details of both personal and wholesale lending.	129 to 130
	27	Discussion of the policies for identifying impaired loans, defining impairments and renegotiated loans, and explaining loan forbearance policies.	137 and 208 to 213
	28	Reconciliations of the opening and closing balances of impaired loans and impairment allowances during the year.	137 and 142 to 143
	29	Analysis of counterparty credit risk that arises from derivative transactions.	150 to 151
	30	Discussion of credit risk mitigation, including collateral held for all sources of credit risk.	146 to 150
Other risks	31	Quantified measures of the management of operational risk.	187 to 189
	32	Discussion of publicly known risk events.	118 to 124

*The 32 recommendations listed above were made in the report *Enhancing the Risk Disclosures of Banks* issued by the Enhanced Disclosure Task Force of the Financial Stability Board in October 2012.*

## HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**Disclosure controls**

The Group Chief Executive and Group Finance Director, with the assistance of other members of management, carried out an evaluation of the effectiveness of the design and operation of HSBC Holdings' disclosure controls and procedures as at 31 December 2014. Based upon that evaluation, the Group Chief Executive and Group Finance Director concluded that our disclosure controls and procedures as at 31 December 2014 were effective to provide reasonable assurance that information required to be disclosed in the reports which the company files and submits under the US Securities Exchange Act of 1934, as amended, is recorded, processed, summarised and reported as and when required. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

There has been no change in HSBC Holdings' internal controls over financial reporting during the year ended 31 December 2014 that has materially affected, or is reasonably likely to materially affect, HSBC Holdings' internal controls over financial reporting.

**Management's assessment of internal controls over financial reporting**

Management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and has completed an assessment of the effectiveness of the Group's internal controls over financial reporting for the year ended 31 December 2014. In making the assessment, management used the framework for internal control evaluation contained in the Financial Reporting Council's Internal Control Revised Guidance for Directors, as well as the criteria established by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (1992).

Based on the assessment performed, management concluded that as at 31 December 2014, the Group's internal controls over financial reporting were effective.

KPMG Audit Plc, which has audited the consolidated financial statements of the Group for the year ended 31 December 2014, 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 329 to 333.

*In May 2013, the Committee of Sponsoring Organisations of the Treadway Commission (COSO) issued the 2013 Internal Control - Integrated Framework (Framework). The 2013 Framework superseded the original 1992 Framework on 15 December 2014. HSBC is in the process of finalising its migration to the 2013 Framework, which it plans to use with respect to the evaluation of its internal control over financial reporting for the year ending 31 December 2015. HSBC continued to evaluate its internal control over financial reporting under the Financial Reporting Council's Internal Control Revised Guidance for Directors and the original 1992 Framework for the*

*year ended 31 December 2014.*

**Change in the Group's certifying accountant**

In 2013 we conducted a tender process for HSBC Holdings plc (the Company) and its subsidiaries (the Group) statutory audit contract. Accordingly the engagement of KPMG Audit Plc (KPMG), HSBC's current auditor, will not be renewed in 2015. As a result of the audit tender process we announced on 2 August 2013 that following completion of the audit of the Group financial statements for the year ended 31 December 2014 and the audit of the effectiveness of internal control over financial reporting as of 31 December 2014, PricewaterhouseCoopers LLP will become the Group's statutory auditor for the financial year ending 31 December 2015, subject to approval by shareholders at the 2015 Annual General Meeting of the Company. This decision was taken by the Board of Directors on the recommendation of the Group Audit Committee.

During the years ended 31 December 2014 and 2013, (1) KPMG has not issued any reports on the financial statements of the Group or on the effectiveness of internal control over financial reporting that contained an adverse opinion or a disclaimer of opinion, nor were the auditors' reports of KPMG qualified or modified as to uncertainty, audit scope, or accounting principles, (2) there has not been any disagreement over any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements if not resolved to KPMG's satisfaction would have caused it to make reference to the subject matter of the disagreement in connection with its auditors' reports, or any reportable event as described in Item 16F(a)(1)(v) of Form 20-F.

Further in the years ended 31 December 2014 and 2013 we have not consulted with PricewaterhouseCoopers LLP regarding either (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered with respect to the consolidated financial statements of the Group; or (ii) any matter that was the subject of a disagreement as that term is used in Item 16F(a)(1)(iv) of Form 20-F or a reportable event as described in Item 16F(a)(1)(v) of Form 20-F.

HSBC HOLDINGS PLC

108a

**Table of Contents****Report of the Directors: Financial Review** (continued)

## Footnotes to pages 40 to 108

**Use of non-GAAP financial measures**

- 1 *The operating results of these disposals were removed from adjusted results in addition to disposal gains and losses.*
- 2 *The operating results of these disposals and acquisitions were not removed from adjusted results as they were not significant.*
- 3 *Excludes items where there are substantial offsets in the income statement for the same year.*
- 4 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue.*
- 5 *Positive numbers are favourable; negative numbers are unfavourable.*
- 6 *Currency translation adjustment is the effect of translating the results of subsidiaries and associates for the previous year at the average rates of exchange applicable in the current year.*
- 7 *Own credit spread includes the fair value movements on our long-term debt attributable to credit spread where the net result of such movements will be zero upon maturity of the debt. This does not include fair value changes due to own credit risk in respect of trading liabilities or derivative liabilities.*
- 8 *From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (see Note 11 on the Financial Statements for further details). Comparative data have been represented accordingly.*

**Consolidated income statement**

- 9 *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. For further information, see footnote 3 on page 39.*
- 10 *Dividends per ordinary share expressed as a percentage of basic earnings per share.*
- 11 *Net interest income includes the cost of internally funding trading assets, while the related external revenues are reported in Trading income. In our global business results, the cost of funding trading assets is included with Global Banking and Market's net trading income as interest expense.*
- 12 *Gross interest yield is the average annualised interest rate earned on average interest-earning assets (AIEA).*
- 13 *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.*
- 14 *Net interest margin is net interest income expressed as an annualised percentage of AIEA.*
- 15 *Interest income on trading assets is reported as Net trading income in the consolidated income statement.*
- 16 *Interest income on financial assets designated at fair value is reported as Net income from financial instruments designated at fair value in the consolidated income statement.*
- 17 *Including interest-bearing bank deposits only.*
- 18 *Interest expense on financial liabilities designated at fair value is reported as Net income on financial instruments designated at fair value in the consolidated income statement, other than interest on own debt which is reported in Interest expense.*

- 19 *Including interest-bearing customer accounts only.*
- 20 *Net trading income includes a favourable movement of US\$15m (2013: unfavourable movement of US\$66m; 2012: unfavourable movement of US\$629m), associated with changes in the fair value of issued structured notes and other hybrid instrument liabilities arising from movements in HSBC issuance spreads.*
- 21 *Trading income also includes movements on non-qualifying hedges. These hedges are derivatives entered into as part of a documented interest rate management strategy for which hedge accounting was not, nor could be, applied. They are principally cross-currency and interest rate swaps used to economically hedge fixed rate debt issued by HSBC Holdings and floating rate debt issued by HSBC Finance. The size and direction of the changes in the fair value of non-qualifying hedges that are recognised in the income statement can be volatile from year-to-year, but do not alter the cash flows expected as part of the documented interest rate management strategy for both the instruments and the underlying economically hedged assets and liabilities if the derivative is held to maturity.*
- 22 *In 2013, we recorded a net gain on US\$553m on the completion of the Ping An disposal. This represented the net effect of US\$1,235m gain on de-recognition of equity securities classified as available for sale and recorded in Gains less losses from financial investments, partly offset by US\$682m on a contingent forward sale contract, recorded in Net trading income.*
- 23 *Other changes in fair value include gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with HSBC's long-term debt issued.*
- 24 *Net insurance claims and benefits paid 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 incurred 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.*
- 25 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*

#### **Consolidated balance sheet**

- 26 *In 2013, GB&M changed the way it manages reverse repo and repo activities in the Credit and Rates business. This led to a decrease in amounts classified as Trading assets and Trading liabilities in the balance sheet and an increase in the amount classified as Non-trading reverse repos at amortised cost and Non-trading repos at amortised cost respectively.*
- 27 *From 1 January 2014, non-trading reverse repos and repos are presented as separate lines in the balance sheet. Previously, non-trading reverse repos were included within Loans and advances to banks and Loans and advances to customers and non-trading repos were included within Deposits by banks and Customer accounts. Comparative data have been re-presented accordingly. Non-trading reverse repos and repos have been presented as separate lines in the balance sheet to align disclosure with market practice and provide more meaningful information in relation to loans and advances. The extent to which reverse repos and repos represent loans to/from customers and banks is set out in Note 17 on the Financial Statements.*
- 28 *Net of impairment allowances.*
- 29 *On 1 January 2014, CRD IV came into force and the calculation of capital resources and risk-weighted assets at 31 December 2014 are calculated and presented on this basis. 2011 to 2013 comparatives are on a Basel 2.5 basis. 2010 comparatives are on a Basel II basis.*
- 30 *Capital resources are total regulatory capital, the calculation of which is set out on page 246.*
- 31 *Including perpetual preferred securities, details of which can be found in Note 30 on the Financial Statements.*
- 32 *The definition of net asset value per ordinary share is total shareholders' equity, less non-cumulative preference shares and capital securities, divided by the number of ordinary shares in issue excluding shares the company has purchased and are held in treasury.*





**Table of Contents****Report of the Directors: Financial Review** (continued)

33 *Currency translation adjustment* is the effect of translating the assets and liabilities of subsidiaries and associates for the previous year-end at the rates of exchange applicable at the current year-end.

34 *Balance included in disposal groups of assets held for sale.*

35 *France primarily comprises the domestic operations of HSBC Finance, HSBC Assurances Vie and the Paris branch of HSBC Bank plc.*

**Reconciliation of RoRWA measures**

36 *Risk-weighted assets ( RWA s) and pre-tax return on average risk-weighted assets ( RoRWA ).*

37 *Adjusted RoRWA is calculated using adjusted pre-tax return and reported average RWAs at constant currency and adjusted for the effects of significant items.*

38 *Other* includes treasury services related to the US Consumer and Mortgage Lending business and commercial operations in run-off. US CML includes loan portfolios within the run-off business that are designated held for sale.

**Global businesses and geographical regions**

39 *The main items reported under Other* are the results of HSBC's holding company and financing operations, which includes net interest earned on free capital held centrally, operating costs incurred by the head office operations in providing stewardship and central management services to HSBC, along with the costs incurred by the Group Service Centres and Shared Service Organisations and associated recoveries. The results also include fines and penalties as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanctions laws, the UK bank levy together with unallocated investment activities, centrally held investment companies, gains arising from the dilution of interests in associates and joint ventures and certain property transactions. In addition, *Other* also includes part of the movement in the fair value of long-term debt designated at fair value (the remainder of the Group's movement on own debt is included in GB&M).

40 *Assets by geographical region and global businesses include intra-HSBC items. These items are eliminated, where appropriate, under the heading Intra-HSBC items or inter-segment elimination, as appropriate.*

41 *For disposed of businesses, this includes the gain or loss on disposal and material results of operations as described on page 40.*

42 *Other income in this context comprises where applicable net trading income, net income/(expense) from other financial instruments designated at fair value, gains less losses from financial investments, dividend income, net insurance premium income and other operating income less net insurance claims and benefits paid and movement in liabilities to policyholders.*

43 *Loan impairment charges and other credit risk provisions.*

44 *Share of profit in associates and joint ventures.*

45 *See Use of non-GAAP financial measures on page 40. Reconciliation of adjusted results to reported results is provided in the Form 20-F filed with the Securities and Exchange Commission, which is available on [www.hsbc.com](http://www.hsbc.com).*

46

*The Principal RBWM business measure excludes the effects of the US run-off portfolio and the disposed-of US CRS business. Concentrating on the Principal RBWM business allows management to identify material changes in the ongoing business and assess the factors and trends which are expected to have a material effect on it in future years. Tables which reconcile reported to adjusted financial measures for Principal RBWM are available on [www.hsbc.com](http://www.hsbc.com).*

- 47 *Investment distribution* includes Investments, which comprises mutual funds (HSBC manufactured and third party), structured products and securities trading, and Wealth Insurance distribution, consisting of HSBC manufactured and third-party life, pension and investment insurance products.
- 48 *Other personal lending* includes personal non-residential closed-end loans and personal overdrafts.
- 49 *Other* mainly includes the distribution and manufacturing (where applicable) of retail and credit protection insurance.
- 50 *In the analysis of global businesses, net trading income/(expense) comprises all gains and losses from changes in the fair value of financial assets and financial liabilities classified as held for trading, related external and internal interest income and interest expense, and dividends received; in the statutory presentation internal interest income and expense are eliminated.*
- 51 *Markets products, Insurance and Investments and Other* includes revenue from Foreign Exchange, insurance manufacturing and distribution, interest rate management and GCF products.
- 52 *In 2014, Markets included a favourable fair value movement of US\$15m on the widening of credit spreads on structured liabilities (2013: adverse fair value movement of US\$66m; 2012: adverse fair value movement of US\$629m).*
- 53 *Other* in GB&M includes net interest earned on free capital held in the global business not assigned to products, allocated funding costs and gains resulting from business disposals. Within the management view of total operating income, notional tax credits are allocated to the businesses to reflect the economic benefit generated by certain activities which is not reflected within operating income, for example notional credits on income earned from tax-exempt investments where the economic benefit of the activity is reflected in tax expense. In order to reflect the total operating income on an IFRS basis, the offset to these tax credits are included within *Other*.
- 54 *Client assets* are translated at the rates of exchange applicable for their respective period-ends, with the effects of currency translation reported separately. The main components of client assets are funds under management (US\$275bn as at 31 December 2014) which are not reported on the Group's balance sheet, and customer deposits (US\$90bn as at 31 December 2014), of which US\$85bn is reported on the Group's balance sheet and US\$5bn are off-balance sheet deposits.
- 55 *Inter-segment elimination comprises (i) the costs of shared services and Group Service Centres included within Other* which are recovered from global businesses, and (ii) the intra-segment funding costs of trading activities undertaken within GB&M. HSBC's Balance Sheet Management business, reported within GB&M, provides funding to the trading businesses. To report GB&M's Net trading income on a fully funded basis, Net interest income and Net interest income/(expense) on trading activities are grossed up to reflect internal funding transactions prior to their elimination in the inter-segment column.
- 56 *Net insurance claims and benefits paid and movement in liabilities to policyholders.*
- 57 *Employee expenses* comprise costs directly incurred by each global business. The reallocation and recharging of employee and other expenses directly incurred in the *Other* category are shown in *Other operating expenses*.
- 58 *RWAs are non-additive across geographical regions due to market risk diversification effects within the Group.*
- 59 *Funds under management and assets held in custody are not reported on the Group's balance sheet, except where it is deemed that we are acting as principal rather than agent in our role as investment manager, and these assets are consolidated as Structured entities (see Note 39 on the Financial Statements).*
- 60 *Taxes paid by HSBC relate to HSBC's own tax liabilities including tax on profits earned, employer taxes, bank levy and other duties/levies such as stamp duty. Numbers are reported on a cash flow basis.*



**Table of Contents****Report of the Directors: Financial Review** (continued)**Average balance sheet**

- 61 *Interest income on trading assets is reported as Net trading income in the consolidated income statement.*
- 62 *Interest income on financial assets designated at fair value is reported as Net income from financial instruments designated at fair value in the consolidated income statement.*
- 63 *From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (see Note 11 on the Financial Statements for further details). Comparative data have been represented accordingly.*
- 64 *This includes interest-bearing bank deposits only. See page 60(n) for an analysis of all bank deposits.*
- 65 *Interest expense on financial liabilities designated at fair value is reported as Net income on financial instruments designated at fair value in the consolidated income statement, other than interest on own debt which is reported in Interest Expense .*
- 66 *This includes interest-bearing customer accounts only. See page 60(n) for an analysis of all customer accounts.*
- 67 *Net interest margin is calculated as net interest income divided by average interest earning assets.*
- 68 *In 2012 CMB results include US\$128m of net operating income and US\$43m of profit before tax related to low income housing tax credit investments in the US which are offset within the Other segment.*

**Ratio of earnings to fixed charges**

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

**Reconciliations of non-GAAP financial measures**

- 70 *The operating results of these disposals were removed from underlying results in addition to disposal gains and losses.*
- 71 *The operating results of these disposals and acquisitions were not removed from underlying results as they were not significant.*
- 72 *Positive numbers are favourable: negative numbers are unfavourable.*
- 73 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue .*
- 74 *Currency translation on adjustment is the effect of translating the results of subsidiaries and associates for the previous year at the average rates of exchange applicable in the current year.*
- 75 *Own credit spread includes the fair value movements on our long-term debt attributable to credit spread where the net result of such movements will be zero upon maturity of the debt. This does not include fair value changes*

*due to own credit risk in respect of trading liabilities or derivative liabilities.*

*76 From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (See Note 11 on the Financial Statements for further details).*

*Comparative data have been represented accordingly.*

*77 Currency translation adjustment is the effect of translating the assets and liabilities of subsidiaries and associates for the previous year-end at the rates of exchange applicable at the current year-end.*

*78 The Principal RBWM business measure excludes the effects of the US run-off portfolio and the disposed-of US CRS business. Concentrating on the Principal RBWM business allows management to identify material changes in the ongoing business and assess the factors and trends which are expected to have a material effect on it in future years. Tables which reconcile reported RBWM financial measures to Principal RBWM financial measures are available on [www.hsbc.com](http://www.hsbc.com).*

*79 Excludes items where there are substantial offsets in the income statement for the same year.*

*80 Other income in this context comprises where applicable net trading income, net income/(expense) from other financial instruments designated at fair value, gains less losses from financial investments, dividend income, net earned insurance premiums and other operating income less net insurance claims incurred and movement in liabilities to policyholders.*

*81 Net insurance claims incurred and movement in liabilities to shareholders.*

HSBC HOLDINGS PLC

110a

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**Regulation and supervision***(Unaudited)*

With listings of its ordinary shares in London, Hong Kong, New York, Paris and Bermuda, HSBC Holdings complies with the relevant requirements for listing and trading on each of these exchanges. In the UK, these are the Listing Rules of the Financial Conduct Authority ( FCA ) in its role as the UK Listing Authority; in Hong Kong, The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ( HKSE ); in the US, where the shares are traded in the form of ADS, HSBC Holdings shares are registered with the US Securities and Exchange Commission ( SEC ). As a consequence of its US listing, HSBC Holdings is also subject to the reporting and other requirements of the US Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the New York Stock Exchange s ( NYSE ) Listed Company Manual, in each case as applied to foreign private issuers. In France and Bermuda, HSBC Holdings is subject to the listing rules of Euronext, Paris and the Bermuda Stock Exchange respectively, applicable to companies with secondary listings.

A statement of our compliance with the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council and with the Hong Kong Corporate Governance Code set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited can be found in the Report of the Directors: Corporate Governance on page 263.

Our operations throughout the world are regulated and supervised by over 400 different central banks and other regulatory authorities in those jurisdictions in which we have offices, branches or subsidiaries. These authorities impose a variety of requirements and controls designed to provide financial stability, transparency in financial markets and a contribution to economic growth. These regulations and controls cover, *inter alia*, capital adequacy, depositor protection, market liquidity, governance standards, customer protection (for example, fair lending practices, product design and marketing and documentation standards), and financial crime and other obligations (for example, anti-money laundering, anti-bribery and corruption, and anti-terrorist financing measures). In addition, a number of countries in which we operate impose rules that affect, or place limitations on, foreign or foreign-owned or controlled banks and financial institutions. The rules include restrictions on the opening of local offices, branches or subsidiaries and the types of banking and non-banking activities that may be conducted by those local offices, branches or subsidiaries; restrictions on the acquisition of local banks or regulations requiring a specified percentage of local ownership; and restrictions on investment and other financial flows entering or leaving the country. Country supervisory and regulatory regimes will determine to some degree our ability to expand into new markets, the services and products that

we will be able to offer in those markets and how we structure specific operations. As a result of government interventions in response to global economic conditions, there has been (and it is expected that there will continue to be) a substantial increase in government regulation and supervision of the financial services industry, including the imposition of higher capital and liquidity requirements, heightened disclosure standards and restrictions on certain types of products or transaction structures.

The Prudential Regulation Authority ( PRA ) is the HSBC Group 's consolidated lead regulator. The other UK regulator, the FCA, supervises 12 HSBC regulated entities in the UK, including 7 where the PRA is responsible for prudential supervision. The FCA also supervises the Group globally in relation to financial crime matters. Additionally, both the PRA and FCA have certain limited direct supervisory powers over our unregulated qualifying parent company HSBC Holdings plc, including (in the FCA 's case) pursuant to the undertaking with the FSA (revised as the FCA Direction on 2 April 2013) in connection with HSBC Holdings plc and HSBC North America Holdings, Inc. having entered into agreements as part of a global settlement with a number of US authorities in relation to the Group 's failure to comply with anti-money laundering ( AML ) rules, US sanctions requirements and related matters. In addition, each operating bank, finance company or insurance operation within HSBC is regulated by local supervisors.

The primary regulatory authorities are those in the UK, Hong Kong and the US, our principal jurisdictions of operation. However, and in addition, with the implementation of the EU 's Single Supervisory Mechanism ( SSM ) in 19 EU member states on 4 November 2014, the European Central Bank ( ECB ) assumed direct supervisory responsibility for HSBC France and HSBC Malta as significant supervised entities within the Eurozone for the purposes of the EU 's SSM Regulation. Under the SSM, the ECB will also increasingly engage with the relevant National Competent Authorities in relation to HSBC 's businesses in other Eurozone countries and more widely with other HSBC regulators. It is therefore expected that we will continue to see changes in how the Group is regulated and supervised on a day-to-day basis in the Eurozone and more generally as the ECB and other of our regulators develop their powers having regard to some of the regulatory initiatives highlighted in this report.

### **UK regulation and supervision**

The UK financial services regulatory structure is comprised of three regulatory bodies: the Financial Policy Committee ( FPC ), a committee of the Bank of England ( BoE ), the PRA, a subsidiary of the BoE and the FCA.

The FPC is responsible for macro-prudential supervision, focussing on systemic risk that may affect the UK 's financial stability. The PRA and the FCA are micro-prudential supervisors. The Group 's banking subsidiaries such as HSBC Bank plc (our principal authorised

HSBC HOLDINGS PLC

110b

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

institution in the UK) are dual-regulated firms, subject to prudential regulation by the PRA and to conduct regulation by the FCA. Other (generally smaller, non-bank) UK based Group subsidiaries are solo regulated by the FCA (i.e. the FCA is responsible for both prudential and conduct regulation of those subsidiaries).

UK banking and financial services institutions are subject to multiple regulations. The primary UK statute in this context is the Financial Services and Markets Act 2000 (FSMA), as amended by subsequent legislation. Other UK financial services legislation includes that derived from EU directives and regulations relating to banking, securities, insurance, investments and sales of personal financial services.

The PRA and FCA are together responsible for authorising and supervising all our operating businesses in the UK which require authorisation under FSMA. These include deposit-taking, retail banking, life and general insurance, pensions, investments, mortgages, custody and share-dealing businesses and treasury and capital markets activity.

PRA and FCA rules establish the minimum criteria for the authorisation of banks and financial services businesses. In the UK and the PRA and FCA have the right to object, on prudential grounds, to persons who hold, or intend to hold, 10% or more of the voting power or shares of a financial institution that it regulates, or of its parent undertaking. PRA rules also set out reporting (and, as applicable, consent) requirements with regard to large individual exposures and large exposures to related borrowers. In its capacity as our supervisor on a consolidated basis, the PRA receives information on the capital adequacy of, and sets requirements for, the Group as a whole. Individual banking subsidiaries in the Group are directly regulated by their local banking supervisors, who set and monitor, *inter alia*, their capital adequacy requirements.

The PRA and FCA monitor authorised institutions through ongoing supervision and the review of routine and *ad hoc* reports relating to financial, prudential and conduct of business matters. They may also obtain independent reports from a skilled person on the adequacy of procedures and systems covering internal control and governing records and accounting. The PRA meet regularly with the Group's senior executives to discuss our adherence to the PRA's prudential guidelines. In addition, both the PRA and FCA regularly discuss fundamental matters relating to our business in the UK and internationally, including areas such as strategic and operating plans, risk control, loan portfolio composition and organisational changes, including succession planning and recovery and resolution arrangements.

With the rapid pace of regulatory change and market conditions, we continue to experience a high level of ongoing interaction with both the PRA and the FCA.

In 2013, we calculated capital at a Group level using the Basel II framework as amended for CRD III, commonly known as Basel 2.5, and also estimated capital on an

end point CRD IV basis. On 1 January 2014, CRD IV came into force and capital and RWAs at 31 December 2014 are calculated and presented on the Group's interpretation of final CRD IV legislation and final rules issued by the PRA.



The Basel III framework, similarly to Basel II, is structured around three pillars : minimum capital requirements, supervisory review process and market discipline. CRD IV implemented Basel III in the EU and, in the UK, the PRA Rulebook CRR Firms Instrument 2013 transposed the various national discretions under CRD IV into UK law.

In its final rules, the PRA did not adopt most of the CRD IV transitional provisions available, instead opting for an acceleration of the CRD IV end point definition of common equity tier 1 ( CET1 ). However CRD IV transitional provisions for unrealised gains were applied, such that unrealised gains on investment property and available-for-sale securities were not recognised for capital until 1 January 2015. As a result, in 2014, our transitional capital ratio is slightly lower than the comparable end point capital ratio.

In April 2014, the PRA published its rules and supervisory statements implementing some of the CRD IV provisions relating to capital buffers. In addition, in June 2014 the PRA published its expectations in relation to capital ratios for major UK banks and building societies, namely that from 1 July 2014, we are expected to meet a 7% CET1 ratio using CRD IV end point definition. This applies alongside CRD IV requirements. This also included a revised PRA expectation in relation to the leverage ratio for major UK banks and building societies, namely that from 1 July 2014, we are expected to meet a 3% end-point tier 1 leverage ratio, calculated using the CRD IV definition of capital for the numerator and the Basel 2014 exposure measure for the denominator.

In January 2015, the PRA issued a letter setting out the approach to be taken for calculating the leverage ratio for 2014 year end disclosures. While the numerator continues to be calculated using the final CRD IV end point tier 1 capital definition, the exposure measure is now calculated based the EU delegated act published in January 2015 (rather than the Basel 2014 definition used in the Interim Report 2014). Further details of this can be found in the Capital section on page 251.

Despite the rules published to date, there remains continued uncertainty around the amount of capital that UK banks will be required to hold. This relates specifically to the quantification and interaction of capital buffers and Pillar 2. The PRA is currently consulting on their revised approach to Pillar 2, the PRA buffer and its interaction with the CRD IV buffers. Furthermore, there are a significant number of draft and unpublished EBA regulatory and implementing technical standards due in 2015.

CRD IV establishes a number of capital buffers, to be met by CET1 capital, broadly aligned with the Basel III framework. CRD IV contemplates that these will be

HSBC HOLDINGS PLC

110c

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

phased in from 1 January 2016, subject to national discretion. Automatic restrictions on capital distributions apply if a bank's CET1 capital falls below the level of its CRD IV combined buffer. This is defined as the total of the capital conservation buffer (CCB), the countercyclical capital buffer (CCyB), the global systemically important institutions (G-SIIs) buffer and the systemic risk buffer (SRB) as these become applicable. The PRA have proposed that the use of the PRA buffer will not result in automatic restrictions on capital distributions.

In April 2014, HM Treasury published the statutory instrument Capital Requirements (Capital Buffers and Macro-Prudential Measures) Regulations 2014 transposing into UK legislation the main provisions in CRD IV related to capital buffers, with the exception of the SRB. In January 2015, HM Treasury published amendments to this statutory instrument in order to transpose the SRB.

The PRA is the designated authority for the G-SII buffer, the other systemically important institutions (O-SIIs) buffer and the CCB. In April 2014, they published rules and supervisory statements implementing the main CRD IV provisions in relation to these buffers. The BoE is the designated authority for the CCyB and macro-prudential measures. Whilst the PRA and the FCA are the designated authorities for applying and determining the SRB, the FPC is responsible for creating the SRB framework for calibration.

The G-SII buffer (which is the EU implementation of the Basel G-SIB buffer) is to be met with CET1 capital and will be phased in from 1 January 2016. In October 2014, finalised Regulatory Technical Standards (RTS) on the methodology for identification of G-SIIs were published in the EU's Official Journal and came into effect from 1 January 2015. In November 2014 the Financial Stability Board (FSB) and the Basel Committee updated the list of G-SIBs, using end-2013 data. The add-on of 2.5% previously assigned to HSBC was left unchanged.

Following direction from the PRA to UK banks in its Supervisory Statement issued in April 2014, and in accordance with the EBA final draft Implementing Technical Standards (ITS) and guidelines published in June 2014, we published the EBA template in July 2014. This disclosed the information used for the identification and scoring process which underpins our G-SIB designation. The final ITS for disclosure requirements were published in September 2014, and will form the basis of our future 2015 disclosure of G-SII indicators.

The CCB was designed to ensure banks build up capital outside periods of stress that can be drawn down when losses are incurred and is set at 2.5% of RWAs. The PRA will phase-in this buffer from 1 January 2016 to 1 January 2019.

CRD IV contemplates a countercyclical buffer in line with Basel III, in the form of an institution-specific CCyB and the application of increased requirements to address macro-prudential or systemic risk. In January 2014, the FPC issued a policy statement on its powers to

supplement capital requirements, through the use of the CCyB and the sectoral capital requirements (SCR) tools.

The CCyB is expected to be set in the range of 0-2.5% of relevant credit exposures RWAs, although it is uncapped. Under UK legislation, the FPC is required to determine whether to recognise any CCyB rates set by other EEA countries before 2016.

In June 2014, the FPC set the CCyB rate for UK exposures at 0%. At its September 2014 meeting, the FPC left the CCyB rate for UK exposures unchanged at 0% and recognised the 1% CCyB rates introduced by Norway and Sweden to become effective from 3 October 2015. In January 2015, the HKMA announced the application of a CCyB rate of 0.625% to Hong Kong exposures, to apply from 1 January 2016. In accordance with UK legislation and PRA supervisory statement PS 3/14, this rate will directly apply to the calculation of our institution-specific CCyB rate from 1 January 2016. The institution-specific CCyB rate for the Group will be based on the weighted average of the CCyB rates that apply in the jurisdictions where relevant credit exposures are located. Currently the Group's institution specific CCyB is zero. The SCR tool is not currently deployed in the UK.

In addition to the measures above, CRD IV sets out a SRB for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigating structural macro-prudential risk.

In January 2015, the legislative changes necessary to transpose the SRB were implemented. The SRB is to be applied to ring-fenced banks and building societies (over a certain threshold), which are together defined as SRB institutions. The SRB can be applied on an individual, sub-consolidated or consolidated basis and is applicable from 1 January 2019. By 31 May 2016, the FPC is required to create a framework for identifying the extent to which the failure or distress of SRB institutions will pose certain long-term non-cyclical systemic or macro-prudential risks. The PRA will apply this framework to determine whether specific SRB institutions would be subject to an SRB rate, and the level at which the buffer would be applied and is able to exercise supervisory judgment to determine what the rate should be. Where applicable, the buffer rate must be set in the range of 1% to 3%. The buffer rate would apply to all the SRB institution's exposures unless the PRA has recognised a buffer rate set in another member state. If the SRB is applied on a consolidated basis it is expected that the higher of the G-SII or SRB would apply, in accordance with CRD IV.

Under the Pillar 2 framework, banks are already required to hold capital in respect of the internal capital adequacy assessment and supervisory review which leads to a final determination by the PRA of individual capital guidance under Pillar 2A and Pillar 2B. Pillar 2A was previously met by total capital, but since 1 January 2015, in accordance with the PRA supervisory statement SS 5/13, is met with at least 56% CET1.

HSBC HOLDINGS PLC

110d

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Pillar 2A guidance is a point in time assessment of the amount of capital the PRA considers that a bank should hold to meet the overall financial adequacy rule. It is therefore subject to change pending annual assessment and the supervisory review process. During 2014, the Group Pillar 2A guidance amounted to 1.5% of RWAs, of which 0.9% was to be met by CET1. In February 2015, this was revised to 2.0% of RWAs, of which 1.1% is to be met by CET1 and is effective immediately.

In January 2015, the PRA published a consultation on the Pillar 2 framework. This set out the methodologies that the PRA proposed to use to inform its setting of firms' Pillar 2 capital requirements, including proposing new approaches for determining Pillar 2 requirements for credit risk, operational risk, credit concentration risk and pension obligation risk.

As part of CRD IV implementation, the PRA proposed to introduce a PRA buffer, to replace the capital planning buffer (CPB) (known as Pillar 2B), also to be held in the form of CET1 capital. This was reconfirmed in the recent PRA consultation on the Pillar 2 framework. It is proposed that a PRA buffer will avoid duplication with CRD IV buffers and will be set for a particular firm depending on its vulnerability in a stress scenario or where the PRA has identified risk management and governance failings. In order to address weaknesses in risk management and governance, the PRA propose a scalar applied to firms' CET1 Pillar 1 and Pillar 2A capital requirements. Where the PRA considers there is overlap between the CRD IV buffers and the PRA buffer assessment, the PRA proposes to set the PRA buffer as the excess capital required over and above the CCB and relevant systemic buffers. The PRA buffer will however be in addition to the CCyB and sectoral capital requirements.

The PRA expects to finalise the Pillar 2 framework in July 2015, with implementation expected from 1 January 2016. Until this consultation is finalised and revised rules and guidance issued, there remains uncertainty as to the exact buffer rate requirements, and their ultimate capital impact.

The FPC has been granted powers to give directions to the FCA or the PRA on the exercise of their supervisory powers, and may make recommendations within the BoE, to HM Treasury, to the FCA or the PRA or to other persons.

Within the BoE, the FPC is responsible for setting the CCyB rate and the use of direction powers over SCR's. The UK legislation enabled use of the CCyB and SCR tools from 1 May 2014. In January 2014, the FPC issued a policy statement on its powers to supplement capital requirements, through the use of the CCyB and the SCR tools. The CCyB allows the FPC to raise capital requirements above the micro-prudential level for all exposures to borrowers in the UK. The SCR is a more targeted tool which allows the FPC to increase capital requirements above minimum regulatory standards for exposures to three broad sectors judged to pose a risk to the stability of the financial system as a whole;

residential and commercial property; and, other parts of the financial sector, potentially on a global basis

The CCyB and SCR tools are stated as broad powers designed to reduce the likelihood and severity of financial crises, their primary purpose being to tackle cyclical risks. Both tools provide the FPC with means to increase the amount of capital that banks must have when threats to financial stability are judged to be emerging.

In October 2014, the FPC published final recommendations on the design of a UK specific leverage ratio framework and calibration. This followed an earlier FPC consultation in July 2014 on the design of the framework. HM Treasury published a consultation paper in November 2014, which responded to and agreed with the FPC recommendations in relation to the design of the leverage ratio framework. Specifically, HM Treasury agreed that the FPC should be granted powers to direct the PRA on a minimum requirement, additional leverage ratio buffer (for G-SIBs, major UK banks and building societies including ring fenced banks) and a countercyclical leverage ratio buffer ( CCLB ). In February 2015, HM Treasury published a summary of responses, alongside the draft instrument which was laid before Parliament. Further details of this can be found in the Capital section on page 255.

In the third quarter of 2014, and in response to UK government proposals, the FPC also recommended that HM Treasury exercise its statutory power to enable the FPC to direct the PRA and FCA to require UK regulated lenders to place limits on residential mortgage lending, both owner occupied and buy-to-let by reference to loan-to-value, debt-to-income and interest coverage ratios. In February 2015, HM Treasury published a summary of responses to an earlier consultation. As part of this, HM Treasury laid secondary legislation before Parliament to provide the FPC with a new power of direction over the housing market.

There are a substantial number of other on-going regulatory initiatives affecting the Group driven by or from the UK. These include the UK bank levy, on-going implementation of requirements regarding recovery and resolution plans ( RRP ) and of the recommendations of the UK Independent Commission on Banking ( ICB ) and the Parliamentary Commission on Banking Standards ( PCBS ) in relation to ring-fencing of retail banking activities.

Legislation in respect of the UK bank levy was substantively created in July 2011, in the form of the Finance Act 2011 and the levy has been applied since January 2011. HSBC is a UK banking group for these purposes and the UK levy is chargeable on the Group's consolidated balance sheet at the year end. A charge of US\$1,108m for the UK bank levy on the 2014 balance sheet has been recognised of which US\$641m does not relate to UK banking activity.

HSBC HOLDINGS PLC

110e

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

In relation to recovery and resolution planning, following the financial crisis, G20 leaders requested the Financial Stability Board (FSB) to establish more effective arrangements for the recovery and resolution of 28 (now 30) designated G-SIBs resulting in a series of policy recommendations in relation to recovery and resolution planning, cross border cooperation agreements and measures to mitigate obstacles to resolution.

In December 2013, the PRA set out rules for recovery and resolution of UK banks and international banks operating in the UK, which came into effect on 1 January 2014. In January 2015, the PRA published a policy statement containing updated requirements for recovery and resolution planning in order to implement the EU Bank Recovery and Resolution Directive (BRRD) which came into effect from 1 January 2015.

In addition to the developing rules in the UK relevant to the Group as a whole, many individual legal entities outside the UK are (or may in future be) subject to their own local requirements regarding RRP.

In December 2013, the UK's Financial Services (Banking Reform) Act 2013 (Banking Reform Act) received royal assent. It implements most of the primary recommendations of the ICB, which *inter alia* require large banking groups to ring-fence UK retail banking activity in a separately incorporated banking subsidiary (a ring-fenced bank) that is prohibited from engaging in significant trading activity. For these purposes, the UK excludes the Crown Dependencies. Ring-fencing will take effect from 1 January 2019.

In July 2014, secondary legislation was finalised. This included provisions further detailing the applicable individuals and enterprises to be transferred to the ring-fenced bank by reference to gross worth and turnover levels respectively. In addition, the secondary legislation places restrictions on the activities and geographical scope of ring-fenced banks.

In October 2014, the PRA published a consultation paper on ring-fencing rules in relation to legal structure, governance and continuity of services and facilities. The PRA also published a discussion paper concerning operational continuity in resolution. The PRA intends to undertake further consultation and finalise ring-fencing rules in due course. The PRA also published a discussion paper concerning operational continuity in resolution. As required by the PRA's consultation paper, a provisional ring-fencing project plan was presented to the UK regulators in November 2014. This plan provided for ring-fencing of the activities prescribed in the legislation, broadly the retail and SME services that are currently part of HSBC Bank plc (HSBC Bank), in a separate subsidiary.

In addition, the plan reflected the operational continuity expectations of each of the PRA's consultation and discussion papers by providing for the proposed enhancement of the ServCo Group. The plan remains subject to further planning and approvals internally and is ultimately subject to the approval of the PRA, FCA and other applicable regulators.

Further reforms currently in the process of implementation as a result of ICB and PCBS proposals

include the introduction of a new framework for individuals aimed at strengthening accountability in banking (including a new Senior Managers Regime) and new remuneration rules intended to strengthen the alignment between risk and reward. Whilst proposed by the PRA and FCA, these initiatives may have some effect on HSBC's staff and operations outside the UK and HSBC is actively engaged in consultations on and preparation for these new regimes.

At a national level in the UK, other relevant regulatory initiatives include a continued high levels of focus by the FCA on the management of conduct of business including attention to sales processes and incentives, product and investment suitability, product governance, employee activities and accountabilities as well as the risks of market abuse in relation to benchmark, index, other rate setting processes and wider trading activities and the financial crime (AML, sanctions and anti-bribery) agenda. The FCA also continues work to establish a new Payment Systems Regulator ( PSR ) in the UK with the intention of the PSR being operational by 1 April 2015.

The FCA continues to make increasing use of existing and new powers of intervention and enforcement, including powers to consider past business undertaken and implement customer compensation and redress schemes or other, potentially significant, remedial work. The FCA is also now regulating areas of activity not previously regulated by them, such as consumer credit, and considering competition issues in the markets they regulate.

These ongoing changes mean that the FCA and other regulators increasingly take actions in response to customer complaints or where they see poor customer outcomes and/or market abuses, either specific to an institution or more generally in relation to a particular product. There have been recent examples of this approach by regulators in the context of the mis-selling of payment protection insurance ( PPI ), interest rate hedging products to SMEs and wealth management products.

The FCA is also involved (along with HM Treasury) in the Fair and Effective Financial Markets Review, established by the UK Government in June 2014 and led by the BoE. This review was established with the aim of reinforcing confidence in the fairness and effectiveness of wholesale financial market activity in the UK and to influence the international debate on trading practices. Work to date includes considering the fairness and effectiveness of the fixed income, foreign exchange and commodities markets and the Review is expected to produce its final report by June 2015.

In a similar vein, on 6 November 2014, and following an earlier consultation, the UK Competition and Markets Authority ( CMA ) announced an in depth investigation into the supply of retail banking services to personal current account and to SME customers in the UK. The investigation is based on the CMA concerns that there are features of both sectors that (alone or in combination) it suspects prevent, restrict or distort competition. The CMA has indicated that it intends to

HSBC HOLDINGS PLC

110f

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

notify provisional findings and possible remedies in September 2015 and the statutory deadline for the CMA's final report is 5 May 2016.

Either or both of these reviews could lead to the imposition of new or additional requirements or remedies which could affect the scope or operation of HSBC's activities in the UK.

Similarly, the UK and other regulators may identify future industry-wide mis-selling, market conduct or other issues that could affect the Group. This may lead from time to time to: (i) significant direct costs or liabilities; and (ii) changes in the practices of such businesses. Further, decisions taken in the UK by the Financial Ombudsman Service in relation to customer complaints (or any overseas equivalent that has jurisdiction) could, if applied to a wider class or grouping of customers, have a material adverse effect on the operating results, financial condition and prospects of the Group.

The FCA also continues to apply close scrutiny to the Group's financial crime control framework both generally in conjunction with the exercise of its wider powers under FSMA and more specifically under the FCA Direction as described above. This includes ongoing consideration of the Group's progress in meeting its obligations under the Deferred Prosecution Agreement and other commitments outlined below.

### **Hong Kong regulation and supervision**

Banking in Hong Kong is subject to the provisions of the Banking Ordinance and to the powers, functions and duties ascribed by the Banking Ordinance to the Hong Kong Monetary Authority (the HKMA). The principal function of the HKMA is to promote the general stability and effective working of the banking system in Hong Kong. The HKMA is responsible for supervising compliance with the provisions of the Banking Ordinance. The Banking Ordinance gives power to the Chief Executive of Hong Kong to give directions to the HKMA and the Financial Secretary with respect to the exercise of their respective functions under the Banking Ordinance.

The HKMA has responsibility for authorising banks, and has discretion to attach conditions to its authorisation. The HKMA requires that banks or their holding companies file regular prudential returns, and holds regular discussions with the management of the banks to review their operations. The HKMA may also conduct on-site examinations of banks and, in the case of banks incorporated in Hong Kong, of any local and overseas branches and subsidiaries. The HKMA requires all authorised institutions to have adequate systems of internal control and requires the institutions external auditors, upon request, to report on those systems and other matters such as the accuracy of information provided to the HKMA. In addition, the HKMA may from time to time conduct tripartite discussions with banks and their external auditors.

The HKMA has the power to serve a notice of objection on persons if they are no longer deemed to be fit and proper to be controllers of the bank, if they may otherwise threaten the interests of depositors or potential depositors, or if they have contravened any conditions specified by the HKMA. The HKMA may revoke authorisation in the event of an institution's non-compliance with the provisions of the Banking Ordinance. These provisions require, among other things, the furnishing of accurate reports. The HKMA has implemented Basel II for all authorised



institutions incorporated in Hong Kong and subsequently adopted Basel III from 1 January 2013, implementing in accordance with the Basel Committee on Banking Supervision's timetable, including transitional arrangements.

The marketing of, dealing in and provision of advice and asset management services in relation to securities and futures in Hong Kong are subject to the provisions of the Securities and Futures Ordinance of Hong Kong. Entities engaging in activities regulated by the Ordinance are required to be licensed. The HKMA is the primary regulator for banks involved in the securities business, while the Securities and Futures Commission (SFC) is the regulator for securities and futures markets. Amongst other functions, the Securities and Futures Ordinance vested the SFC with powers to set and enforce market regulations, including investigating breaches of rules and market misconduct and taking appropriate enforcement action. The SFC is responsible for licensing and supervising intermediaries seeking to conduct SFC regulated activities, for example investment advisors, fund managers and brokers. Additionally the SFC authorises investment products and offering documents prior to their distribution to retail investors.

### **US regulation and supervision**

The Group is subject to extensive federal and state supervision and regulation in the US. Banking laws and regulations of the Board of Governors of the Federal Reserve System (the Federal Reserve Board), the Office of the Comptroller of the Currency (the OCC) and the Federal Deposit Insurance Corporation (the FDIC) (collectively, the US banking regulators) govern many aspects of our US business. Furthermore, since we have substantial operations outside the US which conduct many of their day-to-day transactions in US dollars which are ultimately cleared and settled in the US, HSBC entities' operations outside the US are also subject to the extra-territorial effects of US regulation in many respects. The requirements of the Deferred Prosecution Agreement entered into by HSBC in December 2012 and described in this section under Anti-money laundering and related regulation should also be noted in this context.

In July 2010, the US enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which provided a broad framework for significant regulatory changes extending to almost every area of US financial regulation. The implementation of Dodd-Frank has required further detailed rulemakings by different US regulators, including the Department of the Treasury, the Federal Reserve Board, the FDIC, the SEC, the

HSBC HOLDINGS PLC

110g

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Commodity Futures Trading Commission ( CFTC ), the Financial Stability Oversight Council ( FSOC ) and the Consumer Financial Protection Bureau ( CFPB ). Notwithstanding the time that has passed since Dodd-Frank was enacted, uncertainty remains about some of the final details, timing and impact of the rules.

The Federal Reserve Board, in consultation with the FSOC may take certain actions, including precluding mergers, restricting financial products offered, restricting or terminating activities, imposing conditions on activities or requiring the sale or transfer of assets, against any bank holding company with assets greater than US\$50bn that is found to pose a grave threat to financial stability. The FSOC is supported by the Office of Financial Research ( OFR ) which may impose data reporting requirements on financial institutions. The cost of operating both the FSOC and OFR is paid for through an assessment on large bank holding companies.

In January 2014, the Federal Reserve Board implemented the Basel III capital framework for bank holding companies such as HSBC North America Holdings Inc. ( HNAH ), which will phase in many of the requirements, including a minimum supplementary leverage ratio ( SLR ) of 3% and an effective minimum total risk-based capital ratio of 10.5% over a transition period from 2014 to 2019. The 10.5% ratio includes the capital conservation buffer which is not a minimum requirement, per se, but rather a necessary condition to capital distributions. Additionally, failure to maintain minimum regulatory ratios in simulated stress conditions, as required by the Federal Reserve Board's Comprehensive Capital Analysis and Review ( CCAR ) programme, will restrict HNAH from engaging in capital distributions such as dividends or share repurchases. In addition, large bank holding companies such as HNAH (or their parent companies) are required to file resolution plans identifying material subsidiaries and core business lines domiciled in the US, describing what strategy would be followed in the event of significant financial distress and including identifying how insured bank subsidiaries are adequately protected from risk created by other affiliates. If the Federal Reserve Board and the FDIC were to determine that these plans are not credible (which, although not defined, is generally believed to mean the regulators do not believe the plans are feasible or would otherwise allow the regulators to resolve the US businesses in a way that protects systematically important functions without severed systematic disruption and without exposing taxpayers to loss), our failure to cure the deficiencies in the required time period would enable the US regulators to impose more stringent capital, leverage and liquidity requirements, restrict the growth, activities or operations of the company or, if such failure persists, require the company to divest assets or operations. The Federal Reserve Board has also adopted final rules requiring a series of increased supervisory standards to be followed by large bank holding companies, and certain foreign banking organisations that meet particular thresholds, including stress testing requirements and risk management standards. These rules also authorise the Federal

Reserve to impose a 15-to-1 debt-to-equity ratio limit on non-bank financial companies, bank holding companies and the US operations of foreign banking organisations that the FSOC determines to pose a grave threat to the financial stability of the US.

In October 2012, the US banking regulators published a final rule setting out stress testing requirements for banking organisations. HNAH became subject to the rule from October 2013 and was required to comply with CCAR beginning with its capital plan submission in January 2014. In addition to the CCAR stress testing requirements, these regulations also include the Dodd-Frank stress testing requirements ( DFAST ), which require HNAH to undergo regulatory stress tests conducted by the Federal Reserve Board annually, and, to conduct and publish the results of its

own internal stress tests semi-annually.

Under the CCAR process, the Federal Reserve Board considers a bank holding company's overall financial condition, risk profile and capital adequacy over a nine-quarter forward-looking planning horizon. The Federal Reserve Board assesses a bank holding company's ability to meet qualitative aspects of capital planning and risk management, as well as maintaining minimum regulatory ratios including a 5% Basel I tier 1 common equity ratio, for each quarter of the planning horizon under baseline, adverse and severely adverse economic scenarios. The Federal Reserve Board also takes into account a bank holding company's planned capital actions (such as dividends or share repurchases) over the planning horizon when assessing capital adequacy. If, based on such assessment, the Federal Reserve Board were to issue an objection to a bank holding company's capital plan or planned capital actions, the bank holding company would generally not be able to undertake planned capital actions until approved by the Federal Reserve Board. The Federal Reserve Board will publicly release a summary of its CCAR assessments each year and bank holding companies are also required to publicly release a summary of their stress test results under the supervisory severely adverse scenario.

On 26 March 2014, the Federal Reserve Board informed HNAH that it did not object to HNAH's capital actions, including payment of dividends on outstanding preferred stock and trust preferred securities of HNAH and its subsidiaries. The Federal Reserve Board informed HNAH that it did object to its capital plan submitted for the 2014 CCAR submission due to weaknesses in its capital planning processes. The Federal Reserve Board does not permit bank holding companies to disclose confidential supervisory information including the reason for an objection to a capital plan submitted for CCAR. HNAH submitted its 2015 CCAR capital plan, incorporating enhancements to its processes and which also served as the required re-submission for CCAR 2014, on 5 January 2015.

In July 2014, HNAH submitted its mid-year company-run Dodd-Frank Act Stress Test ( DFAST ) results. HNAH publicly disclosed its mid-cycle DFAST results, as required, in September 2014.

HSBC HOLDINGS PLC

110h

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

In October 2014, the US banking regulators finalised a proposal to revise certain aspects of their rules pertaining to CCAR and DFAST. These revisions include, among other changes, new limitations on the ability of a bank holding company subject to CCAR to make capital distributions in a given quarter if its actual capital issuances in that quarter are less than the amount included in its capital plan. The final rule also shifts the start date of the annual CCAR capital plan and DFAST stress test cycles back by one calendar quarter. The 2015 cycle began on 1 October 2014, with a capital plan submission date on 5 January 2015. However, the next annual cycle will begin 1 January 2016 with a capital plan submission date of 5 April 2016.

In December 2014, the Federal Reserve Board published a proposal to implement the G-SIB buffer in the US. The proposed rule will only apply to US G-SIBs and will not therefore apply to HNAH.

HSBC and its US operations are subject to supervision, regulation and examination by the Federal Reserve Board because HSBC is a bank holding company under the US Bank Holding Company Act of 1956 (BHCA), as a result of its control of HSBC Bank USA, N.A., McLean, Virginia (HSBC Bank USA); and HSBC Trust Company (Delaware), N.A., Wilmington, Delaware (HTCD). HNAH is also a bank holding company. Both HSBC and HNAH have elected to be financial holding companies pursuant to the provisions of the Gramm-Leach-Bliley Act (the GLB Act) and, accordingly, may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature.

Under regulations implemented by the Federal Reserve Board, if any financial holding company, or any depository institution controlled by a financial holding company, ceases to meet certain capital or management standards, the Federal Reserve Board may impose corrective capital and/or managerial requirements on the financial holding company and place limitations on its ability to conduct the broader financial activities permissible for financial holding companies. In addition, the Federal Reserve Board may require divestiture of the holding company's depository institutions or its affiliates engaged in broader financial activities in reliance on financial holding company status under the GLB Act if the deficiencies persist. The regulations also provide that if any depository institution controlled by a financial holding company fails to maintain a satisfactory rating under the Community Reinvestment Act of 1977, the Federal Reserve Board must prohibit the financial holding company and its subsidiaries from engaging in any additional activities other than those permissible for bank holding companies that are not financial holding companies. See page 120 for further information on the regulatory consent orders with which HSBC Bank USA must comply in accordance with the agreement entered into with the Office of the Controller of the Currency (OCC) in December 2012 (the GLBA Agreement).

The two US banks, HSBC Bank USA and HTCD, are subject to regulation and examination primarily by the OCC. HSBC Bank USA and HTCD are subject to additional regulation and supervision, secondly by the FDIC, and by the Federal Reserve Board and the CFPB. Banking laws and regulations restrict many aspects of their operations and administration, including the establishment and maintenance of branch offices, capital and reserve requirements, deposits and borrowings, investment and lending activities, payment of dividends and numerous other matters. In addition, the FDIC requires FDIC-insured banks with US\$50bn or more in total assets (such as HSBC Bank USA) to submit resolution plans that should enable the FDIC to resolve the bank in a manner that ensures that depositors receive access to their insured deposits within one business day of the institution's failure (two business days if the failure occurs on a day other than Friday), maximises the value from the sale or disposition of its assets and minimises

the amount of any loss to be realised by the institution's creditors. HSBC and HSBC Bank USA submitted their second annual resolution plan jointly to the Federal Reserve Board and the FDIC on 26 June 2014.

In February 2014, the Federal Reserve Board finalised its rule requiring enhanced supervision of the US operations of non-US banks such as HSBC Holdings. The rule requires certain large non-US banks with significant operations in the United States to establish a single intermediate holding company ( IHC ) to hold their US bank and non-bank subsidiaries. HSBC currently operates in the US through an IHC structure and HNAH will be designated its IHC. The implementation of this rule, from 1 July 2016, will not have a significant impact on HSBC's US operations. HNAH submitted its IHC implementation plan to the Federal Reserve Board on 31 December 2014, as required.

An IHC may calculate its capital requirements under the US standardised approach, even if it meets the asset thresholds that would require a bank holding company to use the advanced approach. IHCs meeting these thresholds will still be subject to other applicable capital requirements, including the SLR and the countercyclical buffer (if in effect). The rule also provides that IHCs may opt out of the advanced approach and become subject to the standardised approach immediately upon the Federal Reserve Board's approval. In December 2014, HNAH received approval to opt out of the advanced approach. IHCs will be subject to all other US risk-based capital requirements, stress testing requirements, enhanced risk management standards and enhanced governance and stress testing requirements for liquidity management, as well as other prudential standards.

During 2014, HNAH reported its capital ratios in accordance with the US Basel III capital rules, applying the phase in provisions, and Basel I RWAs. From 1 January 2015, HNAH will report its capital ratios using US Basel III standardised RWAs.

In September 2014, the US banking regulators adopted revisions to the SLR denominator in the US to align with the final Basel leverage framework adopted in January

HSBC HOLDINGS PLC

110i

**Table of Contents****Report of the Directors: Financial Review** (continued)

2014. The changes apply to all advanced approach banking organizations subject to the SLR, including HNAH. The SLR is generally consistent with the Basel leverage framework, but also contains certain modifications, including the methodology for averaging total leverage exposure. HNAH must begin publicly disclosing its SLR in 2015, but the SLR does not become a binding regulatory requirement until 1 January 2018.

The US banking regulators have partially implemented the Basel liquidity framework, which includes two minimum liquidity risk measures. On 3 September 2014 the US banking regulators issued a final rule to implement the first of these measures, the liquidity coverage ratio ( LCR ), which is designed to ensure that a banking organisation maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon under an acute liquidity stress scenario. The rule, which will apply to HNAH, is more stringent than the Basel III LCR in several respects. Starting on 1 January 2015, covered companies, including HNAH and HSBC Bank USA, are required to maintain an LCR of 80%, increasing annually by 10% increments and reaching 100% on 1 January 2017.

HSBC Bank USA and HTCD are subject to risk-based assessments from the FDIC, which insures deposits generally to a maximum of US\$250,000 per depositor for domestic deposits. Dodd-Frank changes the FDIC's risk-based deposit insurance assessment framework primarily by basing assessments on an FDIC-insured institution's total assets less tangible equity rather than US domestic deposits, which is expected to shift a greater portion of the aggregate assessments to large FDIC-insured institutions. The new large bank pricing system will result in higher assessment rates for banks with high-risk asset concentrations, less stable balance sheet liquidity, or potentially higher loss severity in the event of failure. On 18 November 2014, the FDIC adopted further changes to the deposit insurance assessment system for large banks to align the assessment system with the standardised approach capital regulations and to eliminate all use of internal models.

HSBC's US consumer finance operations are subject to extensive state-by-state regulation in the US, and to laws relating to consumer protection (both in general, and in respect of sub-prime lending operations, which have been subject to enhanced regulatory scrutiny); discrimination in extending credit; use of credit reports; privacy matters; disclosure of credit terms; and correction of billing errors. These operations are subject to regulations and legislation that limit operations in certain jurisdictions.

On 10 December 2013, US regulators issued final regulations implementing the Volcker Rule. The Volcker Rule limits the ability of banking entities (including HSBC group companies outside the US) to sponsor or invest in private equity or hedge funds or to engage in certain types of proprietary trading in the US. The final rule extended the conformance period for all banking

entities until 21 July 2015, during which Financial institutions subject to the rule must bring their activities and investments into compliance. In December 2014, the Federal Reserve Board further extended by order the conformance period to 21 July 2016 for investments in and relationship with covered funds and foreign funds that were in place prior to 31 December 2013 ( legacy covered funds ). The Federal Reserve Board also indicated that it intends to act next year to grant additional one-year extension, until 21 July 2017, for the same legacy covered fund investments and relationships. The Group continues to update its existing conformance plans, to finalise adjustments necessary to its businesses and risk management and control frameworks both in the US and elsewhere, including

establishing a defined Volcker Compliance programme and related CEO attestation processes to comply with the final rule.

Furthermore, Dodd-Frank provides for an extensive framework for the regulation of over-the-counter ( OTC ) derivatives by the CFTC and the SEC, including mandatory clearing, exchange trading and public and regulatory transaction reporting of certain OTC derivatives, as well as rules regarding the registration of swap dealers and major swap participants, and related capital, margin, business conduct, record keeping and other requirements applicable to such entities.

The CFTC has completed many of these most significant rulemakings, which came into effect in 2013 and 2014. In particular, HSBC Bank USA and HSBC Bank plc are provisionally registered as Swap Dealers with the CFTC. Because HSBC Bank plc is a non-US swap dealer, the CFTC generally limits its direct regulation of HSBC Bank plc to swaps with US persons and certain affiliates of US persons. However, the CFTC is considering whether to apply mandatory clearing, exchange trading, public transaction reporting, margin and business conduct rules to swaps with non-US persons arranged, negotiated or executed by US personnel or agents. The CFTC is also considering whether to apply regulatory transaction reporting to all swaps entered into by a non-US swap dealer or instead to rely on transaction reporting under comparable EU rules. The application of CFTC rules to HSBC Bank plc's swaps with non-US persons could have an adverse effect on the willingness of non-US counterparties to trade swaps with HSBC Bank plc and we continue to assess how developments in these areas will affect our business.

In June 2014, the SEC finalised rules regarding the cross-border application of the security-based swap dealer and major security-based swap participant definitions. These definitions share many similarities with parallel guidance finalised by the CFTC in July 2013. In January 2015, the SEC also finalised rules regarding reporting and public dissemination requirements for security-based swap transaction data. It is expected that the SEC will finalise many of its other OTC derivatives rules during 2015. If the SEC's rules differ significantly from the CFTC's rules, those differences could increase the costs of our equity and credit derivatives businesses.

HSBC HOLDINGS PLC

110j

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

In September 2014, the US banking regulators and the CFTC re-proposed margin rules for non-cleared swaps and security-based swaps entered into with swap dealers, security-based swap dealers, major swap participants and major security-based swap participants. Under the re-proposals, such dealers and major participants would be required to collect and post initial and variation margin for non-cleared swaps and security-based swaps with financial end users that exceed a minimum volume of transactional activity. The two re-proposals would also limit categories of eligible collateral to cash, for variation margin, and cash and certain asset types (subject to standardized haircuts), for initial margin. The two re-proposals would follow a phased implementation schedule, with variation margin requirements coming into effect on 1 December 2015, and initial margin requirements phasing in annually for different counterparties from 1 December 2015 until 1 December 2019, depending on the transactional volume of the parties and their affiliates. Once finalised, these rules, as well as parallel rules outside the United States, are likely to increase the costs and liquidity burden associated with trading non-cleared swaps and security-based swaps and may adversely affect our business in such products.

Dodd-Frank also included a swaps push-out provision that would have effectively limited the range of OTC derivatives activities in which an insured depository institution may engage, including HSBC Bank USA. The scope of this rule was significantly reduced in December 2014 and the provisions will now effectively only restrict HSBC Bank USA's ability to deal in certain structured finance swaps that it entered into after 16 July 2015 and are not entered into for hedging or risk mitigation purposes.

Furthermore, Dodd-Frank provides for an extensive framework for the regulation of over-the-counter (OTC) derivatives, including mandatory clearing, exchange trading and transaction reporting of certain OTC derivatives, as well as rules regarding the registration of swap dealers and major swap participants, and related capital, margin, business conduct, record keeping and other requirements applicable to such entities. These rules became effective in October 2012 and HSBC Bank USA and HSBC Bank plc are provisionally registered as Swap Dealers with the CFTC.

Dodd-Frank grants the SEC discretionary rule-making authority to modify the standard of care that applies to brokers, dealers and investment advisers when providing personalised investment advice to retail customers and to harmonise other rules applying to these regulated entities. Dodd-Frank also expands the extraterritorial jurisdiction of US courts over actions brought by the SEC or the US with respect to violations of the anti-fraud provisions in the Securities Act, the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940. In addition, regulations which the FSOC, the CFPB or other regulators may adopt could affect the nature of the activities which our FDIC-insured depository institution subsidiaries may conduct, and may impose restrictions and limitations on the conduct of such activities.

The ongoing implementation of Dodd-Frank and related final regulations could result in additional costs or limit or restrict the way we conduct our business, both in relation to our US operations and our non-US operations, although uncertainty remains about many of the details, impact and timing of these reforms and the ultimate effect they will have on HSBC.

**Global and regional prudential and other regulatory developments**



The Group is subject to regulation and supervision by a large number of regulatory bodies and other agencies. In addition to changes being pursued at a country level, changes are also being pursued globally through the actions of bodies such as the G-20, the FSB and Basel Committee, as well as regionally through the EU and similar. Key areas include the work of the FSB on global systemically important banks ( G-SIBs ), Basel Committee's development of revised standardised approaches across a number of risk areas, and the FSB's development of requirements for total loss absorbing capacity.

In November 2014, as part of the 'too big to fail' agenda, the FSB published proposals for total loss absorbing capacity ( TLAC ) for G-SIBs. The FSB proposals include a minimum TLAC requirement in the range of 16-20% of RWAs and a TLAC leverage ratio of at least twice the Basel III Tier 1 leverage ratio. The TLAC requirement is to be applied in accordance with individual resolution strategies, as determined by the G-SIB's crisis management group. A quantitative impact study ( QIS ) is currently underway, the results of which will inform finalised proposals. The QIS will inform the conformance period for the TLAC requirement, which is not expected to come into place before 1 January 2019. Once finalised, it is expected that any new TLAC standard should be met alongside the Basel III minimum capital requirements.

The draft proposals require G-SIBs to be subject to a minimum TLAC requirement with the precise requirement to be informed by the QIS. There are a number of requirements relating to the types of liabilities which can be used to meet the TLAC requirement, the composition of TLAC, and the location of liabilities within a banking group, in accordance with its resolution strategy. The TLAC proposals are expected to be finalised in 2015 and will then need to be implemented into national legislation.

Throughout 2014, the Basel Committee published proposals across all Pillar 1 risk types, to update standardised, non-modelled approaches for calculating capital requirements and to provide the basis for the application of capital floors.

In particular, in March 2014, the Basel Committee published finalised proposals for the standardised approach for calculating counterparty credit risk exposures, expected to come into effect on 1 January 2017.

In October 2014, the Basel Committee also consulted on proposals to revise the standardised approach for calculating operational risk. An implementation date is

HSBC HOLDINGS PLC

110k

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

yet to be proposed. Also in October 2014, the Basel Committee finalised another aspect of the Basel III liquidity framework – the Net Stable Funding Ratio ( NSFR ). The NSFR is a significant component of the Basel III reforms. It requires banks to maintain a stable funding profile in relation to their on- and off-balance sheet activities, thus reducing the likelihood that disruptions to a bank's regular sources of funding will erode its liquidity position in a way that could increase the risk of its failure and potentially lead to broader systemic stress. Further details on NSFR can be found on page 164.

In December 2014, the Basel Committee undertook a further consultation on its fundamental review of the trading book. This included revisions to the market risk framework that was published for consultation in October 2013. The Committee intends to carry out a further QIS in early 2015 to inform finalised proposals expected at the end of 2015.

In December 2014, the Basel Committee published a revised framework for securitisation risk, which will come into effect on 1 January 2018.

In December 2014, the Basel Committee also published a consultation paper on revisions to the Standardised Approach for credit risk and a consultation on the design of a capital floor framework, which will replace the Basel I floor. The Committee intends to publish final proposals including calibration and implementation timelines by the end of 2015.

All finalised Basel Committee proposals for standardised approaches for calculating risk requirements and introduction of a revised capital floor would need to be transposed into EU requirements before coming into effect.

### **Recovery and resolution**

Globally there have been a number of developments relating to banking structural reform and the introduction of recovery and resolution regimes.

As recovery and resolution planning has developed, some regulators and national authorities have also required changes to the corporate structures of banks. These include requiring the local incorporation of banks or ring-fencing of certain businesses. In the UK, ring-fencing legislation has been enacted requiring the separation of retail and Small and Medium Size Enterprise ( SME ) deposits from trading activity. Similar requirements have been introduced or are in the process of being introduced in other jurisdictions.

The FSB has been designated by the G-20 as the body responsible for coordinating the delivery of a global reform programme following the financial crisis, a key element of which is that no firm should be too big or too complicated to fail, and that taxpayers should not bear the cost of resolution. HSBC has been classified by the FSB as a G-SIB and therefore subject to what the FSB refers to as a multi-pronged and integrated set of policies . These include proposals that would place an

additional capital and TLAC buffer on the Group and require enhanced reporting.

Following the financial crisis, G20 leaders requested the FSB to establish more effective arrangements for the recovery and resolution of 28 (now 30) designated Global Systemically Important Banks or Financial Institutions ( G-SIB s or G-SIFI s) resulting in a series of policy recommendations in relation to recovery and resolution planning, cross border cooperation agreements and measures to mitigate obstacles to resolution.

In December 2013, the PRA set out rules for the recovery and resolution of UK banks and international banks operating in the UK. These rules were modified as part of the implementation of the EU Bank Recovery and Resolution Directive from January 2015.

We have been working with the Bank of England and the PRA together with the Group s other primary regulators that together form the Crisis Management Group ( CMG ) to develop and agree a resolution strategy for the HSBC Group. It is our view that a resolution strategy whereby the Group breaks up at a subsidiary bank level at the point of resolution (referred to as a Multiple Point of Entry strategy) rather than being kept together as a group at the point of resolution (referred to as Single Point of Entry strategy) is the optimal approach as it is aligned to the Group s existing legal and business structure.

In common with all G-SIBs, we are working with our regulators in the CMG to understand inter-dependencies between different businesses and subsidiary banking entities in the HSBC Group in order to enhance resolvability.

We have initiated plans to mitigate or remove critical inter-dependencies to further facilitate the resolution of the Group. In particular, in order to remove operational dependencies (where one subsidiary bank provides critical services to another), we have determined to transfer such critical services from the subsidiary banks to a separately incorporated group of service companies ( ServCo Group ). A significant portion of the ServCo group already exists and therefore this initiative involves transferring the remaining critical services still held by subsidiary banks into the ServCo Group. The services will then be provided to the subsidiary banks by the ServCo Group.

In accordance with guidance from the FSB and UK requirements, HSBC has produced a recovery plan for the Group, drawing together many of the actions contained in stress testing and scenario planning exercises conducted within the Group. The recovery plan identify a series of early warning signals indicative of developing financial stress and establishes triggers which, if breached, would precipitate pre-planned but urgent action from the Group. The plan also contains a series of recovery options to raise additional capital or funding for the Group or individual entities as appropriate. These options would be reviewed for applicability and feasibility once the cause and magnitude of the financial stress was evident. The Group recovery plan has been submitted to the PRA and the BoE in the UK.

HSBC HOLDINGS PLC

1101

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

#### **European regulation**

Through the UK's membership of the EU, HSBC is both directly and indirectly subject to European financial services regulation.

CRD IV implemented Basel III in the EU and, in the UK, the PRA rulebook CRR Firms Instrument 2013 transposed the various national discretions under CRD IV into UK law. CRD IV and the PRA requirements came into force on 1 January 2014.

Additionally, the EU is implementing its Banking Union to increase integration in the Eurozone banking system. As part of this, in November 2014, the Single Supervisory Mechanism (SSM) established the ECB as the single supervisor for all banks in the Eurozone with direct supervisory responsibility for larger and systemically important banks, including HSBC France and HSBC Malta. A Single Resolution Mechanism (SRM) was also established to apply to all banks covered by the SSM. This is intended to ensure that bank resolution is managed effectively through a Single Resolution Board and a Single Resolution Fund, financed by the banking sector.

Non-Eurozone countries within the EU may opt to join the Banking Union, but the UK has indicated that it will not do so.

In January 2014, the European Commission published legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors, at their discretion, to require trading activities such as market-making, complex derivatives and securitisation operations to be undertaken in a separate subsidiary from deposit taking activities.

The ring-fenced deposit taking entity would be subject to separation from the trading entity including requirements for separate capital and management structures, issuance of own debt and arms-length transactions between entities.

The draft proposals contain a provision which would permit derogation by member states which have implemented their own structural reform legislation, subject to meeting certain conditions. This derogation may benefit the UK in view of the UK Financial Services (Banking Reform) Act 2013.

The proposals are currently subject to discussion in the European Parliament and the Council. The implementation date for any separation under the final rules would depend upon the date on which the final legislation is agreed.

In the EU, BRRD was finalised and published in June 2014. This came into effect from 1 January 2015, with

the option to delay implementation of bail-in provisions until 1 January 2016. Regardless of this, the UK introduced bail in powers from 1 January 2015. The UK transposition of the BRRD builds on the resolution framework already in place in the UK. In January 2015, the PRA published a policy statement containing updated requirements for recovery and resolution planning which revises PRA rules that have been in force since 1 January 2014. In addition, the European Banking Authority has produced a number of RTS, some of which are yet to be finalised, that will further inform the BRRD requirements.

The EU also continues to pursue the development of markets, and conduct-related EU regulations. This includes its work under e.g. the Short Selling Regulation and the European Markets Infrastructure Regulation, most or all parts of which have been or are now being implemented. A number of other EU market-related regulations are still in the legislative process. For example, in 2014 the Markets in Financial Instrument Regulation/Directive (MiFID II) and the Market Abuse Regulation texts were finalised and the EU legislative process is now focused on agreeing the supplementary technical standards and delegated acts ahead of implementation in 2016/2017. Amongst others, the EU's Framework for Benchmarks and Indices, Mortgage Credit Directive, Packaged Retail Investment and Insurance Products Regulation, Second Payment Services Directive, Money Markets Fund Regulation and Payment Accounts Directive are all expected to progress further towards implementation during 2015 and the Group continues to enhance and strengthen its governance and resourcing more generally around regulatory change management and the implementation of required measures, actively to address this ongoing and significant agenda of regulatory change.

#### **Anti-money laundering and Sanctions regulation**

HSBC places a high priority on its obligations to deter money laundering and terrorist financing and to enforce global sanctions. The European Commission has proposed a Fourth Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (known as the Fourth Money Laundering Directive). Political agreement between the European Council and European Parliament has been reached on the text of the Directive and it is due to go forward for further review and endorsement before being put to a vote in the European Parliament in 2015, meaning that the new regime is likely to come into force in 2016. HSBC policy requires that all Group companies must adhere to the letter and spirit of all applicable laws and regulations and we have policies, procedures and training intended to ensure that our employees know and understand our criteria for deciding when a client relationship or business should be evaluated as higher risk.

HSBC HOLDINGS PLC

110m

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

Risk mitigation measures aimed at deterring money laundering, terrorist and proliferation (weapons) financing (collectively referred to as AML) and enforcing Sanctions have been focused in three key areas:

managing risk;

transitioning to a new operating and governance model; and

meeting HSBC's regulatory obligations.

HSBC met all obligations due in 2014 under the Deferred Prosecution Agreement with the US Department of Justice. Furthermore, HSBC's Deferred Prosecution Agreement with the New York County District Attorney's Office expired on 11 December 2014.

To maximise information sharing across the Group, two key units were formed in 2014: the Financial Intelligence Unit (FIU) and AML Investigations (AMLi). The FIU has been built out with the global team and five regional hubs in place. Additionally, six country FIUs have also been implemented. An AMLi function has been trained in eight priority countries with further resources operating across another 53 countries. The next tranche of 11 countries will begin to adopt AMLi global standards in 2015.

Enhanced global AML and sanctions policies, incorporating risk appetite, were approved by the Board in January 2014. The policies adopt and enforce the highest or most effective standards globally, including a globally consistent approach to knowing our customers.

The Policies are being implemented in phases through the development and application of procedures required to embed those policies in our day to day business operations globally. The overriding policy objective is for every employee to engage in only the right kind of business, conducted in the right way.

Conducting customer due diligence (CDD) is one of the fundamental ways in which we know our customers and understand and manage financial crime risk. Enhanced minimum standards for CDD, including, as applicable, standards to determine beneficial ownership information, are continuing to be deployed across the four global businesses. In-country CDD deployment has been initiated in 32 countries, with deployment to the remaining 29 countries driven by a risk prioritisation framework.

The AML and sanctions programmes are being better aligned to the three lines of defence model (described on page 112) with roles and accountability across all three lines clearly set out and embedded through employee awareness initiatives.

As part of our continuing evaluation of AML and sanctions risk, we also monitor activities relating to the countries subject to US economic sanctions programmes administered by OFAC, as well as those subject to United Nations, UK

and EU sanctions. HSBC Group Policy requires all Group companies to comply to the extent applicable with US law and regulation, including the country, territory and individual economic sanctions ( US Sanctions ). This means that not only must US subsidiaries and US nationals comply with US Sanctions, but that HSBC subsidiaries outside the US which are not

US persons must not participate in transactions within US jurisdictions (including most US dollar transactions) that would contravene the US Sanctions. We do not consider that our business activities with counterparties with whom transactions are restricted or prohibited under US Sanctions are material to our business, and such activities represented a very small part of the Group's total assets at 31 December 2014 and total revenues for the year ended 31 December 2014.

### **Other**

HSBC Bank USA entered into a Consent Cease and Desist Order with the OCC, and HNAH entered into a Consent Cease and Desist Order with the Federal Reserve Board in October 2010. These Orders require improvement of our Compliance Risk Management Programme including AML controls across our US businesses. Steps continue to be taken to address the requirements of these Orders and to ensure that compliance and effective policies and procedures are maintained.

### **Disclosures pursuant to Section 13(r) of the Securities Exchange Act**

Section 13(r) of the Securities Exchange Act, requires each issuer registered with the SEC to disclose in its annual or quarterly reports whether it or any of its affiliates have knowingly engaged in specified activities or transactions with persons or entities targeted by US Sanctions programmes relating to Iran, terrorism, or the proliferation of weapons of mass destruction, even if those activities are not prohibited by US law and are conducted outside the US by non-US affiliates in compliance with local laws and regulations.

In order to comply with this requirement, HSBC Holdings Plc (together with its affiliates, HSBC ) has requested relevant information from its affiliates globally. The following activities are disclosed in response to Section 13(r).

#### **Loans in repayment**

Between 2001 and 2005, the Project and Export Finance ( PEF ) division of HSBC arranged or participated in a portfolio of loans to Iranian energy companies and banks. All of these loans were guaranteed by European and Asian export credit agencies, and they have varied maturity dates with final maturity in 2018. For those loans that remain outstanding, we continue to seek repayment in accordance with our obligations to the supporting export credit agencies and, in all cases, with appropriate regulatory approvals. Details of these loans follow.

At December 31, 2014, we had 11 loans outstanding to an Iranian petrochemical company. These loans are supported by the official Export Credit Agencies of the following countries: the United Kingdom, France, Germany, Spain, South Korea and Japan. We continue to seek repayments from the company under the existing loans in accordance with the original maturity profiles.

HSBC HOLDINGS PLC

110n

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

All repayments made by the Iranian company have received a licence or an authorisation from relevant authorities. Two repayments were received under each loan in 2014.

Bank Melli and Bank Saderat acted as sub-participants in three of the aforementioned loans. The repayments due to these banks under the loan agreements were paid into frozen accounts under licences or authorisations from relevant European governments.

In 2002, we provided a loan to Bank Tejarat with a guarantee from the Government of Iran to fund the construction of a petrochemical plant undertaken by a UK contractor. This loan was supported by the UK Export Credit Agency and is administered under licence from the relevant European Government. This facility has now matured and the final claim for non-payment was processed by the supporting Export Credit Agency in 2014.

We also maintained sub-participations in four loans provided by other international banks to Bank Tejarat and Bank Mellat with guarantees from the Government of Iran. These sub-participations were supported by the Export Credit Agencies of Italy, The Netherlands and Spain.

With respect to Bank Mellat, we held two sub-participations in loans provided by another internal bank to Bank Mellat with a guarantee from the Government of Iran, supported by the Dutch and Spanish Export Credit Agencies. The facilities have matured and the final claims for non-payment were processed by the supporting export credit agency in 2014.

In relation to Bank Tejarat, we held two sub-participations in loans provided by another international bank to Bank Tejarat with a guarantee from the Government of Iran, supported by the Italian Export Credit Agency. Both facilities matured in 2014. The final claim for non-payment on one of the transactions was paid by the Italian Export Credit Agency in 2014 and the claim for the other transaction is currently being processed with the Italian Export Credit Agency. Licenses and relevant authorisations have been obtained from the competent authorities of the European Union with regard to the transactions.

Estimated gross revenue generated by these loans in repayment for 2014, which includes interest and fees, was approximately US\$1.7m whilst net estimated profit was approximately US\$1.1m. While we intend to continue to seek repayment under the existing loans, we do not intend to extend any new loans.

**Legacy contractual obligations related to guarantees**

Between 1996 and 2007, we provided guarantees to a number of its non-Iranian customers in Europe and the Middle East for various business activities in Iran. In a number of cases, we issued counter indemnities in support of guarantees issued by Iranian banks as the Iranian beneficiaries of the guarantees required that they be backed directly by Iranian banks. The Iranian

banks to which we provided counter indemnities included Bank Tejarat, Bank Melli, and the Bank of Industry and Mine.



We have worked with relevant regulatory authorities to obtain licences where required and ensure compliance with laws and regulations while seeking to cancel the guarantees and counter indemnities. None were cancelled during 2014 and approximately 20 remain outstanding.

There was no measurable gross revenue generated by this activity in 2014. We do not allocate direct costs to fees and commissions, and therefore, have not disclosed a separate net profit measure. We are seeking to cancel all relevant guarantees and do not intend to provide any new guarantees involving Iran.

### **Other relationships with Iranian banks**

Activity related to US-sanctioned Iranian banks not covered elsewhere in this disclosure includes the following:

We maintain a frozen account in the UK for an Iranian-owned, UK-regulated financial institution. In April 2007, the UK government issued a licence to allow us to handle certain transactions (operational payments and settlement of pre-sanction transactions) for this institution. In December 2013, the UK government issued a new licence allowing HSBC to deposit certain cheque payments. There was some licensed activity in 2014.

We acted as the trustee and administrator for pension schemes involving four employees of a US-sanctioned Iranian bank in Hong Kong. Under the rules of these schemes, we accepted contributions from the Iranian bank each month and allocated the funds into the pension accounts of the four Iranian bank employees. We ran and operated these pension schemes in accordance with Hong Kong laws and regulations. During 2014, one of the two schemes was terminated and the only member and accrued benefits were transferred into the other scheme. Notices of resignation were received for two employees and accrued benefits were transferred into the former members' personal accounts. We continue to act as trustee and administrator for the remaining pension scheme.

In 2010, we closed our representative office in Iran. We maintained a local account with an Iranian bank in Tehran in order to facilitate residual activity related to the closure. We were authorised by the US Government (and by relevant non-US regulators) to engage in such activity in connection with the liquidation and deregistration of the representative office in Tehran. During 2014, we initiated a payment of approximately US\$55,000 into the account and paid fees in the amount of approximately US\$90,500 from the account to settle tax assessments. Funds from this account were also used to pay outstanding and future accounting, legal and administrative related expenses associated with the closure. All debts have been satisfied and the account was closed with a zero balance in the fourth quarter of 2014.

HSBC HOLDINGS PLC

110o

**Table of Contents**

**Report of the Directors: Financial Review (continued)**

Estimated gross revenue in 2014 for all Iranian bank-related activity described in this section, which includes fees and/or commissions, was approximately US\$585,370. We do not allocate direct costs to fees and commissions and therefore have not disclosed a separate net profit measure. We intend to continue to wind down this Iranian bank-related activity and not enter into any new such activity.

**Activity related to US Executive Order 13224**

We maintain a frozen personal account for an individual sanctioned under Executive Order 13224 and by the UK and the UN Security Council. Activity on this account in 2014 was permitted by a licence issued by the UK Government. There was no measurable gross revenue or net profit generated in 2014.

We undertook a review of an account held for a customer in the UK in the first quarter of 2014 and identified a domestic currency payment in the second quarter of 2013 from an entity designated under Executive Order 13224. We have exited this customer relationship.

**Activity related to US Executive Order 13382**

We held accounts for a customer in France that was sanctioned under Executive Order 13382 in the first quarter of 2014. We closed all accounts for the customer. There was no measurable gross revenue or net profits generated to HSBC in the first quarter of 2014. OFAC removed the designation placed on the customer in October 2014. We also maintain an account for a customer in the UK for whom we processed a payment received from the same sanctioned entity. The payment related to an invoice generated prior to designation.

We held an account for a customer in the Middle East who was sanctioned under Executive Order 13382 in the first quarter of 2014. We closed the account in the

second quarter. There was no measurable gross revenue or net profit generated in the first and second quarters of 2014.

We held an account and an investment plan for a customer that was a wholly owned subsidiary of an entity sanctioned under Executive Order 13382. Sanctions were lifted from the parent entity in the third quarter of 2014. The account was closed in the fourth quarter of 2014 and the investment plan is active. The investment plan matures in 2015, and we intend to exit the customer relationship. The estimated gross revenue and the estimated net profits generated to HSBC were approximately US\$2,000 in 2014.

**Other activity**

We hold a lease of branch premises in London which HSBC entered into in 2005 and is due to expire in 2020. The premises are owned by the Iranian government and the landlord is a specially designated national under US Sanctions programmes. We have exercised a break clause in the lease and are in the process of exiting the property. The relationship will be terminated in 2015 and we closed the branch in the third quarter of 2014. There was no gross revenue or net profit to HSBC in 2014.

We maintain an account for a customer in the US for whom we processed cheques involving the Iranian Interests Section of the Embassy of Pakistan in relation to intellectual property protection in Iran. The estimated gross revenue and estimated net profits generated to HSBC were approximately US\$48 in 2014.

We maintain an account for a corporate customer in UAE for whom we processed a supplier payment to a hospital owned by the Government of Iran. There was no measurable gross revenue or net profit to HSBC in 2014.

**Frozen accounts and transactions**

We maintain several accounts that are frozen under relevant sanctions programmes and on which no activity, except as licensed or otherwise authorised, took place during 2014. In 2014, we also froze payments where required under relevant sanctions programmes. There was no gross revenue or net profit to HSBC.

HSBC HOLDINGS PLC

110p

**Table of Contents****Report of the Directors: Financial Review (continued)**

<b>Risk</b>	<b>Page</b>	<b>App<sup>1</sup></b>
<u><b>Risk profile<sup>2</sup></b></u>	111	
<u><b>Risk factors</b></u>	111a	
<u><b>Managing risk<sup>2</sup></b></u>	112	
<u>Risk management framework</u>	112	
<u>Risk factors</u>	113	
<u>Risks managed by HSBC</u>	114	
<u>Risk management processes and procedures</u>	117	
<u>Risk governance</u>		204
<u>Risk appetite</u>		205
<u><b>Top and emerging risks<sup>2</sup></b></u>	118	
<u>Macroeconomic and geopolitical risk</u>	118	
<u>Macro-prudential, regulatory and legal risks to our business model</u>	119	

<u>Regulatory commitments and consent orders</u>	120	
<u>Risks related to our business operations, governance and internal control systems</u>	122	
<b><u>Areas of special interest<sup>2</sup></u></b>	124	
<u>Financial crime compliance and regulatory compliance</u>	124	
<u>Private Bank</u>	124	
<u>Regulatory stress tests</u>	125	
<u>Oil and gas prices</u>	126	
<u>Russia</u>	126	
<u>Eurozone</u>	126	
<b><u>Credit risk<sup>4</sup></u></b>	127	206
<b><u>Liquidity and funding<sup>4</sup></u></b>	163	215
<b><u>Market risk<sup>4</sup></u></b>	175	221
<b><u>Operational risk<sup>2</sup></u></b>	186	228
<u>Compliance risk</u>	189	229
<u>Legal risk</u>		229

—	<u>Global security and fraud risk</u>		230
=	<u>Systems risk</u>		230
=	<u>Vendor risk management</u>		231
=	<b><u>Risk management of insurance operations<sup>3</sup></u></b>	190	231
=	<b><u>Other material risks<sup>2</sup></u></b>	199	
=	<u>Reputational risk</u>	199	235
=	<u>Fiduciary risk</u>	200	235
=	<u>Pension risk</u>	200	236
=	<u>Sustainability risk</u>	201	237

1 *Appendix to Risk* risk policies and practices.

2 *Unaudited.* 3 *Audited.* 4 *Audited where indicated.*

*For details of HSBC's policies and practices regarding risk management and governance see the Appendix to Risk on page 204.*

## **Risk profile**

*(Unaudited)*

### **Managing our risk profile**

A strong balance sheet remains core to our philosophy.

Our portfolios continue to be aligned to our risk appetite and strategy.

Our risk management framework is supported by strong forward-looking risk identification.

**Maintaining capital strength and a strong liquidity position**

Our transitional common equity tier 1 capital ratio remains strong at 10.9%.

We have sustained our strong liquidity position throughout 2014.

The ratio of customer advances to deposits remains significantly below 90%.

**Strong governance**

Robust risk governance and accountability is embedded across the Group.

The Board, advised by the Group Risk Committee, approves our risk appetite.

Our global risk operating model supports adherence to globally consistent standards and risk management policies across the Group.

**Our top and emerging risks**

Macroeconomic and geopolitical risk.

Macro-prudential, regulatory and legal risks to our business model.

Risks related to our business operations, governance and internal control systems.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Risk factors**

*(Unaudited)*

**Macroeconomic and geopolitical risk**

Current economic and market conditions may adversely affect our results

Our earnings are affected by global and local economic and market conditions. Economic growth in emerging markets remained weak in 2014, while concerns remained over the sustainability of economic growth in many developed markets. The significant decline in oil prices since the middle of 2014 as a result of increasing global demand-supply imbalances may lead to fiscal and financing challenges for energy exporters, and although it may bring benefits for oil importers, it also accentuates deflationary risks among some of these (particularly in the eurozone).

The uncertain economic conditions continue to create a challenging operating environment for financial services companies such as HSBC. In particular, we may face the following challenges to our operations and operating model in connection with these factors:

the demand for borrowing from creditworthy customers may diminish if economic activity slows or remains subdued;

as capital flows are increasingly disrupted, some emerging markets could be tempted to impose protectionist measures that could affect financial institutions and their clients;

European banks may come under renewed stress as a result of the interdependencies between economic conditions and the sovereign financial situation in the eurozone;

geopolitical risks, which remain elevated in many parts of the world, directly affect the economies of the countries in which we operate and present a clear risk of disruption to the global economy due to links to the global resources supply chain;

a prolonged period of low, or negative, interest rates will constrain, for example, through margin compression and low returns on assets, the net interest income we earn from investing our excess deposits;



our ability to borrow from other financial institutions or to engage in funding transactions may be adversely affected by market disruption, for example, in the event of contagion from stress in the eurozone sovereign and financial sectors; and

market developments may depress consumer and business confidence beyond expected levels. If economic growth remains subdued, for example, asset prices and payment patterns may be adversely affected, leading to greater than expected increases in our delinquencies, default rates, write-offs and loan impairment charges.

The occurrence of any of these events or circumstances could have a material adverse effect on our business, our financial condition, our prospects, our customers and their operations and/or results of our operations.

We are subject to political and economic risks in the countries in which we operate, including the risk of government intervention

We operate through an international network of subsidiaries and affiliates in over 70 countries and territories around the world. Our results are, therefore, subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and changes in government policies on such matters as expropriation, authorisations, international ownership, interest-rate caps, limits on dividend flows and tax in the jurisdictions in which we operate.

For example, military escalation and/or civil war remain a possibility in Ukraine, while sanctions targeting the Russian government, institutions and individuals, together with falling oil prices, have had an adverse effect on the Russian economy. In the Middle East, the civil war in Syria has been complicated by the seizure of parts of Iraq and Syria by Islamic State, a terrorist group. Elsewhere in the region, chaos in Libya, ongoing tensions between Israel and Palestine and fraught negotiations over Iran's nuclear programme are combining to increase risks to stability. In East Asia, tensions over maritime sovereignty disputes involving mainland China and its neighbours may intensify, while tensions remain high over the line of control between India and Pakistan, raising concerns over a possible wider conflict between the two nuclear-armed neighbours. A break-up of the eurozone or continued social unrest triggered by the ongoing economic crisis and related austerity programmes may result in political or social disruption throughout Europe.

We may suffer adverse effects as a result of the renewed economic and sovereign debt tensions in the eurozone

Although in recent years the EU has introduced a series of legislative changes designed to better equip it to deal with a financial crisis and to reduce the risks of contagion in the event of an EU member country experiencing financial difficulties, the outcome of current negotiations on the terms of the Greek bail out is highly uncertain. The debt may be rescheduled or Greece may default on its debts; there is also the possibility that Greece may eventually exit the euro.

Any default on the sovereign debt of Greece or any eurozone nation and the resulting impact on other eurozone countries could have a material adverse effect on us, including (a) significant market dislocation, (b) heightened counterparty risk and (c) an adverse effect on the management of market risk.

Moreover, a significant number of financial institutions throughout Europe have substantial exposures to sovereign debt issued by eurozone nations that are under severe financial stress. Should any of those nations default on their debt, or experience a significant widening of credit spreads, major financial institutions and banking systems throughout Europe could be destabilised, resulting in, among other things, significant disruptions in financial activities.

HSBC HOLDINGS PLC

111a

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

As a result, a default on the sovereign debt of any eurozone nation may have a material adverse effect on our operating results, financial condition and prospects.

Changes in foreign currency exchange rates may affect our results

We prepare our accounts in US dollars because the US dollar and currencies linked to it form the major currency bloc in which we transact and fund our business. A substantial portion of our assets, liabilities, assets under management, revenues and expenses are denominated in other currencies. Changes in foreign exchange rates, including those which may result from a currency becoming de-pegged from the US dollar, have an effect on our reported income, cash flows and shareholders' equity and may have a material adverse effect on our business, prospects, financial condition and/or results of operations.

**Macro-prudential, regulatory and legal risks to our business model**

Failure to implement our obligations under the deferred prosecution agreements could have a material adverse effect on our results and operations

In December 2012, HSBC Holdings, HSBC North America Holdings, Inc ( HNAH ), and HSBC Bank USA N.A. ( HSBC Bank USA ) entered into agreements with US and UK government agencies regarding past inadequate compliance with the US Bank Secrecy Act (the BSA ), anti-money laundering ( AML ) and sanctions laws. Among other agreements, HSBC Holdings and HSBC Bank USA entered into a five-year Deferred Prosecution Agreement with the US Department of Justice ( DoJ ), the US Attorney's Office for the Eastern District of New York, and the US Attorney's Office for the Northern District of West Virginia ( US DPA ); HSBC Holdings entered into a two-year deferred prosecution agreement with the New York County District Attorney ( DANY DPA ); and HSBC Holdings consented to a cease-and-desist order and HSBC Holdings and HNAH consented to a civil monetary penalty order with the Federal Reserve Board ( FRB ). In addition, HSBC Bank USA entered into a civil monetary penalty order with the Financial Crimes Enforcement Network and a separate civil monetary penalty order with the Office of the Comptroller of the Currency ( OCC ). HSBC Holdings entered into an agreement with the Office of Foreign Assets Control ( OFAC ) regarding historical transactions involving parties subject to OFAC sanctions and an undertaking with the FSA (now the FCA) to comply with certain forward-looking obligations with respect to AML and sanctions requirements ( FCA Direction ). HSBC Bank USA is also subject to an agreement entered into with the OCC, the Gramm-Leach-Bliley Act ( GLBA ) Agreement and other consent orders.

Under the agreements with the DoJ, FCA and FRB , an independent monitor (who is, for FCA purposes, a skilled person under Section 156 of the Financial Services and

Markets Act) is evaluating and regularly assessing the effectiveness of our AML and sanctions compliance function and our progress in implementing our remedial obligations under the agreements. The Monitor began his work on 22 July 2013.

HSBC has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two-year period of that agreement in December 2014.

Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA. Any such breach of the US DPA or the FCA Direction leading to further enforcement action, including the prosecution of HSBC, would have a material adverse effect on our business, financial condition, results of operations and prospects, including the potential significant loss of business and withdrawal of funding.

HSBC Bank USA, as clearer for all US dollar transactions for HSBC globally, manages a significant AML risk in the global correspondent banking area because of its breadth and scale, especially as it relates to transactions involving affiliates and global correspondent banks in high risk AML jurisdictions. A significant AML violation in this area or the utilisation of the global affiliate and correspondent banking network by terrorists or other perpetrators of financial crimes could have materially adverse consequences under the US DPA or our other consent agreements. The design and execution of AML and sanctions remediation plans is complex and requires major investments in people, systems and other infrastructure. This complexity creates significant execution risk, which could impact our ability to effectively manage financial crime risk and remedy AML and sanctions compliance deficiencies in a timely manner. This could, in turn, impact HSBC's ability to satisfy the Monitor or comply with the terms of the US DPA, the FCA Direction, or the FRB's cease and desist order and may require HSBC to take additional remedial measures.

Failure to comply with certain regulatory requirements would have a material adverse effect on our results and operations

As reflected in the agreement entered into with the OCC in December 2012 ( the GLBA Agreement ), the OCC has determined that HSBC Bank USA is not in compliance with the requirements that a national bank, and each depository institution affiliate of the national bank, must be both well capitalised and well managed in order to own or control a financial subsidiary. As a result, HSBC Bank USA and its parent holding companies, including HSBC Holdings, do not meet the qualification requirements for financial holding company status. If all of our affiliate depository institutions are not in compliance with these requirements within the time periods specified in the GLBA Agreement, as they may be extended, HSBC could be required either to divest HSBC Bank USA or to divest or terminate any financial activities conducted in reliance on financial holding company status under the GLBA. Similar consequences could

HSBC HOLDINGS PLC

111b

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

result for financial subsidiaries of HSBC Bank USA that engage in activities in reliance on expanded powers provided for in the GLBA. Any such divestiture or termination of activities would have a material adverse effect on our business, prospects, financial condition and results of operation.

Failure to meet the requirements of regulatory stress tests could have a material adverse effect on our capital position, operations, results and future prospects

We are subject to regulatory stress testing in many jurisdictions. These have increased both in frequency and in the granularity of information required by supervisors.

These exercises are designed to assess the resilience of banks to adverse economic or financial developments and ensure that they have robust, forward-looking capital planning processes that account for the risks associated with their business profile. Assessment by regulators is on both a quantitative and qualitative basis, the latter focusing on our data provision, stress testing capability and internal management processes and controls.

During 2014, we participated in the regulatory stress test programmes of the PRA, the FRB, the OCC, the ECB, the EBA and the HKMA, among others, which are described on page 125.

The PRA and the EBA disclosed the results of their stress test exercises on 16 December 2014 and 26 October 2014, respectively. HSBC's stressed CET1 ratio remained above the required minimum thresholds.

On 26 March 2014, the FRB informed HNAH that it did not object to HNAH's capital actions, including payment of dividends on outstanding preferred stock and trust preferred securities of HNAH and its subsidiaries. However, the FRB informed HNAH that it did object to the capital plan submitted for the 2014 Comprehensive Capital Analysis and Review (CCAR) programme due to weaknesses in its capital planning processes. The FRB does not permit bank holding companies to disclose confidential supervisory information, including the reason for an objection to a capital plan submitted for CCAR. HNAH made its CCAR 2015 submission, which also served as the required re-submission for CCAR 2014, on 5 January 2015. Disclosure by the FRB and HNAH of the results of the exercises will be made in March 2015.

Failure to meet quantitative or qualitative requirements of regulatory stress test programmes, or the failure by regulators to approve our stress results and capital plans, could have a material adverse effect on our operations, results and future prospects.

We are subject to a number of legal and regulatory actions and investigations, the outcomes of which are inherently difficult to predict, but unfavourable outcomes could have a material adverse effect on our operating results and brand

We face significant legal and regulatory risks in our business. The volume and amount of damages claimed in litigation, regulatory proceedings and other adversarial proceedings against financial institutions are increasing for many reasons, including a substantial increase in the number of regulatory changes taking place globally, increased media attention and higher expectations from regulators and the public. In addition, criminal prosecutions of financial institutions for, among other alleged conduct, breaches of AML and sanctions regulations, antitrust violations, market

manipulation, aiding and abetting tax evasion, and providing unlicensed cross-border banking services, have become more commonplace and may increase in frequency due to increased media attention and higher expectations from prosecutors and the public. Any such prosecution of HSBC or one or more of its subsidiaries could have a material adverse effect on our business, could result in substantial fines, penalties and/or forfeitures and could have a material adverse effect on our business, financial condition, results of operations, prospects and reputation, including the potential loss of key licences, requirement to exit certain businesses and withdrawal of funding from depositors and other stakeholders.

Additionally, we continue to be subject to a number of material legal proceedings, regulatory actions and investigations (including criminal) as described in Note 40 on the Financial Statements. It is inherently difficult to predict the outcome of many of the legal, regulatory and other adversarial proceedings involving our businesses, particularly those cases in which the matters are brought on behalf of various classes of claimants, seek damages of unspecified or indeterminate amounts or involve novel legal claims. Moreover, we may face additional legal proceedings, investigations or regulatory actions in the future, including in other jurisdictions and/or with respect to matters similar to, or broader than, the existing legal proceedings, investigations or regulatory actions. An unfavourable result in one or more of these proceedings could have a material adverse effect on our business, prospects, financial condition, reputation and/or results of operations.

Unfavourable legislative or regulatory developments, or changes in the policy of regulators or governments, could have a material adverse effect on our operations, financial condition and prospects

Our businesses are subject to ongoing regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies, voluntary codes of practice and interpretations in the UK, the US, Hong Kong, the EU and the other markets in which we operate. This is particularly so in the current environment, where we expect government and regulatory intervention in the banking sector to continue to remain high for the foreseeable future. Additionally, many of these changes increasingly have an impact beyond the country in which they are effected as regulators either deliberately enact regulation with

HSBC HOLDINGS PLC

111c

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

extra-territorial impact of our operations mean that the Group is obliged to give effect to local laws and regulations on a wider basis.

Since 2008, regulators and governments have focused on reforming both the prudential regulation of the financial services industry, to improve financial stability, and the ways in which business is conducted. Measures include enhanced capital, liquidity and funding requirements, the separation or prohibition of certain activities by banks, changes in the capital regime and the operation of capital markets activities, the introduction of tax levies and transaction taxes, changes in compensation practices and adjustments to how business is conducted. The US Government, the UK Government, our regulators in the UK, US, Hong Kong, the EU or elsewhere may intervene further in relation to areas of industry risk already identified, or in new areas, which could adversely affect us.

HSBC has been classified by the Financial Stability Board (FSB) as a global systemically important bank (G-SIB) and therefore is subject to what the FSB refers to as a multi-pronged and integrated set of policies. These include proposals that would place additional capital and Total Loss Absorbing Capacity (TLAC) buffers on the Group and require enhanced reporting.

Furthermore, the BRRD introduces requirements for banks to maintain at all times a sufficient aggregate amount of own funds and eligible liabilities (that is, liabilities that may be bailed in using the bail-in tool), known as the minimum requirements for eligible liabilities (MREL). The BoE is required to issue further secondary legislation to implement MREL requirements by 2016, which will take into account the regulatory technical standards to be developed by the EBA. The EBA has stated that these technical standards would be compatible with the proposed term sheet published by the FSB on TLAC requirements for G-SIBs, but the extent to which MREL and TLAC requirements may differ remains uncertain.

More stringent regulatory requirements, including enhanced capital, liquidity and funding requirements and those governing the development of parameters applied in, and controls around, models used for measuring risk can give rise to changes that may adversely affect our business, including increases in capital requirements.

Changes in laws, rules or regulations, or in their interpretation or enforcement, or in how new laws, rules or regulations are implemented may adversely affect our business, prospects, financial condition and/or results of operations. Further, uncertainty and lack of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect our ability to engage in effective business, capital and risk management planning.

We may fail to comply with all applicable regulations, particularly in areas where applicable regulations may be unclear or where regulators revise existing guidance or courts overturn previous rulings. Authorities in many jurisdictions have the power to bring administrative or

judicial proceedings against us which could result in, among other things, the suspension or revocation of our licenses, cease and desist orders, fines, civil penalties, criminal penalties or other disciplinary action which could have a material adverse effect on our business, prospects, financial condition, reputation and/or results of operations and seriously harm our reputation.

Areas where changes could have an adverse effect on our business, prospects, financial condition or results of operations include, but are not limited to:

general changes in government, central bank or regulatory or competition policy, or changes in regulatory regimes that may influence investor decisions in particular markets in which we operate;

the structural separation of banking and trading activities proposed or enacted in a number of jurisdictions (see below);

requirements flowing from arrangements for the resolution strategy of the Group and its individual operating entities, which may have different effects in different countries;

the implementation of extra-territorial laws, including the US Foreign Account Tax Compliance Act ( FATCA ) and other related initiatives to share tax information such as those being pursued by the OECD more generally;

the implementation of CRD IV, notably the UK application of the capital buffer framework and its interaction with Pillar 2 and the PRA buffer;

the implementation of the BRRD s minimum requirements for eligible liabilities by the BoE and its interaction with TLAC requirements for G-SIBs;

the increasing focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets, promoting effective competition in the interests of consumers and ensuring the orderly and transparent operation of global financial markets;

restrictions on the structure of remuneration imposed under CRD IV and UK regulations and increasing requirements to detail management accountability within the Group to meet the requirements of the Senior Managers Regime in the UK (including the continued focus in the UK on the progress being made in implementing wider recommendations made by the Parliamentary Commission on Banking Standards on matters relating to institutional culture , employee conduct and obligations more generally such as whistleblowing);

the implementation of any measures as a result of regulators increased focus on conduct matters (including any measures resulting from the FCA s February 2015 announced plans to launch its first wholesale market study into investment and corporate banking to assess whether competition in the sector is working properly, as well as the FCA s ongoing retail banking market studies into whether

HSBC HOLDINGS PLC

111d



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

competition is working effectively in the cash savings and consumer credit markets), which may include customer compensation and redress schemes or other, potentially significant, remedial work;

the proposals from the FSB which are subject to consultation and translation into national regulations but which would require G-SIBs to hold minimum levels of capital and TLAC;

external bodies applying or interpreting standards or laws differently to us;

further requirements relating to financial reporting, corporate governance and employee compensation; and

expropriation, nationalisation, confiscation of assets and changes in legislation or regulations relating to foreign ownership.

These developments, which are discussed in more detail on pages 110(b) to 110(n), are expected to continue to change the way in which we are regulated and supervised and could affect the manner in which we conduct our business activities, capital requirements, results of operations or how the Group is structured.

We and our UK subsidiaries may become subject to stabilisation provisions under the Bank Act 2009, as amended, in certain significant stress situations.

Under the Banking Act 2009, as amended (the Banking Act ), substantial powers have been granted to HM Treasury, the BoE and the PRA and FCA (as successors to the FSA) (together, the Authorities ) as part of the special resolution regime ( SRR ). These powers enable the Authorities to deal with and stabilise UK-incorporated institutions with permission to accept deposits pursuant to Part 4A of the FSMA that are failing or are likely to fail to satisfy the threshold conditions (within the meaning of section 55B of the FSMA). The SRR presently consists of three stabilisation options: (i) transfer of all or part of the business of the relevant entity or the shares of the relevant entity to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a bridge bank wholly-owned by the Bank of England; and (iii) temporary public ownership of the relevant entity. HM Treasury may also take a parent company of a relevant entity into temporary public ownership where certain conditions are met. The SRR also provides for two new insolvency and administration procedures for relevant entities. Certain ancillary powers include the power to modify certain contractual arrangements in certain circumstances.

In general, the Banking Act requires the Authorities to have regard to specified objectives in exercising the powers provided for by the Banking Act. One of the objectives (which is required to be balanced as appropriate with the other specified objectives) refers to the protection and enhancement of the stability of the financial system of the United Kingdom. The Banking Act

includes provisions related to compensation in respect of transfer instruments and orders made under it. The Authorities are also empowered by order to amend the law for the purpose of enabling the powers under the SRR to be

used effectively. An order may make provision which has retrospective effect.

There is considerable uncertainty about the scope of the powers afforded to the Authorities under the Banking Act and how the Authorities may choose to exercise them or the powers that may be granted to the Authorities under future legislation. However, if we are at or approaching the point of non-viability such as to require regulatory intervention, any exercise of any resolution regime powers by the Authorities may result in holders of our ordinary shares losing all or a part of their shareholdings and/or in the rights of holders of our ordinary shares being adversely affected, including by the dilution of their percentage ownership of our share capital, and/or could have a material adverse effect on the market price of our ordinary shares.

Structural separation of banking and trading activities proposed or enacted in a number of jurisdictions could have a material adverse effect on our operations and operating results.

In December 2013, the UK Financial Services (Banking Reform) Act 2013 received Royal Assent. It implements the recommendations of the Independent Commission on Banking ( ICB ), which *inter alia* establish a framework for ring-fencing UK retail banking in separately incorporated banking entities ( ring-fenced banks ) from trading activities. Secondary legislation has also been finalised, and in October 2014 the PRA published a consultation on ring-fencing rules in relation to group structures, governance and arrangements to ensure continuity of services and facilities. Finalised rules are expected to be published in 2016, with the implementation of ring-fencing in 2019.

The proposed separation of retail and SME banking in the UK would be a material change to the structure of HSBC Bank plc. Considerable uncertainty remains over the likely cost of implementing structural separation at this time, although we expect it to be material.

In January 2014, the European Commission published legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors to require trading activities such as market-making, complex derivatives and securitisation operations to be undertaken in a separate subsidiary from deposit taking activities. The proposals are currently subject to discussion in the European Parliament and the Council. The implementation date for any separation under the final rules would depend upon the date on which the final legislation is agreed.

Structural separation of retail and investment banking and trading activities is discussed in more detail on page 119.

HSBC HOLDINGS PLC

111e

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

We are subject to tax-related risks in the countries in which we operate which could have a material adverse effect on our operating results

HSBC is subject to the substance and interpretation of tax laws in all countries in which we operate and is subject to routine review and audit by tax authorities in relation thereto. We provide for potential tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. The amounts ultimately paid may differ materially from the amounts provided depending on the ultimate resolution of such matters. Changes to tax law, tax rates and penalties for failure to comply could have a material adverse effect on our business, financial condition and/or results of operations.

**Risks related to our business, business operations, governance and internal control systems**

The delivery of our strategic priorities is subject to execution risk

The financial services industry is currently facing an unprecedented period of scrutiny. Regulatory requests, legal matters and business initiatives all require a significant amount of time and resources to implement. The magnitude and complexity of projects within HSBC required to meet these demands has resulted in heightened execution risk. Organisational change and external factors, including the challenging macroeconomic environment and the extent and pace of regulatory change also contribute to execution risk. These factors could adversely affect the successful delivery of our strategic priorities.

There also remains heightened risk around the execution of a number of disposals across the Group in line with our Strategy. The potential risks of disposals include regulatory breaches, industrial action, loss of key personnel and interruption to systems and processes during business transformation. They can have both financial and reputational implications and could also adversely affect the successful delivery of our strategic priorities.

We may not achieve all the expected benefits of our strategic initiatives

The Group's strategy (see page 11), is built around two trends, the continued growth of international trade and capital flows, and wealth creation, particularly in faster-growing markets. We have analysed those trends, and have developed criteria to help us better deploy capital in response. The development and implementation of our strategy requires difficult, subjective and complex judgements, including forecasts of economic conditions in various parts of the world. We may fail to correctly identify the trends we seek to exploit and the relevant factors in making decisions as to capital deployment and cost reduction.

Our ability to execute our strategy may also be limited by our operational capacity and the increasing complexity of the regulatory environment in which we operate. In

addition, factors beyond our control, including but not limited to, the economic and market conditions and other challenges discussed in detail above, could limit our ability to achieve all of the expected benefits of these initiatives.

We operate in markets that are highly competitive

We compete with other financial institutions in a highly competitive industry that is undergoing significant changes as a result of financial regulatory reform and increased public scrutiny stemming from the financial crisis and continued challenging economic conditions.

We target internationally mobile clients who need sophisticated global solutions and generally compete on the basis of the quality of our customer service, the wide variety of products and services that we can offer our customers and the ability of those products and services to satisfy our customers' needs, the extensive distribution channels available for our customers, our innovation, and our reputation. Continued and increased competition in any one or all of these areas may negatively affect our market share and results of operations and/or cause us to increase our capital investment in our businesses in order to remain competitive. Additionally, if our products and services are not accepted by our targeted clients, this may have a material adverse effect on our business, financial condition and results of operations.

In many markets, there is increased competitive pressure to provide products and services at current or lower prices. Consequently, our ability to reposition or reprice our products and services from time to time may be limited and could be influenced significantly by the actions of our competitors who may or may not charge similar fees for their products and services. Any changes in the types of products and services that we offer our customers and/or the pricing for those products and services could result in a loss of customers and market share and could materially adversely affect our results of operations.

Further, new entrants to the market or new technologies could require us to spend more to modify or adapt our products to attract and retain customers. We may not respond effectively to these competitive threats from existing and new competitors and may be forced to increase our investment in our business to modify or adapt our existing products and services or develop new products and services to respond to our customers' needs.

Our risk management measures may not be successful

The management of risk is an integral part of all our activities. Risk constitutes our exposure to uncertainty and the consequent variability of return. Specifically, risk equates to the adverse effect on profitability or financial condition arising from different sources of uncertainty including retail and wholesale credit risk, market risk, operational risk, non-traded

HSBC HOLDINGS PLC

111f

**Table of Contents**

**Report of the Directors: Financial Review (continued)**

market risk, insurance risk, concentration risk, liquidity and funding risk, litigation risk, reputational risk, strategic risk, pension obligation risk and regulatory risk. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, such techniques and the judgements that accompany their application cannot anticipate every unfavourable event or the specifics and timing of every outcome. Failure to manage risks appropriately could have a significant effect on our business prospects, financial condition and/or results of operations.

Operational risks are inherent in our business

We are exposed to many types of operational risk that are inherent in banking operations including fraudulent and other criminal activities (both internal and external), breakdowns in processes or procedures and systems failure or non-availability. These risks apply equally when we rely on outside suppliers or vendors to provide services to us and our customers. These operational risks could have a material adverse effect on our business, prospects, financial condition and results of operation.

Our operations are subject to the threat of fraudulent activity

Fraudsters may target any of our products, services and delivery channels including lending, internet banking, payments, bank accounts and cards. This may result in financial loss to the bank, an adverse customer experience, reputational damage and potential regulatory action depending on the circumstances of the event.

Our operations are subject to disruption from the external environment

HSBC operates in many geographical locations, which are subject to events that are outside our control. These events may be acts of God such as natural disasters and epidemics, geopolitical risks including acts of terrorism and social unrest, and infrastructure issues such as transport or power failure. These risk events may give rise to disruption to our services, result in physical damage and/or loss of life, and could have a material adverse effect on our business, prospects, financial condition and results of operation.

Our operations utilise third-party suppliers and service providers

HSBC places reliance on third-party firms for the supply of goods and services or outsourcing of certain activities. There has been increased scrutiny by global regulators of the use by financial institutions of third-party service providers, including how outsourcing decisions are made and how the key relationships are managed. Risks arising from the use of third-party service providers may be less transparent and therefore more challenging to manage or influence. The risk of inadequate management of risks associated with the use of significant third-party service providers could lead to a failure to meet our operational and business requirements which, in turn, may involve regulatory breaches, financial crime, loss of confidential

information, civil or monetary penalties or damage both to shareholder value and to our reputation/brand image.

Our operations are highly dependent on our information technology systems

The reliability and security of our information and technology infrastructure and our customer databases are crucial to maintaining the service availability of banking applications and processes and to protecting the HSBC brand. The proper functioning of our payment systems, financial control, risk management, credit analysis and reporting, accounting, customer service and other information technology systems, as well as the communication networks between our branches and main data processing centres, are critical to our operations.

Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to our ability to service our clients, could breach regulations under which we operate and could cause long-term damage to our business and brand that could have a material adverse effect on our business, prospects, financial condition, reputation and/or results of operations. This includes the operation of our key payments services.

HSBC remains susceptible to a wide range of cyber risks that impact and/or are facilitated by technology. The threat from cyber attacks is a concern for our organisation and failure to protect our operations from internet crime or cyber attacks may result in financial loss and/or loss of customer data or other sensitive information which could undermine our reputation and our ability to attract and keep customers. This could have a material adverse effect on our business, financial condition and/or results of our operations.

A cyber security breach in HSBC Turkey in November 2014 exposed the details of credit and debit card information for 2.7m customers. Although the exposure was not linked to fraudulent transactions and the breach was detected through internal security controls, customers and the local regulator were informed.

During 2014, we were subjected to 12 denial of service attacks on our external facing websites across the Group. A denial of service attack is the attempt to intentionally disrupt, paralyse and potentially extract data from a computer network by flooding it with data sent simultaneously from many individual computers.

Although most cyber attacks in 2014 had a negligible effect on our customers, services or firm, future cyber attacks could have a material adverse effect on our business, financial condition and/or results of operations and reputation.

We may not be able to meet regulatory requests for data

The volume, granularity, frequency and scale of regulatory and other reporting requirements necessitate a clear data strategy to enable consistent data aggregation, reporting and management. Inadequate

HSBC HOLDINGS PLC

111g

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

management information systems or processes, including those relating to risk data aggregation and risk reporting, could lead to a failure to meet regulatory reporting requirements or other internal or external information demands. Financial institutions that fail to comply with the principles for effective risk data aggregation and risk reporting as set out by the Basel Committee on Banking Supervision by the required deadline may face supervisory measures.

Our operations have inherent reputational risk

Reputational risk is the risk of failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC, its employees or those with whom it is associated, that may cause stakeholders to form a negative view of HSBC. It could also arise from negative public opinion about the actual, or perceived, manner in which we conduct our business activities, our financial performance, as well as actual or perceived practices in banking and the financial services industry generally. Reputational risk could lead to adverse financial or non-financial consequences, including loss of confidence or adverse effects on our ability to retain and attract customers. Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk.

Modern technologies, in particular online social media channels and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may significantly enhance and accelerate the impact of damaging information and allegations. Negative public opinion may adversely affect our ability to keep and attract customers and, in particular, corporate and retail depositors, and could have a material adverse effect on our business, prospects, financial condition, reputation and/or results of operations.

We may suffer losses due to employee misconduct

Our businesses are exposed to risk from potential non-compliance with policies, including the HSBC Values and related behaviours, and employee misconduct, such as fraud or negligence, all of which could result in regulatory sanctions or reputational or financial harm. In recent years, a number of multinational financial institutions have suffered material losses due to the actions of rogue traders or other employees. It is not always possible to deter employee misconduct and the precautions we take to prevent and detect this activity may not always be effective.

We rely on recruiting, retaining and developing appropriate senior management and skilled personnel

The demands being placed on the human capital of the Group are unprecedented. The cumulative workload arising from a regulatory reform programme that is often extra-territorial and still evolving is hugely consumptive of human resources, placing increasingly complex and

conflicting demands on a workforce where the required expert capabilities are in short supply and globally mobile.

Our continued success depends in part on the retention of key members of our management team and wider employee base. The ability to continue to attract, train, motivate and retain highly qualified professionals is a key element of our strategy. The successful implementation of our growth strategy depends on the availability of skilled management in each of our global businesses or global functions. If global businesses or global functions fail to staff their operations

appropriately, or lose one or more of their key senior executives, and fail to replace them in a satisfactory and timely manner, or fail to implement successfully the organisational changes required to support the Group's strategy, our business prospects, financial condition and/or results of operations, including control and operational risks, may be materially adversely affected.

Our financial statements are based in part on judgements, estimates and assumptions which are subject to uncertainty

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, particularly those involving the use of complex models, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements, assumptions and models are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The accounting policies deemed critical to our results and financial position, based upon materiality and significant judgements and estimates, include impairment of loans and advances, goodwill impairment, valuation of financial instruments, deferred tax assets, provisions and interests in associates, which are discussed in detail in Critical accounting estimates and judgements on page 348.

The valuation of financial instruments measured at fair value can be subjective, in particular where models are used which include unobservable inputs. Given the uncertainty and subjectivity associated with valuing such instruments, future outcomes may differ materially from those assumed using information available at the reporting date. The effect of these differences on the future results of operations and the future financial position of the Group may be material. For further details, see Critical accounting estimates and judgements on page 348.

If the judgement, estimates and assumptions we use in preparing our consolidated financial statements are subsequently found to be materially different from those assumed using information available at the reporting

HSBC HOLDINGS PLC

111h



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

date, this could affect our business, financial conditions, prospects, and/or results of operations and have a corresponding effect on our funding requirements and capital ratios.

HSBC could incur losses or be required to hold additional capital as a result of model limitations or failure

HSBC uses models for a range of purposes in managing its business, including regulatory and economic capital calculations, stress testing, granting credit, pricing and financial reporting, including the valuation of financial instruments measured at fair value, as explained above. HSBC could face adverse consequences as a result of decisions, which may lead to actions by management, based on models that are poorly developed, implemented or used, or as a result of the modelled outcome being misunderstood or the use of such information for purposes for which it was not designed. Risks arising from use of models could have a material adverse effect on our business, financial condition and/or results of operations, minimum capital requirements and reputation.

In addition, supervisory concerns over the internal models and assumptions used by banks in the calculation of regulatory capital have led to the imposition of risk weight and loss given default floors, which has the potential to increase our capital requirement.

Third parties may use us as a conduit for illegal activities without our knowledge, which could have a material adverse effect on us

We are required to comply with applicable anti-money laundering laws and regulations and have adopted various policies and procedures, including internal control and know your customer procedures, aimed at preventing use of HSBC products and services for the purpose of committing or concealing financial crime. A major focus of US and UK government policy relating to financial institutions in recent years has been combating money laundering and enforcing compliance with US and EU economic sanctions, and this prioritisation is evidenced by our agreements with US and UK authorities relating to various investigations regarding past inadequate compliance with anti-money laundering and sanctions laws. Certain US subsidiaries of HSBC Holdings have entered into a consent cease and desist order with the OCC and a similar consent order with the FRB which require the implementation of improvements to compliance procedures regarding obligations under the US Bank Secrecy Act (the BSA ), FCA Direction and anti-money laundering ( AML ) rules. These consent orders do not preclude additional enforcement actions by bank regulatory, governmental or law enforcement agencies or private litigation.

A number of the remedial actions taken or being taken as a result of the matters to which the US DPA relates are intended to ensure that the Group s businesses are better protected in respect of these risks. However, there can be no assurance that the steps that continue to be taken to address the requirements of the US DPA

will be completely effective. Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC in relation to the matters which are the subject of the US DPA.

In relevant situations, and where permitted by regulation, we may rely upon certain counterparties to maintain and properly apply their own appropriate AML procedures. While permitted by regulation, such reliance may not be effective in preventing third parties from using us (and our relevant counterparties) as a conduit for money laundering

including illegal cash operations without our knowledge (and that of our relevant counterparties). Becoming a party to money laundering, association with, or even accusations of being associated with money laundering will damage our reputation and could make us subject to fines, sanctions and/or legal enforcement (including being added to blacklists that would prohibit certain parties from engaging in transactions with us). Any one of these outcomes could have a material adverse effect on our business, prospects, financial condition and/or results of operations.

We have significant exposure to counterparty risk

We are exposed to counterparties that are involved in virtually all major industries, and we routinely execute transactions with counterparties in financial services, including brokers and dealers, central clearing counterparties, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default by our counterparty or client. Our ability to engage in routine transactions to fund our operations and manage our risks could be materially adversely affected by the actions and commercial soundness of other financial services institutions. Financial institutions are necessarily interdependent because of trading, clearing, counterparty or other relationships. As a consequence, a default by, or decline in market confidence in, individual institutions, or anxiety about the financial services industry generally, can lead to further individual and/or systemic difficulties, defaults and losses.

Mandatory central clearing of over the counter ( OTC ) derivatives, including under the Dodd-Frank Act and the EU s European Market Infrastructure Regulation ( EMIR ), brings new risks to HSBC. As a clearing member, we will be required to underwrite losses incurred at Central Counterparty ( CCP ) by the default of other clearing members and their clients. Hence central clearing brings with it a new element of interconnectedness between clearing members and clients which we believe may increase rather than reduce our exposure to systemic risk. At the same time, our ability to manage such risk ourselves will be reduced because control has been largely outsourced to CCPs and it is unclear at present how, at a time of stress, regulators and resolution authorities will intervene.

HSBC HOLDINGS PLC

111i

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

Where bilateral counterparty risk has been mitigated by taking collateral, our credit risk may remain high if the collateral we hold cannot be realised or has to be liquidated at prices which are insufficient to recover the full amount of our loan or derivative exposure. There is a risk that collateral cannot be realised, including situations where this arises by change of law that may influence our ability to foreclose on collateral or otherwise enforce contractual rights.

The Group also has credit exposure arising from mitigants such as credit default swaps ( CDS s), and other credit derivatives, each of which is carried at fair value. The risk of default by counterparties to CDSs and other credit derivatives used as mitigants affects the fair value of these instruments depending on the valuation and the perceived credit risk of the underlying instrument against which protection has been purchased. Any such adjustments or fair value changes may have a material adverse effect on our financial condition and results of operations.

Market fluctuations may reduce our income or the value of our portfolios

Our businesses are inherently subject to risks in financial markets and in the wider economy, including changes in, and increased volatility of, interest rates, inflation rates, credit spreads, foreign exchange rates, commodity, equity, bond and property prices and the risk that our customers act in a manner inconsistent with our business, pricing and hedging assumptions.

Market movements will continue to significantly affect us in a number of key areas. For example, banking and trading activities are subject to interest rate risk, foreign exchange risk, inflation risk and credit spread risk. Changes in interest rate levels, interbank spreads over official rates, yield curves and spreads affect the interest rate spread realised between lending and borrowing costs. The potential for future volatility and margin changes remains. Competitive pressures on fixed rates or product terms in existing loans and deposits sometimes restrict our ability to change interest rates applying to customers in response to changes in official and wholesale market rates. Our pension scheme assets include equity and debt securities, the cash flows of which change as equity prices and interest rates vary.

Our insurance businesses are exposed to the risk that market fluctuations will cause mismatches to occur between product liabilities and the investment assets which back them. Market risks can affect our insurance products in a number of ways depending upon the product and associated contract. For example, mismatches between assets and liability yields and maturities give rise to interest rate risk. Some of these risks are borne directly by the customer and some are borne by the insurance businesses, with their excess capital invested in the markets. Some insurance contracts involve guarantees and options that increase in value in adverse investment markets. There is a risk that the insurance businesses will bear some of the cost of such guarantees and options. The performance of the investment markets will thus have a direct effect upon the value embedded in the insurance and investment

contracts and our operating results, financial condition and prospects.

It is difficult to predict with any accuracy changes in market conditions, and such changes may have a material adverse effect on our business, operating results, financial condition and prospects.

Liquidity, or ready access to funds, is essential to our businesses

Our ability to borrow on a secured or unsecured basis and the cost of so doing can be affected by increases in interest rates or credit spreads, the availability of credit, regulatory requirements relating to liquidity or the market perceptions of risk relating to HSBC or the banking sector, including our perceived or actual creditworthiness.

Current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon preserving investor confidence in our capital strength and liquidity, and on comparable and transparent pricing. Although deposits have been, over time, a stable source of funding, this may not continue.

We also access wholesale markets in order to provide funding for entities that do not accept deposits, to align asset and liability maturities and currencies and to maintain a presence in local markets. In 2014, we issued the equivalent of US\$20bn of debt securities in the public capital markets in a range of currencies and maturities from a number of Group entities, including US\$9.1bn of subordinated securities issued by HSBC Holdings. An inability to obtain financing in the unsecured long-term or short-term debt capital markets, or to access the secured lending markets, could have a substantial adverse effect on our liquidity. Unfavourable macroeconomic developments, market disruptions or regulatory developments may increase our funding costs or challenge our ability to raise funds to support or expand our businesses, materially adversely affecting our business, prospects, financial condition and/or results of operations.

If we are unable to raise funds through deposits and/or in the capital markets, our liquidity position could be adversely affected and we might be unable to meet deposit withdrawals on demand or at their contractual maturity, to repay borrowings as they mature, to meet our obligations under committed financing facilities and insurance contracts, or to fund new loans, investments and businesses. We may need to liquidate unencumbered assets to meet our liabilities. In a time of reduced liquidity, we may be unable to sell some of our assets, or we may need to sell assets at depressed prices, which in either case could materially adversely affect our business, prospects, results of operations and/or financial condition.

HSBC HOLDINGS PLC

111j

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

Any reduction in the credit rating assigned to HSBC Holdings, any subsidiaries of HSBC Holdings or any of their respective debt securities could increase the cost or decrease the availability of our funding and adversely affect our liquidity position and net interest margin

Credit ratings affect the cost and other terms upon which we are able to obtain market funding. Rating agencies regularly evaluate HSBC Holdings and certain of its subsidiaries, as well as their respective debt securities. Their ratings are based on a number of factors, including their assessment of the relative financial strength of HSBC or of the relevant entity, as well as conditions affecting the financial services industry generally. There can be no assurance that the rating agencies will maintain HSBC's or the relevant entity's current ratings or outlook, particularly given the rating agencies' current review of their bank rating methodologies and the potential impact on HSBC's or its subsidiaries' ratings.

As of the date hereof, HSBC Holdings' long-term debt was rated AA-, A, Aa3 by Fitch, Standard & Poor's (S&P) and Moody's, respectively. Ratings outlook by Fitch and S&P were stable and Moody's rating outlook was negative. Among other factors, Moody's rating outlook reflects the potential removal of government support (in whole or in part) as a factor in our rating due to the European resolution framework, including BRRD and the UK bail-in power. S&P lowered our long-term debt rating in February 2015 to reflect their view that extraordinary government support is unlikely. Any reductions in these ratings and outlook could increase the cost of our funding, limit access to capital markets and require additional collateral to be placed and, consequently, materially adversely affect our interest margins and/or our liquidity position.

Under the terms of our current collateral obligations under derivative contracts, we could be required to post additional collateral as a result of a downgrade in HSBC's credit rating as described on page 173.

Risks concerning borrower credit quality are inherent in our businesses

Risks arising from changes in credit quality and the recoverability of loans and amounts due from borrowers and counterparties (e.g. reinsurers and counterparties in derivative transactions) are inherent in a wide range of our businesses. Adverse changes in the credit quality of our borrowers and counterparties arising from a general deterioration in economic conditions or systemic risks in the financial systems could reduce the recoverability and value of our assets and require an increase in our loan impairment charges.

We estimate and recognise impairment allowances for credit losses inherent in our credit exposure. This process, which is critical to our results and financial condition, requires difficult, subjective and complex judgements, including forecasts of how these economic conditions might impair the ability of our borrowers to repay their loans and the ability of other counterparties

to meet their obligations. As is the case with any such assessments, we may fail to estimate accurately the effect of factors that we identify or fail to identify relevant factors. Further, the information we use to assess the creditworthiness of our counterparties may be inaccurate or incorrect. Any failure by us to accurately estimate the ability of our counterparties to meet their obligations may have a material adverse effect on our business, prospects, financial conditions and/or results of operations.

Our insurance businesses are subject to risks relating to insurance claim rates and changes in insurance customer behaviour

We provide various insurance products for customers with whom we have a banking relationship, including several types of life insurance products. The cost of claims and benefits can be influenced by many factors, including mortality and morbidity rates, lapse and surrender rates and, if the policy has a savings element, the performance of assets to support the liabilities. Adverse developments in any of these factors may materially adversely affect our financial condition and results of operations.

HSBC Holdings is a holding company and as a result, is dependent on loan payments and dividends from its subsidiaries to meet its obligations, including obligations with respect to its debt securities, and to provide profits for payment of future dividends to shareholders

HSBC Holdings is a non-operating holding company and, as such, its principal source of income is from operating subsidiaries which hold the principal assets of HSBC. As a separate legal entity, HSBC Holdings relies on remittance of its subsidiaries' loan interest payments and dividends in order to be able to pay obligations to debt holders as they fall due and to pay dividends to its shareholders. The ability of HSBC Holdings subsidiaries and affiliates to pay dividends could be restricted by changes in regulation, exchange controls and other requirements.

We may be required to make substantial contributions to our pension plans

We operate a number of pension plans throughout the world, including defined benefit plans. Pension scheme obligations fluctuate with changes in long-term interest rates, inflation, salary levels and the longevity of scheme members. The level of contributions we make to our pension plans has a direct effect on our cash flow. To the extent plan assets are insufficient to cover existing liabilities, higher levels of contributions will be required. As a result, deficits in those pension plans may have a material adverse effect on our business, prospects, financial condition and/or results of operations.

HSBC HOLDINGS PLC

111k

## **Table of Contents**

### **Report of the Directors: Financial Review** (continued)

#### **Managing risk**

*(Unaudited)*

As a provider of banking and financial services, we actively manage risk as a core part of our day-to-day activities.

#### **Risk management framework**

Our risk management framework, which is employed at all levels of the organisation, is set out on page 24. The key elements are discussed below.

The Group's Risk Appetite Statement is a key component in our management of risk and is described on page 24.

#### **Risk governance framework**

Robust risk governance and accountability are embedded throughout the Group through an established framework that ensures appropriate oversight of and accountability for the effective management of risk at all levels of the organisation and across all risk types. Adherence to consistent standards and risk management policies is required across HSBC by our Global Standards and our Global Risk operating model.

The Board has ultimate responsibility for approving HSBC's risk appetite and the effective management of risk.

The Group Risk Committee advises the Board on risk appetite and its alignment with strategy, risk governance and internal controls and high-level risk related matters.

The Financial System Vulnerabilities Committee reports to the Board on matters relating to financial crime and financial system abuse and provides a forward-looking perspective on financial crime risk.

The Conduct & Values Committee was established in January 2014 to oversee the design and application of HSBC's policies, procedures and standards, to ensure that we conduct business responsibly and consistently adhere to HSBC Values and to advise the Board accordingly.

Executive accountability for the ongoing monitoring, assessment and management of the risk environment and the effectiveness of our risk management policies resides with the Risk Management Meeting of the GMB. Day-to-day risk management activities are the responsibility of senior managers of individual businesses, supported by global functions as described under 'Three lines of defence' below.

The executive and non-executive risk governance structures and their interactions are set out on page 204, with similar arrangements in place for major operating subsidiaries.

*The report of the Group Risk Committee is on page 280. The Report of the Financial System Vulnerabilities Committee is on page 282. The report of the Conduct & Values Committee is on page 286.*

### Three lines of defence

We use a three lines of defence model in the management of risk.

**First line** every employee is responsible for the risks that form part of their day to day jobs. The first line of defence ensures that all key risks within their operations are identified, mitigated and monitored by appropriate internal controls within an overall control environment.

**Second line** global functions such as Risk, Finance and Human Resources form the second line of defence. They are responsible for providing assurance, challenge and oversight of the activities conducted by the first line.

**Third line** Internal Audit forms the third line of defence, providing independent assurance to senior management and the Board over the first and second lines of defence.

*For details of our operational risk management framework, see page 186.*

### People

All employees are required to identify, assess and manage risk within the scope of their assigned responsibilities and, as such, they are critical to the effectiveness of the three lines of defence. Personal accountability for Global Standards is reinforced by HSBC Values.

Clear and consistent employee communication on risk conveys strategic messages and sets the tone from senior leadership. A suite of mandatory training on critical risk and compliance topics is deployed to embed skills and understanding and strengthen the risk culture within HSBC. It reinforces the attitude to risk in the behaviour expected of employees, as described in our risk policies. The training is updated regularly, describing technical aspects of the various risks assumed by the Group and how they should be managed effectively. Staff are supported in their roles by a disclosure line which enables them to raise concerns confidentially (see page 20).

Our risk culture is reinforced by our approach to remuneration. Individual awards, including those for executives, are based on compliance with HSBC Values and the achievement of financial and non-financial objectives which are aligned to our risk appetite and global strategy.

*For further information on risk and remuneration, see the Report of the Group Remuneration Committee on page 300.*

### Independent Risk function

Global Risk, headed by the Group Chief Risk Officer, is responsible for enterprise-wide risk oversight including the establishment of global policy, the monitoring of risk profiles and forward-looking risk identification and management. Global Risk also has functional responsibility for risk management in support of HSBC's global businesses and regions through an integrated network of Risk sub-functions which are independent from the sales and trading functions of our businesses. This independence ensures the necessary balance in risk/return decisions.





**Table of Contents**

**Report of the Directors: Financial Review** (continued)

We run Global Risk like a business, ensuring that the function is dynamic and responsive to the needs of its stakeholders.

**Risks faced by HSBC**

All of our activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks.

**Risk factors**

We have identified a comprehensive suite of risk factors which covers the broad range of risks our businesses are exposed to.

A number of the risk factors have the potential to affect the results of our operations or financial condition, but may not necessarily be deemed as top or emerging risks. However, they inform the ongoing assessment of our top and emerging risks which may result in our risk appetite being revised. The risk factors are:

**Macroeconomic and geopolitical risk**

Current economic and market conditions may adversely affect our results.

We are subject to political and economic risks in the countries in which we operate, including the risk of government intervention.

We may suffer adverse effects as a result of the renewed economic and sovereign debt tensions in the eurozone.

Changes in foreign currency exchange rates may affect our results.

**Macro-prudential, regulatory and legal risks to our business model**

Failure to implement our obligations under the deferred prosecution agreements could have a material adverse effect on our results and operations.

Failure to comply with certain regulatory requirements would have a material adverse effect on our results and operations.

Failure to meet the requirements of regulatory stress tests could have a material adverse effect on our capital position, operations, results and future prospects.

We are subject to a number of legal and regulatory actions and investigations, the outcomes of which are inherently difficult to predict, but unfavourable outcomes could have a material adverse effect on our operating results and brand.

Unfavourable legislative or regulatory developments, or changes in the policy of regulators or governments, could have a material adverse effect on our operations, financial condition and prospects.

HSBC Holdings and its UK subsidiaries may become subject to stabilisation provisions under the Bank Act 2009, as amended, in certain significant stress situations.

Structural separation of banking and trading activities proposed or enacted in a number of jurisdictions could have a material adverse effect on our operations and operating results.

We are subject to tax-related risks in the countries in which we operate which could have a material adverse effect on our operating results.

**Risks related to our business, business operations, governance and internal control systems**

The delivery of our strategic priorities is subject to execution risk.

We may not achieve all the expected benefits of our strategic initiatives.

We operate in markets that are highly competitive.

Our risk management measures may not be successful.

Operational risks are inherent in our business.

Our operations are subject to the threat of fraudulent activity.

Our operations are subject to disruption from the external environment.

Our operations utilise third-party suppliers and service providers.

Our operations are highly dependent on our information technology systems.

We may not be able to meet regulatory requests for data.

Our operations have inherent reputational risk.

We may suffer losses due to employee misconduct.

We rely on recruiting, retaining and developing appropriate senior management and skilled personnel.

Our financial statements are based in part on judgements, estimates and assumptions which are subject to uncertainty.

HSBC could incur losses or be required to hold additional capital as a result of model limitations or failure.

Third parties may use us as a conduit for illegal activities without our knowledge, which could have a material adverse effect on us.

We have significant exposure to counterparty risk.

Market fluctuations may reduce our income or the value of our portfolios.

Liquidity, or ready access to funds, is essential to our businesses.

Any reduction in the credit rating assigned to HSBC Holdings, any subsidiaries of HSBC Holdings or any of their respective debt securities could increase the cost or decrease the availability of our funding and adversely affect our liquidity position and interest margins.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

Risks concerning borrower credit quality are inherent in our businesses.

Our insurance business is subject to risks relating to insurance claim rates and changes in insurance customer behaviour.

HSBC Holdings is a holding company and, as a result, is dependent on loan payments and dividends from its subsidiaries to meet its obligations, including obligations with respect to its debt securities, and to provide profits for payment of future dividends to shareholders.

We may be required to make substantial contributions to our pension plans.

**Risks managed by HSBC**

The principal risks associated with our banking and insurance manufacturing operations are described in the tables below.

*Description of risks banking operations*

Risks	Arising from	Measurement, monitoring and management of risk
<b>Credit risk</b> (page 127)		
<i>The risk of financial loss if a customer or counterparty fails to meet an obligation under a contract.</i>	Credit risk arises principally from direct lending, trade finance and leasing business, but also from certain other products such as guarantees and derivatives.	Credit risk is:  <b>measured</b> as the amount which could be lost if a customer or counterparty fails to make repayments. In the case of derivatives, the measurement of exposure takes

into account the current mark-to-market value to HSBC of the contract and the expected potential change in that value over time caused by movements in market rates;

**monitored** within limits approved by individuals within a framework of delegated authorities. These limits represent the peak exposure or loss to which HSBC could be subjected should the customer or counterparty fail to perform its contractual obligations; and

**managed** through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers.

**Liquidity and funding risk** (page 163)

*The risk that we do not have sufficient financial resources to meet our obligations as they fall due or that we can only do so at excessive cost.*

Liquidity risk arises from mismatches in the timing of cash flows.

Funding risk arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.

Liquidity and funding risk is:

**measured** using internal metrics including stressed operational cash flow projections, coverage ratios and advances to core funding ratios;

**monitored** against the Group's liquidity and funding risk framework and overseen by regional Asset and Liability Management Committees (ALCOs), Group ALCO and the Risk Management Meeting; and

**managed** on a stand-alone basis with no reliance on any Group entity (unless pre-committed) or central bank unless this represents routine established business as usual market practice.

**Market risk** (page 175)

*The risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce*

Exposure to market risk is separated into two portfolios:

Market risk is:

*our income or the value of our portfolios.*

trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions.

**measured** in terms of value at risk, which is used to estimate potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence, augmented with stress testing to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables;

non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from our insurance operations (page 198).

**monitored** using measures including the sensitivity of net interest income and the sensitivity of structural foreign exchange which are applied to the market risk positions within each risk type; and

**managed** using risk limits approved by the GMB for HSBC Holdings and our various global businesses. These units are allocated across business lines and to the Group's legal entities.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

Risks	Arising from	Measurement, monitoring and management of risk
<p><b>Operational risk</b> (page 186)</p> <p><i>The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk (along with accounting, tax, security and fraud, people, systems, projects, operations and organisational change risk).</i></p>	<p>Operational risk arises from day to day operations or external events, and is relevant to every aspect of our business.</p> <p>Compliance risk and fiduciary risk are discussed below. Other operational risks are covered in the Appendix to Risk (page 204).</p>	<p>Operational risk is:</p> <p><b>measured</b> using both the top risk analysis process and the risk and control assessment process, which assess the level of risk and effectiveness of controls;</p> <p><b>monitored</b> using key indicators and other internal control activities; and</p> <p><b>managed</b> primarily by global business and functional managers. They identify and assess risks, implement controls to manage them and monitor the effectiveness of these controls utilising the operational risk management framework. Global Operational Risk is responsible for the framework and for overseeing the management of operational risks within businesses and functions.</p>
<p><b>Compliance risk</b> (page 189)</p> <p><i>The risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations</i></p>	<p>Compliance risk is part of operational risk, and arises from rules, regulations, other</p>	<p>Compliance risk is:</p>



*and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.*

standards and Group policies, including those relating to anti-money laundering, anti-bribery and corruption, counter-terrorist and proliferation financing, sanctions compliance and conduct of business.

**measured** by reference to identified metrics, incident assessments (whether affecting HSBC or the wider industry), regulatory feedback and the judgement and assessment of the managers of our global businesses and functions;

The DPA is discussed on page 120 and the Monitor on page 27.

**monitored** against our compliance risk assessments and metrics, the results of the monitoring and control activities of the second line of defence functions, including the Financial Crime Compliance and Regulatory Compliance functions, and the results of internal and external audits and regulatory inspections; and

**managed** by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to assure their observance. Proactive risk control and/or remediation work is undertaken where required.

## Other material risks

### Reputational risk (page 199)

*The risk that illegal, unethical or inappropriate behaviour by the Group itself, members of staff or clients or representatives of the Group will damage HSBC's reputation, leading potentially to a loss of business, fines or penalties.*

Reputational risk is the risk of failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC itself, its employees or those with whom it is associated, that may cause stakeholders to form a negative view of HSBC.

Reputational risk is:

**measured** by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees;

**monitored** through a reputational risk management framework, taking into account the results of the compliance risk monitoring activity outlined above; and

**managed** by every member of staff and is covered by a number of policies and guidelines. There is a clear structure of committees and individuals charged with mitigating reputational risk, including the Group Reputational Risk Policy Committee and regional/business equivalents.

**Fiduciary risk** (page 200)

*The risk of breaching our fiduciary duties, defined as any duty where HSBC holds, manages, oversees or has responsibilities for assets for a third party that involves a legal and/or regulatory duty to act with the highest standard of care and with utmost good faith.*

Fiduciary risk is part of operational risk, and arises from our business activities where we act in a fiduciary capacity ( designated businesses ) as Trustee, Investment Manager or as mandated by law or regulation.

Fiduciary risk is:

**measured** by each designated business monitoring against their own risk appetite statements and by the operational risk and control assessment process, which assesses the level of risk and the effectiveness of the key controls;

**monitored** through a combination of testing, key indicators and other metrics such as client and regulatory feedback; and

**managed** within the designated businesses via established governance frameworks, and comprehensive policies, procedures and training programmes.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Description of risks banking operations (continued)*

Risks	Arising from	Measurement, monitoring and management of risk
<b>Pension risk</b> (page 236)		
<i>The risk that contributions from Group companies and members fail to generate sufficient funds to meet the cost of accruing benefits for the future service of active members, and the risk that the performance of assets held in pension funds is insufficient to cover existing pension liabilities.</i>	Pension risk arises from investments delivering an inadequate return, economic conditions leading to corporate failures, adverse changes in interest rates or inflation, or members living longer than expected (longevity risk). Pension risk includes operational risks listed above.	<p>Pension risk is:</p> <p><b>measured</b> in terms of the schemes' ability to generate sufficient funds to meet the cost of their accrued benefits;</p> <p><b>monitored</b> through the specific risk appetite that has been developed at both Group and regional levels; and</p> <p><b>managed</b> locally through the appropriate pension risk governance structure and globally through the Risk Management Meeting.</p>
<b>Sustainability risk</b> (page 237)		
<i>The risk that the environmental and social effects of providing financial services outweigh the economic benefits.</i>	Sustainability risk arises from the provision of financial services to companies or projects which run counter to the needs of sustainable development.	<p>Sustainability risk is:</p> <p><b>measured</b> by assessing the potential sustainability effect of a customer's activities and assigning a</p>

Sustainability Risk Rating to all high risk transactions;

**monitored** quarterly by the Risk Management Meeting and monthly by Group Sustainability Risk management; and

**managed** using sustainability risk policies covering project finance lending and sector-based sustainability polices for sectors with high environmental or social impacts.

Our insurance manufacturing subsidiaries are separately regulated from our banking operations. Risks in the insurance entities are managed using methodologies and processes appropriate to insurance activities, but remain subject to oversight at Group level. Our insurance

operations are also subject to the operational risks and the other material risks presented above in relation to the banking operations, and these are covered by the Group's risk management processes.

*Description of risks – insurance manufacturing operations*

Risks	Arising from	Measurement, monitoring and management of risk
<b>Financial risks</b> (page 194)		
<i>Our ability to effectively match the liabilities arising under insurance contracts with the asset portfolios that back them are contingent on the management of financial risks such as market, credit and liquidity risks, and the extent to which these risks are borne by the policyholders.</i>	Exposure to financial risks arises from:  market risk of changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, foreign exchange rates and equity prices;	Financial risks are:  <b>measured</b> separately for each type of risk:  market risk is measured in terms of exposure to fluctuations in key financial variables;

<p><i>Liabilities to policyholders under unit-linked contracts move in line with the value of the underlying assets, and as such the policyholder bears the majority of the financial risks.</i></p>	<p>credit risk and the potential for financial loss following the default of third parties in meeting their obligations; and</p>	<p>credit risk is measured as the amount which could be lost if a customer or counterparty fails to make repayments; and</p> <p>liquidity risk is measured using internal metrics including stressed operational cash flow projections.</p>
<p><i>Contracts with DPF share the performance of the underlying assets between policyholders and the shareholder in line with the type of contract and the specific contract terms.</i></p>	<p>liquidity risk of entities not being able to make payments to policyholders as they fall due as there are insufficient assets that can be realised as cash.</p>	<p><b>monitored</b> within limits approved by individuals within a framework of delegated authorities; and</p> <p><b>managed</b> through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers. Subsidiaries manufacturing products with guarantees are usually exposed to falls in market interest rates and equity prices to the extent that the market exposure cannot be managed by utilising any discretionary participation (or bonus) features within the policy contracts they issue.</p>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

Risks	Arising from	Measurement, monitoring and management of risk
<b>Insurance risk</b> (page 198)		
<p><i>The risk that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income.</i></p>	<p>The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.</p>	<p>Insurance risk is:</p> <p><b>measured</b> in terms of life insurance liabilities;</p> <p><b>monitored</b> by the RBWM Risk Management Committee, which checks the risk profile of the insurance operations against a risk appetite for insurance business agreed by the GMB; and</p> <p><b>managed</b> both centrally and locally using product design, underwriting, reinsurance and claims-handling procedures.</p>

**Risk management processes and procedures**

In addition to risk appetite, the following processes are integral to risk management at HSBC:

risk identification through our top and emerging risk process;

mapping our risk profile; and

stress testing and scenario analysis.

## Risk identification

We identify and monitor risks continuously. This process, which is informed by analysis of our risk factors and the results of our stress testing programme, gives rise to the classification of certain key risks as top or emerging. Changes in our assessment of top and emerging risks may result in adjustments to our business strategy and, potentially, our risk appetite.

Our current top and emerging risks are discussed below.

## Mapping our risk profile

Risks are assumed by our global businesses in accordance with their risk appetite and are managed at Group, global business and regional levels. All risks are recorded and monitored through our risk map process, which describes our risk profile by risk type in the different regions and global businesses.

In addition to our principal banking and insurance risks, the risk map process identifies and monitors risks such as model, financial management, capital, Islamic finance and strategic risks. These risks are regularly assessed through our risk appetite framework, stress tested and considered for classification as top and emerging risks.

## Stress testing

We conduct stress testing scenarios across the Group on both an enterprise-wide basis and at a major subsidiary level, reflecting our business strategy and its resultant risk exposures. Our stress testing and scenario analysis programme examines the sensitivities of our capital plans and unplanned demand for regulatory capital under a number of scenarios and ensures that top and emerging risks are appropriately considered. These scenarios include, but are not limited to, adverse macroeconomic events, failures at country, sector and counterparty levels, geopolitical occurrences and a variety of projected major operational risk events.

The Stress Testing Management Board, which is chaired by the Group Finance Director, is responsible for stress testing strategy and stewardship. Stress testing models are approved through the Group's Model Oversight Committee framework. Updates on stress testing are provided at each meeting of the Risk Management Meeting of the GMB. The Group Risk Committee is informed and consulted, and approves, as appropriate.

The development of macroeconomic scenarios is a critical part of the process. Potential scenarios are defined and generated by an expert panel comprising economic experts from various global teams including Risk and Finance. Variables and assumptions underpinning the scenarios, including economic indicators such as yield curves, exchange rates and volatilities, are expanded and enriched by internal and external teams. Once approved by the governing committee, they are circulated to the regional and global business stress testing teams along with instructions for the exercise.

Scenarios are translated into financial impacts, such as on our forecast profitability and RWAs, using a suite of stress testing models and methodologies. Models are subject to independent model review and go through a process of validation and approval. Model overlays may be considered where necessary.

Stress testing results are subject to a review and challenge process at regional and Group levels and action plans are developed to mitigate identified risks. The extent to which these action plans would be implemented in the event of particular scenarios occurring depends on senior management's evaluation of the risks and their potential consequences, taking into account HSBC's risk appetite.

In addition to the Group-wide risk scenarios, each major HSBC subsidiary conducts regular macroeconomic and event-driven scenario analyses specific to their region. They may also participate in local regulatory stress testing

programmes.

Stress testing is applied to risks such as market risk, liquidity and funding risk and credit risk to evaluate the potential effect of stress scenarios on portfolio values, structural long-term funding positions, income or capital.

Reverse stress testing is run annually on both Group and subsidiary entity bases. This stress test is conducted by assuming the business model is non-viable and working backwards to identify a range of occurrences that could

HSBC HOLDINGS PLC

117



**Table of Contents****Report of the Directors: Financial Review** (continued)

bring that event about. Non-viability might occur before the bank's capital is depleted, and could result from a variety of events. These include idiosyncratic or systemic events or combinations thereof, and/or could imply failure of the Group's holding company or one of its major subsidiaries. They would not necessarily mean the simultaneous failure of all the major subsidiaries. Reverse stress testing is used to strengthen our resilience by helping to inform early-warning triggers, management actions and contingency plans designed to mitigate the potential stresses and vulnerabilities which the Group might face.

HSBC participated in regulatory stress testing programmes in a number of jurisdictions during 2014, as outlined on page 125.

**Top and emerging risks**

*(Unaudited)*

/

Our approach to identifying and monitoring top and emerging risks is described on page 22.

During 2014, senior management paid particular attention to a number of top and emerging risks. Our current top and emerging risks are as follows:

**Macroeconomic and geopolitical risks**

Economic outlook and government intervention

Increased geopolitical risk

**Economic outlook and government intervention**

Economic growth in both developed and emerging market countries remained weak in 2014.

Oil and commodity prices have declined significantly since the middle of 2014 as a result of increasing global demand-supply imbalances. The precipitous fall in energy prices over such a short span of time changes both the nature and the distribution of risks. It sharpens fiscal and financing challenges for energy exporters, and although it brings benefits for oil importers, it also accentuates deflationary risks among some of these (particularly in the eurozone). In addition, the prospect of low oil prices for a prolonged period may reduce investment in exploration and thus poses the danger of significantly reduced future supply.

The economic recovery in the eurozone is still at risk. Deflationary pressures persist as a result of low oil prices and despite much looser monetary policy. Acceleration in the structural reform agenda could also accentuate deflationary pressures in the short-term. The eurozone is discussed further in *Areas of special interest* on page 126. Japan fell into a technical recession in the third quarter of 2014 and policy responses may not be sufficient to support a recovery in economic activity. Resilience in US economic activity represents an upside to the world economy.

Emerging markets, particularly those with domestic vulnerabilities, remain exposed to monetary policy normalisation in the US and to greater risk aversion. While high by international standards, mainland China's GDP growth in 2014 was the lowest in over two decades and recent forecasts indicate a lower trajectory than in recent years. Years of excessive investment, notably in the property market, has stoked potential financial bubbles, requiring the implementation of a new economic growth model.

### **Potential impact on HSBC**

HSBC's results could be adversely affected by a prolonged period of low or negative interest rates, low inflation levels or deflation and/or low oil prices.

We earn a significant proportion of our profits from our operations in emerging markets. Our results could be adversely affected by a prolonged slowdown in emerging market growth.

Global trade and capital flows may contract as a result of weaker economic growth, the introduction of protectionist measures, the emergence of geopolitical risks or increasing redenomination risk. This may curtail our profitability.

### **Mitigating actions**

We closely monitor economic developments in key markets and sectors with the aim of ensuring trends are identified, the implications for specific customers, customer segments or portfolios are assessed and appropriate mitigating action, which may include revising key risk appetite metrics and limits, is taken as circumstances evolve.

We use stress testing, both internal and regulatory programmes, to assess the effect of changes in economic conditions on our operations. Regulatory stress tests are discussed on page 124.

#### **Increased geopolitical risk**

Our operations are exposed to risks arising from political instability and civil unrest in many parts of the world, which may have a wider effect on regional stability and regional and global economies.

Geopolitical risk increased during 2014. Military escalation and/or civil war remain a possibility in Ukraine, while sanctions targeting the Russian government, institutions and individuals, together with falling oil prices, have had an adverse effect on the Russian economy.

In the Middle East, the civil war in Syria has been complicated by the seizure of parts of Iraq and Syria by Islamic State, a terrorist group. Elsewhere in the region, chaos in Libya, ongoing tensions between Israel and Palestine and fraught negotiations over Iran's nuclear programme are combining to increase risks to stability. In Asia, there was no easing in the maritime sovereignty disputes involving mainland China and its neighbours, while tensions remain high

over the line of control between India and Pakistan, raising concerns over a possible wider conflict between the two nuclear-armed neighbours.

HSBC HOLDINGS PLC

118

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

Civil unrest and demonstrations in a number of countries during 2014, including Turkey and Hong Kong, have also contributed to geopolitical risk as governments took measures to contain them.

A number of emerging and developed markets will hold elections in 2015, which could lead to further market volatility. In addition, a sustained period of low oil prices may affect stability in countries that rely heavily on oil production as a significant source of revenue.

**Potential impact on HSBC**

Our results are subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and changes in government policies on matters such as expropriation, authorisations, international ownership, interest-rate caps, foreign exchange transferability and tax in the jurisdictions in which we operate.

Actual conflict could expose our staff to physical risk and/or result in physical damage to our assets.

**Mitigating actions**

We continuously monitor the geopolitical outlook, in particular in countries where we have material exposures and/or a physical presence.

Our internal credit risk rating of sovereign counterparties takes these factors into account and drives our appetite for conducting business in those countries. Where necessary, we adjust our country limits and exposures to reflect our risk appetite and mitigate risks as appropriate.

**Macro-prudential, regulatory and legal risks to our business model**

Regulatory developments affecting our business model and Group profitability
Regulatory investigations, fines, sanctions, commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand
Dispute risk

Financial service providers face increasingly stringent and costly regulatory and supervisory requirements, often involving the provision of large amounts of data, particularly in the areas of capital and liquidity management, conduct of business, operational structures and the integrity of financial services delivery. Increased government intervention and control over financial institutions both on a sector-wide basis and individually, together with measures to reduce systemic risk, may significantly alter the competitive landscape locally, regionally and/or globally

for some or all of the Group's businesses. These measures may be introduced as formal requirements in a supra-equivalent manner and to differing timetables by different regulatory regimes.

**Regulatory developments affecting our business model and Group profitability**

Regulatory changes affect our activities, both of the Group as a whole and of some or all of our principal subsidiaries. These changes include:

the UK's Financial Services (Banking Reform) Act 2013 which requires the ring-fencing of our UK retail banking activities from wholesale banking, together with the structural separation of other activities as envisaged in the legislation and rules adopted in the US (including the Volcker Rule adopted in December 2013 under the Dodd-Frank Act), measures adopted in France restricting certain trading activities and potential further changes under European Commission proposals for structural measures for larger EU banks;

the implementation of extra-territorial laws, including the US Foreign Account Tax Compliance Act ( FATCA ) and other related initiatives to share tax information such as those being pursued by the OECD more generally;

changes in the regime for the operation of capital markets, notably mandatory central clearing of over the counter ( OTC ) derivatives, including under the Dodd-Frank Act and the EU's European Market Infrastructure Regulation ( EMIR );

changes arising from the increasing focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets, promoting effective competition in the interests of consumers (including the outcome of the current investigation by the UK Competition and Markets Authority on the personal current account and SME banking market in the UK and recent indications of further FCA focus on UK wholesale markets);

the outcome of the Fair and Effective Financial Markets Review being undertaken by the Bank of England which will consider changes in the operation of wholesale financial markets in the UK;

restrictions on the structure of remuneration imposed under CRD IV and UK regulations and increasing requirements to detail management accountability within the Group to meet the requirements of the Senior Managers Regime in the UK (including the continued focus in the UK on the progress being made in implementing wider recommendations made by the Parliamentary Commission on Banking Standards on matters relating to institutional culture , employee conduct and obligations more generally such as whistleblowing etc.);

the implementation of CRD IV, notably the UK application of the capital buffer framework and its interaction with Pillar 2;

the effect of proposals for the UK Financial Policy Committee to be given more powers to impose leverage constraints on UK banks;



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

the proposals from the Financial Stability Board which are subject to consultation and translation into national regulations but which would require G-SIBs to hold minimum levels of capital and subordinated debt as total loss absorbing capacity ( TLAC );

requirements flowing from arrangements for the resolution strategy of the Group and its individual operating entities, which may have different effects in different countries;

the continuing stress tests by supervisory authorities and the implication for capital requirements and capital transfers within the Group;

the tightening by regulators in a number of countries of credit controls on mortgage lending and unsecured portfolios; and

the continued risk of further changes to regulation relating to taxes affecting financial service providers, including financial transaction taxes.

**Potential impact on HSBC**

Proposed changes in and/or the implementation of regulations including mandatory central clearing of OTC derivatives, EMIR, ring-fencing and similar requirements, the Volcker Rule, recovery and resolution plans, FATCA and findings from competition orientated enquiries and investigations may affect the manner in which we conduct our activities and how the Group is structured.

Requirements for higher levels of capital or TLAC may increase the funding costs for the Group and reduce our return on equity.

Mandatory central clearing of OTC derivatives also brings new risks to HSBC in our role as a clearing member, as we will be required to underwrite losses incurred by central clearing counterparties from the default of other clearing members and their clients. Hence central clearing brings with it a new element of interconnectedness between clearing members and clients which we believe may increase rather than reduce our exposure to systemic risk.

Increased regulatory scrutiny of conduct of business (including incentive structures, remuneration, product governance and sales processes) and management accountability may affect the industry in areas such as employee

recruitment and retention, product pricing and profitability in both retail and wholesale markets. HSBC's businesses may be affected by these developments.

These measures have the potential to increase our cost of doing business and curtail the types of business we can carry out, with the consequent risk of decreased profitability.

### **Mitigating actions**

We are engaged closely with governments and regulators in the countries in which we operate to help ensure that the new requirements are considered properly and can be implemented in an effective manner.

We have developed and are implementing a global approach to the management of conduct and have established a Conduct & Values Committee as a sub-committee of the Board to oversee the management of conduct across the Group.

We have enhanced our governance around central clearing counterparties and appointed specialists to manage the associated liquidity and collateral risks.

We continue to enhance and strengthen governance and resourcing more generally around regulatory change management and the implementation of required measures to actively address this ongoing and significant agenda of regulatory change.

### **Regulatory investigations, fines, sanctions, commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand**

Financial service providers are at risk of regulatory sanctions or fines related to conduct of business and financial crime. The incidence of regulatory proceedings against financial service firms is increasing, with a consequent increase also in civil litigation arising from or relating to issues which are subject to regulatory investigation, sanction or fine. In addition, criminal prosecutions of financial institutions for, among other alleged conduct, breaches of AML and sanctions regulations, antitrust violations, market manipulation, aiding and abetting tax evasion, and providing unlicensed cross-border banking services, have become more commonplace and may increase in frequency due to increased media attention and higher expectations from prosecutors and the public. Moreover, financial service providers may face similar or broader legal proceedings, investigations or regulatory actions across many jurisdictions as a result of, among other things, increased media attention and higher expectations from regulators and the public. Any such prosecution or investigation of, or legal proceeding or regulatory action brought against, HSBC or one or more of its subsidiaries could result in substantial fines, penalties and/or forfeitures and could have a material adverse effect on our results, business, financial condition, prospects and reputation, including the potential loss of key licences, requirement to exit certain businesses and withdrawal of funding from depositors and other stakeholders.

### **Regulatory commitments and consent orders**

In December 2012, HSBC Holdings, HSBC North America Holdings Inc. ( HNAH ) and HSBC Bank USA, N.A. ( HSBC Bank USA ) entered into agreements with US and UK authorities regarding past inadequate compliance with AML and sanctions laws. Among these agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement ( US DPA ) with the US Department of Justice ( DoJ ) and HSBC Holdings entered



HSBC HOLDINGS PLC

120

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

into a two-year DPA with the New York County District Attorney (the DANY DPA ). HSBC Holdings also entered into an undertaking with the FSA (the FCA Direction ) to comply with certain forward-looking obligations with respect to AML and sanctions requirements. In addition, HSBC Holdings entered into a cease and desist order with the US FRB with respect to compliance with US AML and sanctions requirements.

The agreements with the DoJ and the FRB and the FCA Direction require us to retain an independent monitor to evaluate our progress in fully implementing our obligations and produce regular assessments of the effectiveness of our Financial Crime Compliance function. The Monitor is discussed on page 27.

HSBC has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two-year period of that agreement in December 2014.

While we still have significant work to do to build and improve our AML and sanctions compliance programme, and our DPA with the DoJ and other settlement agreements remain in place, the expiration of the DANY DPA is an important milestone.

HSBC Bank USA is also subject to an agreement entered into with the Office of the Comptroller of the Currency ( OCC ) in December 2012, the Gramm-Leach-Bliley Act ( GLBA ) Agreement and other consent orders.

**Potential impact on HSBC**

It is difficult to predict the outcome of the regulatory proceedings involving our businesses. Unfavourable outcomes may have a material adverse effect on our reputation, brand and results, including loss of business and withdrawal of funding.

Our significant involvement in facilitating international capital flows and trade exposes the Group to the risk of financial crime or inadvertently breaching restrictions and sanctions imposed by the US Office of Foreign Assets Control and other regulators.

Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA.

The design and execution of AML and sanctions remediation plans is complex and requires major investments in people, systems and other infrastructure. This complexity creates significant execution risk, which could impact our ability to effectively manage financial crime risk and remedy AML and sanctions compliance deficiencies in a timely manner. This could, in turn, impact HSBC's ability to satisfy the Monitor or comply with the terms of the US DPA, the FCA Direction, or the FRB Cease and Desist Order, and may require HSBC to take additional remedial

measures in the future.

Failure to comply with the requirements of consent orders or the GLBA Agreement within the time periods specified in them or otherwise as may be extended, could result in supervisory action. Any such action could have a material adverse effect on the consolidated results and operation of HSBC.

### **Mitigating actions**

Steps to address many of the requirements of the US DPA, the FCA Direction and the GLBA Agreement have either already been taken or are under way in consultation with the relevant regulatory agencies. These include simplifying the Group's control structure, strengthening the governance structure with new leadership appointments, revising key policies and implementing Global Standards to detect, deter and protect against financial crime (see page 26). In addition, we have substantially increased spending and staffing in the Financial Crime Compliance and Regulatory Compliance functions in the past few years.

During 2014, we approved a new global strategy for transaction monitoring. Globally standardised AML investigations processes have been developed and are being implemented, starting in priority countries.

### **Conduct of business**

Regulators in the UK and other countries have continued to increase their focus on conduct matters relating to fair outcomes for customers and orderly/transparent markets including, for example, attention to sales processes and incentives, product and investment suitability, product governance, employee activities and accountabilities as well as the risks of market abuse in relation to benchmark, index, other rate setting processes, wider trading activities and more general conduct of business concerns.

In the UK, the FCA is making increasing use of existing and new powers of intervention and enforcement, including powers to consider past business undertaken and implement customer compensation and redress schemes or other, potentially significant, remedial work. The FCA is also now regulating areas of activity not previously regulated by them, such as consumer credit, and considering competition issues in the markets they regulate. Additionally, the FCA and other regulators increasingly take actions in response to customer complaints or where they see poor customer outcomes and/or market abuses, either specific to an institution or more generally in relation to a particular product. There have been examples of this approach by regulators in the context of the possible mis-selling of PPI, of interest rate hedging products for SMEs and of wealth management products.

The Group also remains subject to a number of other regulatory proceedings including investigations and reviews by various national regulatory, competition and enforcement authorities relating to certain past submissions made by panel banks and the process for making submissions in connection with the setting of Libor and other interbank offered and benchmark

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

interest rates. There are also ongoing investigations into foreign exchange, precious metals and credit default swap related activities. Details of these investigations can be found in Note 40 on the Financial Statements.

### **Potential impact on HSBC**

HSBC may face regulatory censure or sanctions including fines and/or be exposed to legal proceedings and litigation.

Regulators in the UK and other countries may identify future industry-wide mis-selling, market conduct or other issues that could affect the Group. This may lead from time to time to significant direct costs or liabilities and/or changes in the practices of such businesses. Also, decisions taken by the Financial Ombudsman Service in the UK (or similar overseas bodies) could, if applied to a wider class or grouping of customers, have a material adverse effect on the operating results, financial condition and prospects of the Group.

### **Mitigating actions**

Programmes to enhance the management of conduct of business are progressing in all global businesses and functions.

Performance management arrangements for managers and staff are being reviewed, focusing on reward linked to values-based behaviour and good conduct.

Enhancements to surveillance capabilities and benchmark rate setting processes are ongoing and HSBC Holdings and its subsidiaries are cooperating fully with all regulatory investigations and reviews.

#### **Dispute risk**

HSBC is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Further details are provided in Note 40 on the Financial Statements.

### **Potential impact on HSBC**

Dispute risk gives rise to potential financial loss and significant reputational damage which could adversely affect customer and investor confidence.

**Mitigating actions**

We continue to focus on identifying emerging regulatory and judicial trends in order to limit exposure to litigation or regulatory enforcement action in the future.

We are enhancing our financial crime and regulatory compliance controls and resources.

**Risks related to our business operations, governance and internal control systems**

	Heightened execution risk
	People risk
	Internet crime and fraud
	Information security risk
	Data management
	Model risk
	Third party risk management

**Heightened execution risk**

The financial services industry is currently facing an unprecedented period of scrutiny. Regulatory requests, legal matters and business initiatives all require a significant amount of time and resources to implement. The magnitude and complexity of projects within HSBC required to meet these demands has resulted in heightened execution risk. There also remains heightened risk around the execution of a number of disposals across the Group in line with our strategy.

**Potential impact on HSBC**

These factors may affect the successful delivery of our strategic priorities.

The potential risks of disposals include regulatory breaches, industrial action, loss of key personnel and interruption to systems and processes during business transformation. They can have both financial and reputational implications.

**Mitigating actions**

We have strengthened our prioritisation and governance processes for significant projects and have invested in our project implementation and IT capabilities.

Risks related to disposals are carefully assessed and monitored and are subject to close management oversight.

**People risk**

The demands being placed on the human capital of the Group are unprecedented. The cumulative workload arising from a regulatory reform programme that is often extra-territorial and still evolving is hugely consumptive of human resources, placing increasingly complex and conflicting demands on a workforce where the expertise is in short supply and globally mobile.

**Potential impact on HSBC**

Changes in remuneration policy and practice resulting from the new regulations under CRD IV apply globally to all employees of EU headquartered banks. The key change is the application of a cap on variable pay that can be paid to any material risk-taker (based on qualitative and quantitative criteria issued by the

HSBC HOLDINGS PLC

122

## **Table of Contents**

### **Report of the Directors: Financial Review** (continued)

EBA). This presents significant challenges for HSBC because a significant number of our material risk takers are based outside the EU.

The policy statement issued by the PRA extends the Remuneration Code to require all PRA-authorized firms to apply clawback to vested/paid variable remuneration on a Group-wide basis for any material risk takers receiving variable pay from 1 January 2015.

The introduction by the PRA and FCA in the UK of the Senior Managers and Certification regimes and of the related Rules of Conduct (the detail of which is currently subject to consultation) are intended to set clearer expectations of the accountabilities and behaviour of both senior and more junior employees. However, there are a number of uncertainties around the precise impact of these regimes at present (including on more senior employees, on non-UK based employees and on non-executive directors).

Organisational changes to support the Group's strategy and/or implement regulatory reform programmes have the potential to lead to increased staff turnover.

#### **Mitigating actions**

The changes in remuneration under the new CRD IV regulations has necessitated a review of our remuneration policy, especially the balance between fixed and variable pay, to ensure we can remain competitive on a total compensation basis and retain our key talent.

Risks related to organisational change and disposals are subject to close management oversight.

We continue to increase the level of specialist resources within Financial Crime Compliance, Regulatory Compliance and stress testing and to engage with our regulators as they finalise new regulations.

#### **Internet crime and fraud**

HSBC is increasingly exposed to fraudulent and criminal activities as a result of increased usage of internet and mobile services by customers. We also face the risk of breakdowns in processes or procedures and systems failure or unavailability, and our business is subject to disruption from events that are wholly or partially beyond our control, such as internet crime and acts of terrorism.

#### **Potential impact on HSBC**

Internet crime could result in financial loss and/or customer data and sensitive information being compromised. They may also give rise to losses in service to customers. The same threats apply equally when we rely on external suppliers or vendors for services provided to us and our customers.

**Mitigating actions**

We continually assess these threats as they evolve and adapt our controls to mitigate them. We have increased our defences through enhanced monitoring and have implemented additional controls, such as two-factor authentication, to reduce the possibility of losses from fraud.

**Information security risk**

The security of our information and technology infrastructure is crucial for maintaining our banking applications and processes while protecting our customers and the HSBC brand. HSBC and other multinational organisations continue to be the targets of cyber-attacks which may disrupt services including the availability of our external facing websites, compromise organisational and customer information or expose security weaknesses.

**Potential impact on HSBC**

Information security risk gives rise to potential financial loss and reputational damage which could adversely affect customer and investor confidence. Loss of customer data would also trigger regulatory breaches which could result in fines and penalties being incurred.

**Mitigating actions**

We have invested significantly in addressing this risk through increased training to raise staff awareness of the requirements, enhanced multi-layered controls protecting our information and technical infrastructure, heightened monitoring and management of potential cyber-attacks and continued vulnerability assessment.

**Data management**

HSBC must have a clear data strategy to meet the volume, granularity, frequency and scale of regulatory and other reporting requirements. As a G-SIB, HSBC is also required to comply with the principles for effective risk data aggregation and risk reporting as set out by the Basel Committee on Banking Supervision ( the Basel Committee ) in its paper.

**Potential impact on HSBC**

Ineffective data management could adversely affect our ability to aggregate and report complete, accurate and consistent data to regulators, investors and senior management on a timely basis.



Financial institutions that fail to meet their Basel Committee data obligations by the required deadline may face supervisory measures.

**Mitigating actions**

Since the Data Strategy Board was established in 2012, we have set a data strategy for the Group and defined Group-level principles, standards and policies to enable consistent data aggregation, reporting and management.

HSBC HOLDINGS PLC

123

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

A number of key initiatives and projects to implement our data strategy and work towards meeting our Basel Committee data obligations are in progress.

#### **Model risk**

HSBC uses models for a range of purposes in managing its business, including regulatory and economic capital calculations, stress testing, granting credit, pricing and financial reporting. Model risk is the potential for adverse consequences as a result of decisions based on incorrect model outputs and reports or the use of such information for purposes for which it was not designed. Model risk could arise from models that are poorly developed, implemented or used, or from the modelled outcome being misunderstood and acted upon inappropriately by management. The regulatory environment and supervisory concerns over banks' use of internal models to determine regulatory capital further contribute to model risk.

#### **Potential impact on HSBC**

HSBC could incur losses or be required to hold additional capital as a result of model limitations or failure.

Supervisory concerns over the internal models and assumptions used by banks in the calculation of regulatory capital have led to the imposition of risk weight and loss given default floors. Such changes have the potential to increase our capital requirement and/or make it more volatile.

#### **Mitigating actions**

We aim to mitigate model risk through appropriate governance over model development, usage and validation, together with independent review, monitoring and feedback.

#### **Third-party risk management**

We have increased our risk management focus on our use of third-party service providers, in part in response to increased scrutiny by global regulators. This includes how outsourcing decisions are made, how the key relationships are managed and the consistency of risk management across the range of third parties used. Risks arising from the use of third-party service providers may be less transparent and therefore more challenging to manage or influence.

#### **Potential impact on HSBC**

Any deficiency in the management of third-party service providers could lead to a variety of risks including business disruption, regulatory failings, loss of confidential information and financial crime.

**Mitigating actions**

We are enhancing our third-party risk management capability in line with guidance issued by the OCC and FRB, strengthening controls over third-party use and increasing the monitoring and assurance over these controls.

**Areas of special interest**

*(Unaudited)*

During 2014, we considered a number of particular areas because of the effect they may have on the Group. Whilst these areas may already have been identified in top and emerging risks, further details of the actions taken during the year are provided below.

**Financial crime compliance and regulatory compliance**

In recent years, we have experienced increasing levels of compliance risk as regulators and other agencies pursued investigations into historical activities, and we continued to work with them in relation to existing issues. This has included the matters giving rise to the DPAs reached with US authorities in relation to investigations regarding inadequate compliance with anti-money laundering and sanctions law, and the related undertaking with the FSA (the FCA Direction ). The work of the Monitor, who has been appointed to assess our progress against our various obligations is discussed on page 27.

We continue to respond to a number of investigations by the FCA into the possible mis-selling in the UK of certain products, including sales of PPI, of interest rate hedging products for SMEs and of wealth management products. In addition, we also remain subject to a number of other regulatory proceedings including investigations and reviews by various national regulatory, competition and enforcement authorities relating to certain past submissions made by panel banks and the process for making submissions in connection with the setting of Libor and other interbank offered and benchmark interest rates. There are also investigations in progress into activities related to foreign exchange, precious metals and credit default swaps. Details of these investigations and legal proceedings can be found in Note 40 on the Financial Statements.

It is clear from both our own and wider industry experience that the level of activity among regulators and law enforcement agencies in investigating possible breaches of regulations has increased, and that the direct and indirect costs of such breaches can be significant. Coupled with a substantial rise in the volume of new regulation, much of which has some element of extra-territorial reach, and the geographical spread of our businesses, we believe that the level of inherent compliance risk that we face as a Group will continue to remain high for the foreseeable future.

Further information about the Group's compliance risk management may be found on page 189.

**Private Bank**

Past practices at our Swiss private bank and the financial affairs of some of our Swiss private banking clients have been subject to recent media coverage. The media focus has been on historical events that show the standards to which we operate today were not universally in place in our Swiss operations eight years ago.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Since then, we have fundamentally changed the way HSBC is run and have established much tighter central control around who are our customers. We have put in place tough, world-class financial crime, regulatory compliance and tax transparency standards, enforced by a team of over 7,000 compliance staff.

GPB, and in particular its Swiss private bank, has undergone a radical transformation. We have taken significant steps over the past several years to implement reforms and exit clients who did not meet strict new HSBC standards, including those where we had concerns in relation to tax compliance. As a result of this repositioning, HSBC's Swiss private bank has reduced its client base by almost 70% since 2007.

We are fully committed to the exchange of information with relevant authorities and are actively pursuing measures that ensure clients are tax transparent, even in advance of a regulatory or legal requirement to do so. We are also cooperating with relevant authorities investigating these matters.

**Regulatory stress tests**

Stress testing is an important tool for regulators to assess vulnerabilities in the banking sector and in individual banks, the results of which could have a significant effect on minimum capital requirements, risk and capital management practices and planned capital actions, including the payment of dividends, going forward.

We are subject to regulatory stress testing in many jurisdictions. These have increased both in frequency and in the granularity of information required by supervisors. They include the programmes of the PRA, the FRB, the EBA, the ECB, the Hong Kong Monetary Authority ( HKMA ) and other regulators. Assessment by regulators is on both quantitative and qualitative bases, the latter focusing on portfolio quality, data provision, stress testing capability, forward-looking capital management processes and internal management processes.

In 2014, the Group took part in the first PRA concurrent stress test exercise involving major UK banks. The exercise was run on an enterprise-wide basis and comprised the EBA base scenario and a stress scenario that predominantly followed the EBA stress scenario with an additional overlay of variables reflecting the vulnerabilities facing the UK banking system, including significant declines in the value of sterling, residential and commercial property prices and bond and equity prices, along with a downturn in economic activity and rising unemployment. HSBC's submission was made to the PRA at the end of June 2014. The Group also participated in the complementary programme of regular data provision to the Bank of England under its Firm Data Submission Framework.

The PRA disclosed the results of the 2014 Concurrent Stress Test on 16 December 2014. The stressed CET1 capital ratio of HSBC was deemed by the PRA to fall to a minimum of 8.7%, taking into account approved management mitigating actions. This was above the target minimum of 4.5%.

The EBA conducted a Europe-wide stress test in the first half of 2014, administered via the PRA for UK banks. The base scenario covered a wide range of risks including credit, market, securitisation, sovereign and funding risks. The adverse macroeconomic scenario included country-specific shocks to sovereign bond spreads, short-term interest rates and residential property prices, together with a decline in world trade, currency depreciation in Central and Eastern

Europe and slow-downs or contractions in GDP growth around the world.

The EBA disclosed results of the stress test exercise on 26 October 2014. Our stressed CET1 capital ratio was projected to fall to a low point of 8.7% at the end of 2015, above the EBA minimum threshold of 5.5%. Our fully-loaded stressed CET1 ratio was projected to be 9.3% at the end of 2016, which compared favourably with other major European banks.

The PRA and EBA results demonstrate HSBC's continued capital strength.

The ECB conducted its comprehensive assessment in the first half of 2014, which comprised an Asset Quality Review and the ECB's stress testing process, the latter using the EBA scenarios. HSBC France and HSBC Malta fell within scope and both passed the exercise, the results of which were also published in October 2014. The CET1 ratio for HSBC France was projected to fall from 12.9% in 2013 to 6.6% by the end of 2016, remaining above the regulatory minimum. The fall reflected the impact of stress on HSBC France's business model, which includes the Group's euro Rates trading business, and the effect of ECB credit loss benchmarks on the loan portfolio.

HNAH participates in the Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Stress Testing (DFAST) programmes of the FRB and HSBC Bank USA in the OCC's DFAST programme. Both made their first submissions under these programmes on 6 January 2014. On 26 March 2014, the FRB informed HNAH that it objected to the submitted capital plan on qualitative grounds and a resubmission of its capital plan was required by 5 January 2015, together with improvements to its stress testing processes. However, the FRB approved the capital actions included in HNAH's CCAR submission and HNAH was allowed to proceed with the payment of dividends on the outstanding preferred shares and trust preferred securities of HNAH and its subsidiaries. HNAH's stressed CET1 capital ratio was forecast by the FRB to fall to a minimum of 9.4% under the supervisory severely adverse scenario, above the regulatory minimum ratio of 4.5%. HNAH made its CCAR 2015 submission, which also served as the required re-submission for the CCAR 2014, and HSBC Bank USA made its DFAST 2015 submission, on 5 January 2015. Disclosure by the FRB and HNAH and HSBC Bank USA of the results of the exercises, based on the supervisory scenarios published in November 2014, will be made in

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

March 2015. In addition, the FRB will also provide its non-objection or objection to HNAH's capital plan and the capital actions included within its 2015 CCAR submission.

The Hongkong and Shanghai Banking Corporation participated in the HKMA stress test exercise in the first half of 2014. The HKMA stress scenario envisaged a significant deceleration of growth in mainland China and a sharper contraction in Hong Kong.

### **Oil and gas prices**

Oil and commodity prices have declined significantly since the middle of 2014 as a result of increasing global demand and supply imbalances and changes in market sentiment. There is considerable uncertainty regarding the future price levels during 2015 and beyond. Prolonged depressed oil prices will affect countries, industries and individual companies differently:

Country level: net oil importers are likely to benefit from reduced oil prices. In advanced economies, this is likely to increase consumer disposable income while in emerging market countries it is more likely to benefit the governments' fiscal position. The impact on oil exporting countries will depend on the importance of the oil receipts to fiscal revenues, the extraction costs and the amount of fiscal reserves that the countries are able to draw upon.

Industry level: the oil and gas industry and supporting services will be affected, though this will vary depending on the relevant sub-sector. Large integrated producers are likely to remain resilient. Within the pure producers sector, the higher cost pure producers, such as shale and oil sands producers, are likely to experience higher levels of stress. Similarly, infrastructure and services providers are likely to come under stress as producers curtail capital expenditure. Industries where oil and gas represent major costs, such as haulage, transport and shipping, are likely to benefit if prices remain depressed.

The oil and gas sector has been considered a higher risk sector for some time and has been under enhanced monitoring and controls with risk appetite and new money lending under increased scrutiny.

HSBC has a diversified lending profile to the oil and gas sector. Lending in GB&M is concentrated predominately in upstream activities and with large investment-grade global integrated producers. CMB mainly focuses on lending to service companies and pure producers. The exposures are diversified across a number of countries.

The overall portfolio has drawn risk exposures amounting to about US\$34bn, with just over 47% consisting of exposures to oil service companies and non-integrated producers. In-depth client reviews have been conducted on larger clients considered to be potentially vulnerable to depressed oil prices for a period of one to two years, particularly, but not exclusively, focusing on oil service companies, and producers (and their suppliers) reliant on expensive extraction methods such as shale or oil sands.

Following these reviews, about US\$0.5bn of exposures have been identified as being of sufficient concern to require close management. Whilst weakening credit is evident in this population, no new customers were identified as being impaired at this stage.

## **Russia**

During 2014, tensions have risen between the Russian Federation ( Russia ) and western countries ( the West ) in respect of Ukraine. The West's response to date has been to impose sanctions on a selected list of Russian individuals, banks and corporates during the course of 2014. Monitoring and action in response to the sanctions requirements is ongoing and will impose some restrictions on HSBC's business in Russia, although the effect on the Group is not expected to be significant. Our exposures to counterparties incorporated or domiciled in Ukraine are not considered material.

The fourth quarter of 2014 saw significant falls in the value of the Russian rouble and the price of crude oil, and multiple interest rate rises implemented by Russia's central bank. The impact of these developments is being monitored by management and, combined with the sanctions, means the outlook for Russia remains highly uncertain with the economy expected to contract in 2015.

Our exposures to Russia mainly consist of loans and advances. At 31 December 2014 these amounted to US\$4bn.

In addition to the above, a number of our multinational clients have indirect exposure to Russia through majority or minority stakes in Russia-based entities, via dependency of supply or from reliance on exports. The operations and businesses of such clients may be negatively affected should the scope and nature of sanctions and other actions be widened or the Russian economy deteriorate. Also, we run operations in neighbouring countries where the financial system has strong links to the Russian economy. Management is monitoring the quantum and potential severity of such risks.

## **Eurozone**

In recent years the EU has introduced a series of legislative changes designed to better equip it to deal with a financial crisis and to reduce the risks of contagion in the event of an EU member country experiencing financial difficulties. The outcome of current negotiations on the terms of the Greek bail out is highly uncertain. The debt may be rescheduled or Greece may default on its debts; there is also the possibility that Greece may eventually exit the euro. Our exposures to Greece mainly consist of loans and advances and reverse repos. At 31 December 2014 these amounted to US\$4bn and US\$2bn respectively. Included in loans and advances are US\$2bn related to the shipping industry, denominated in US dollars and booked in the UK. We believe the shipping industry is less sensitive to the Greek economy as it is mainly dependent on international trade.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review (continued)****Credit risk**

	Page	App <sup>1</sup>	Tables	Page
<b><u>Credit risk</u></b>	129	206	<i>Summary of credit risk</i>	129
			<i>Gross loans to customers and banks over five years</i>	130
			<i>Loan impairment charge over five years</i>	130
			<i>Loan impairment charges by geographical region</i>	130
			<i>Loan impairment charges by industry</i>	130
			<i>Loan impairment allowances over five years</i>	130
<b><u>Credit risk management</u></b>		206		
<b><u>Credit exposure</u></b>	130			
<b><u>Maximum exposure to credit risk</u></b>	130			
<b><u>Other credit risk mitigants</u></b>	130		<i>Maximum exposure to credit risk</i>	131
			<i>Loan and other credit-related commitments</i>	131
<b><u>Concentration of exposure</u></b>	132	206		
<b><u>Financial investments</u></b>	132			
<b><u>Trading assets</u></b>	132			
<b><u>Derivatives</u></b>	132			
<b><u>Loans and advances</u></b>	132		<i>Gross loans and advances to customers by industry sector and by geographical region</i>	132
<b><u>Credit quality of financial instruments</u></b>	133	207		
<b><u>Credit quality classification</u></b>			<i>Distribution of financial instruments by credit quality</i>	134
<b><u>Past due but not impaired gross financial instruments</u></b>	136		<i>Past due but not impaired gross financial instruments by geographical region</i>	136

		<u>Ageing analysis of days for past due but not impaired gross financial instruments</u>	136
<b><u>Impaired loans</u></b>	137	<u>Movement in impaired loans by geographical region</u>	137
<u>Renegotiated loans and forbearance</u>	138	<u>Renegotiated loans and advances to customers by geographical region</u>	139
	208	<u>Movement in renegotiated loans by geographical region</u>	140
<u>Impairment of loans and advances</u>	141	<u>Loan impairment charge to the income statement by industry sector</u>	141
		<u>Loan impairment charge to the income statement by assessment type</u>	141
		<u>Charge for impairment losses as a percentage of average gross loans and advances to customers by geographical region</u>	142
		<u>Movement in impairment allowances by industry sector and geographical region</u>	142
		<u>Movement in impairment allowances on loans and advances to customers and banks</u>	143
<u>Impairment assessment</u>	212		
<b><u>Wholesale lending</u></b>	144	<u>Total wholesale lending</u>	144
<u>Commercial real estate</u>	145	<u>Commercial real estate lending</u>	145
		<u>Commercial real estate loans and advances including loan commitments by level of collateral</u>	147
		<u>Other corporate, commercial and financial (non-bank) loans and advances including loan commitments by level of collateral rated CRR/EL8 to 10 only</u>	148
		<u>Loans and advances to banks including loan commitments by level of collateral</u>	149
<u>Other credit risk exposures</u>	149		
<u>Derivatives</u>	149	<u>Notional contract amounts and fair values of derivatives by product type</u>	150
		<u>OTC collateral agreements by type</u>	150
<u>Reverse repos non-trading by geographical region</u>	151	<u>Reverse repos non-trading by geographical region</u>	151
<u>Loan Management Unit</u>	213		

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review (continued)**

	Page	App <sup>1</sup>	Tables	Page
<b><u>Personal lending</u></b>	151		<i><u>Total personal lending</u></i>	151
<u>Mortgage lending</u>	152		<i><u>HSBC Finance US Consumer and Mortgage Lending residential mortgages</u></i>	153
<u>Other personal lending</u>	153		<i><u>HSBC Finance: foreclosed properties in the US</u></i>	153
			<i><u>Trends in two months and over contractual delinquency in the US</u></i>	153
			<i><u>Gross loan portfolio of HSBC Finance and real estate secured balances</u></i>	154
			<i><u>Number of renegotiated real estate secured accounts remaining in HSBC Finance's portfolio</u></i>	154
<u>HSBC Finance loan modifications and re-age programmes</u>	154		<i><u>Residential mortgage loans including loan commitments by level of collateral</u></i>	156
<u>Collateral and other credit enhancements held</u>	156		<i><u>Gross loans and advances by industry sector over 5 years</u></i>	157
<u>Supplementary information</u>	157		<i><u>Reconciliation of reported and constant currency impaired loans, allowances and charges by geographical region</u></i>	158
			<i><u>Reconciliation of reported and constant currency loan impairment charges to the income statement</u></i>	158
			<i><u>Loan impairment charges by industry sector over 5 years</u></i>	159
			<i><u>Charge for impairment losses as a percentage of average gross loans and advances to customers</u></i>	159
			<i><u>Movement in impairment allowances over 5 years</u></i>	159
			<i><u>Gross loans and advances to customers by country</u></i>	160
<u>Refinance risk</u>		214		

<b><u>HSBC Holdings</u></b>	161		<i><u>HSBC Holdings maximum exposure to credit risk</u></i>	161
<b><u>Securitisation exposures and other structured products</u></b>	161	214	<i><u>Overall exposure of HSBC Carrying amount of HSBC's consolidated holdings of ABSs</u></i>	161
			<i><u>Definitions and classifications of ABSs and CDOs</u></i>	162
				214
<b><u>Representations and warranties related to mortgage sales and securitisation activities</u></b>	162			
<b><u>Risk elements in the loan portfolio</u></b>	162a			
<u>Interest foregone on impaired and restructured loans</u>	162a			
<u>Interest recognised on impaired and restructured loans</u>	162a			
<u>Impaired loans</u>	162a			
<u>Unimpaired loans more than 90 days past due</u>	162b			
<u>Troubled debt restructurings</u>	162b			
<u>Potential problem loans</u>	162b		<i><u>Analysis of risk elements in the loan portfolio by geographical region</u></i>	162c
<b><u>Country distribution of outstandings and cross-border exposures</u></b>	162d			

1 Appendix to Risk risk policies and practices.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Credit risk**

*(Unaudited)*

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from other products such as guarantees and credit derivatives and from holding assets in the form of debt securities.

There were no material changes to our policies and practices for the management of credit risk in 2014.

*A summary of our current policies and practices regarding credit risk is provided in the Appendix to Risk on page 204.*

Our maximum exposure to credit risk is presented on page 131 and credit quality on page 133. While credit risk arises across most of our balance sheet, losses have typically been incurred on loans and advances and securitisation exposures and other structured products. As a result, our disclosures focus primarily on these two areas.

This year we have redesigned the Credit risk section in order to enhance clarity and reduce duplication. It now begins with a summary of credit risk followed by an overview of our gross exposures. We describe various measures of credit quality such as past due status, impaired loans and renegotiated loans before analysing impairment allowances. There are specific sections on wholesale lending and personal lending where additional detail is provided and we cover areas of particular focus such as our exposure to commercial real estate in wholesale lending and our Consumer and Mortgage Lending ( CML ) portfolio in personal lending. This is followed by a section describing our securitisation exposures and other structured products. Information on our exposures to oil and gas, Russia and Greece is provided in Areas of special interest on page 126.

Following the change in balance sheet presentation explained on page 347, non-trading reverse repos are shown separately on the balance sheet and are no longer included in Loans and advances to customers and Loans and advances to banks . Comparative data have been re-presented accordingly. As a result, any analysis that references loans and advances to customers or banks excludes non-trading reverse repos. The amount of the non-trading reverse repos to customers and banks is set out on page 151.

Loan impairment charges, loan impairment allowances and impaired loans all reduced compared with 2013.

Gross loans and advances decreased by US\$28bn which included adverse foreign exchange movements of US\$51bn; excluding these movements customer lending grew in 2014.

The commentary that follows is on a constant currency basis, whilst tables are presented on a reported basis.

*Summary of credit risk*

*(Unaudited)*

	<b>2014</b>	2013	Page
	<b>US\$bn</b>	US\$bn	
<b>At year-end</b>			
Maximum exposure to credit risk	<b>3,133</b>	3,112	131
Gross loans and advances <sup>1</sup>			
personal lending	<b>393</b>	411	132
wholesale lending	<b>706</b>	716	132
Total	<b>1,099</b>	1,127	132
Impaired loans			
personal lending	<b>15</b>	19	137
wholesale lending	<b>14</b>	18	137
Total	<b>29</b>	37	137
Impaired loans as a % of gross loans and advances			
personal lending	<b>3.9%</b>	4.6%	
wholesale lending	<b>2.0%</b>	2.5%	
total	<b>2.7%</b>	3.3%	
	<b>US\$bn</b>	US\$bn	
Impairment allowances			
personal lending	<b>4.6</b>	6.6	143
wholesale lending	<b>7.8</b>	8.6	143
Total	<b>12.4</b>	15.2	143
Loans and advances net of impairment allowances <sup>1</sup>	<b>1,087</b>	1,112	
<b>For year ended 31 December</b>			
Loan impairment charge			
personal lending	<b>1.8</b>	3.1	141
wholesale lending	<b>2.3</b>	2.9	141
Total	<b>4.1</b>	6.0	141

For footnotes, see page 202.

*See page 158 for further details in respect of the constant currency reconciliation. For an analysis of loans and advances by country see page 160.*

Wholesale gross loans and advances increased by US\$21bn. Asia grew by US\$16bn and North America by US\$10bn with more modest levels of growth in the Middle East and North Africa and Latin America. This was offset by a decrease of US\$15bn in Europe. Loan impairment charges were lower in 2014 as we continued to benefit from the improvement in various economies and the low interest rate environment.

Personal lending balances, excluding the planned US CML portfolio run off, grew by US\$7.7bn. This was primarily driven by increased mortgage and other lending in Asia and growth in the mortgage portfolio in both North America and Latin America. The growth was partially offset by lower lending balances in Europe due to repayments on the mortgage and credit card portfolio in the UK. The CML portfolio declined by a further US\$5.7bn during the year. Loan impairment charges were down as a result of improvements in the US housing market and the continued run-off of the CML portfolio.



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

*Gross loans to customers and banks over five years<sup>1</sup> (US\$bn)*

*(Unaudited)*

*Loan impairment charge over five years (US\$bn)*

*(Unaudited)*

*Loan impairment charges by geographical region (US\$bn)*

*(Unaudited)*

*Loan impairment charges by industry (US\$bn)*

*(Unaudited)*

*Loan impairment allowances over five years*

*(Unaudited)*

*For footnote, see page 202.*

**Credit exposure**

**Maximum exposure to credit risk**



*(Audited)*

The table on page 131 provides information on balance sheet items, offsets and loan and other credit-related commitments. Commentary on balance sheet movements is provided on page 58. The offset on derivatives increased in line with the increase in maximum exposure amounts.

The offset on corporate and commercial loans to customers decreased by US\$31bn. This reduction was in the UK where a small number of clients benefit from the use of net interest arrangements across their overdraft and deposit positions. During the year, as we aligned our approach in our Payments and Cash Management business to be more globally consistent, many of these clients increased the frequency with which they settled these balances thereby reducing the amount of offset available.

### **Maximum exposure to credit risk table (page 131)**

The table presents our maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments before taking account of any collateral held or other credit enhancements (unless such enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments, it is generally the full amount of the committed facilities.

The offset in the table relates to amounts where there is a legally enforceable right of offset in the event of counterparty default and where, as a result, there is a net exposure for credit risk purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes.

In the case of derivatives the offset column also includes collateral received in cash and other financial assets.

### **Other credit risk mitigants**

While not disclosed as an offset in the Maximum exposure to credit risk table, other arrangements are in place which reduce our maximum exposure to credit risk. These include a charge over collateral over borrowers' specific assets such as residential properties. Other credit risk mitigants include short positions in securities and financial assets held as part of linked insurance/investment contracts where the risk is predominantly borne by the policyholder. In addition, we hold collateral in the form of financial instruments that are not recognised on the balance sheet.

*See Note 32 and from page 147 and page 156 respectively on the Financial Statements for further details on collateral in respect of certain loans and advances and derivatives.*

HSBC HOLDINGS PLC

130

**Table of Contents****Report of the Directors: Financial Review** (continued)*Maximum exposure to credit risk**(Audited)*

	2014			2013		
	Maximum exposure	Offset	Net	Maximum exposure	Offset	Net
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Cash and balances at central banks	129,957		129,957	166,599		166,599
Items in the course of collection from other banks	4,927		4,927	6,021		6,021
Hong Kong Government certificates of indebtedness	27,674		27,674	25,220		25,220
Trading assets	228,944		228,944	239,301	(1,777)	237,524
Treasury and other eligible bills	16,170		16,170	21,584		21,584
debt securities	141,532		141,532	141,644		141,644
loans and advances to banks	27,581		27,581	27,885		27,885
loans and advances to customers	43,661		43,661	48,188	(1,777)	46,411
Financial assets designated at fair value	9,031		9,031	12,719		12,719
Treasury and other eligible bills	56		56	50		50
debt securities	8,891		8,891	12,589		12,589
loans and advances to banks	84		84	76		76
loans and advances to customers				4		4
Derivatives	345,008	(313,300)	31,708	282,265	(252,344)	29,921
Loans and advances to customers held at amortised cost <sup>1</sup>	974,660	(67,094)	907,566	992,089	(96,726)	895,363
personal	388,954	(4,412)	384,542	404,126	(1,348)	402,778
corporate and commercial financial (non-bank financial institutions)	535,184	(59,197)	475,987	537,922	(90,215)	447,707
financial (non-bank financial institutions)	50,522	(3,485)	47,037	50,041	(5,163)	44,878
Loans and advances to banks held at amortised cost <sup>1</sup>	112,149	(258)	111,891	120,046	(587)	119,459
	161,713	(5,750)	155,963	179,690	(22,267)	157,423

Reverse repurchase agreements non-trading					
Financial investments	<b>404,773</b>		<b>404,773</b>	416,785	416,785
Treasury and other similar bills	<b>81,517</b>		<b>81,517</b>	78,111	78,111
debt securities	<b>323,256</b>		<b>323,256</b>	338,674	338,674
Other assets	<b>35,264</b>		<b>35,264</b>	37,324	(22)
assets held for sale	<b>1,375</b>		<b>1,375</b>	3,306	(22)
endorsements and acceptances	<b>10,775</b>		<b>10,775</b>	11,624	
other	<b>23,114</b>		<b>23,114</b>	22,394	
Financial guarantees and similar contracts <sup>2</sup>	<b>47,078</b>		<b>47,078</b>	46,300	
Loan and other credit-related commitments <sup>3</sup>	<b>651,380</b>		<b>651,380</b>	587,603	587,603
<b>At 31 December</b>	<b>3,132,558</b>	<b>(386,402)</b>	<b>2,746,156</b>	3,111,962	(373,723)

For footnotes, see page 202.

### *Loan and other credit-related commitments<sup>3</sup>*

*(Unaudited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Personal	<b>86,247</b>	<b>96,497</b>	<b>2,995</b>	<b>15,636</b>	<b>11,679</b>	<b>213,054</b>
Corporate and commercial	<b>98,045</b>	<b>138,366</b>	<b>20,141</b>	<b>102,911</b>	<b>17,540</b>	<b>377,003</b>
Financial <sup>5</sup>	<b>26,605</b>	<b>9,355</b>	<b>711</b>	<b>23,559</b>	<b>1,093</b>	<b>61,323</b>
<b>At 31 December 2014</b>	<b>210,897</b>	<b>244,218</b>	<b>23,847</b>	<b>142,106</b>	<b>30,312</b>	<b>651,380</b>
Personal	92,148	74,445	2,940	15,647	9,774	194,954
Corporate and commercial	91,895	120,084	19,045	92,837	21,956	345,817
Financial <sup>5</sup>	18,930	8,477	705	17,478	1,242	46,832
At 31 December 2013	202,973	203,006	22,690	125,962	32,972	587,603

*For footnotes, see page 202.*

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

#### **Concentration of exposure**

*(Unaudited)*

*Concentrations of credit risk are described in the Appendix to Risk on page 206.*

The geographical diversification of our lending portfolio and our broad range of global businesses and products ensured that we did not overly depend on a few markets to generate growth in 2014. This diversification also supported our strategy for growth in faster-growing markets and those with international connectivity.

#### **Financial investments**

Our holdings of available-for-sale government and government agency debt securities, corporate debt securities, ABSs and other securities were spread across a wide range of issuers and geographical regions in 2014, with 15% invested in securities issued by banks and other financial institutions and 72% in government or government agency debt securities. We also held assets backing insurance and investment contracts.

*For an analysis of financial investments, see Note 18 on the Financial Statements.*

#### **Trading assets**

Trading securities remained the largest concentration within trading assets at 77% compared with 75% in 2013. The largest concentration within the trading securities

portfolio was in government and government agency debt securities. We had significant exposures to US Treasury and government agency debt securities (US\$26bn) and UK (US\$9.3bn) and Hong Kong (US\$6.9bn) government debt securities.

*For an analysis of debt and equity securities held for trading, see Note 12 on the Financial Statements.*

#### **Derivatives**

Derivative assets were US\$345bn at 31 December 2014 (2013: US\$282bn). Details of derivative amounts cleared through an exchange, central counterparty and non-central counterparty are shown on page 150.

*For an analysis of derivatives, see page 150 and Note 16 on the Financial Statements.*

#### **Loans and advances to customers**

The following tables analyse loans and advances to customers by industry sector and by the location of the principal operations of the lending subsidiary or, in the case of the operations of The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East Limited ( HSBC Bank Middle East ) and HSBC Bank USA, by the

location of the lending branch. The distribution of loans across geographical regions and industries remained similar to last year.

*For an analysis of loans and advances by country see page 160.*

*Gross loans and advances to customers by industry sector and by geographical region*

*(Audited)*

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m	As a % of total gross loans
Personal first lien residential mortgages <sup>6</sup>	178,531	129,515	6,571	65,400	13,537	393,554	39.9
other personal <sup>7</sup>	47,531	36,368	3,924	9,823	9,384	107,030	10.9
Corporate and commercial	210,585	220,799	20,588	57,862	30,722	540,556	54.8
manufacturing	39,456	37,767	2,413	15,299	12,051	106,986	10.9
international trade and services	76,629	72,814	9,675	13,484	8,189	180,791	18.3
commercial real estate	28,187	35,678	579	6,558	2,291	73,293	7.4
other	7,126	34,379	1,667	8,934	281	52,387	5.3
property-related	2,264	1,195	1,552	164	968	6,143	0.6
government	56,923	38,966	4,702	13,423	6,942	120,956	12.3
other commercial <sup>8</sup>	23,103	13,997	3,291	9,034	1,393	50,818	5.1
Financial non-bank financial institutions	21,867	13,410	3,289	9,034	1,199	48,799	4.9
settlement accounts	1,236	587	2		194	2,019	0.2
Asset-backed securities reclassified	1,938			131		2,069	0.2
<b>Total gross loans and</b>	<b>414,157</b>	<b>364,311</b>	<b>30,450</b>	<b>132,427</b>	<b>45,652</b>	<b>986,997</b>	<b>100.0</b>

**advances to  
customers at  
31 December  
2014 (A)**

Percentage of A  
by geographical  
region

	<b>42.0%</b>	<b>36.9%</b>	<b>3.1%</b>	<b>13.4%</b>	<b>4.6%</b>	<b>100.0%</b>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review (continued)**

							As a % of total gross loans
	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m	
Personal	192,107	124,529	6,484	72,690	14,918	410,728	40.8
first lien residential mortgages <sup>6</sup>	140,474	92,047	2,451	60,955	3,948	299,875	29.8
other personal	51,633	32,482	4,033	11,735	10,970	110,853	11.0
Corporate and commercial	239,116	203,894	19,760	50,307	30,188	543,265	53.9
manufacturing	55,920	30,758	3,180	11,778	12,214	113,850	11.3
international trade and services	76,700	79,368	8,629	11,676	8,295	184,668	18.3
commercial real estate	31,326	34,560	639	5,900	2,421	74,846	7.4
other	7,308	27,147	1,333	8,716	328	44,832	4.5
property-related government	3,340	1,021	1,443	499	974	7,277	0.7
other commercial	64,522	31,040	4,536	11,738	5,956	117,792	11.7
Financial	27,872	9,688	2,532	9,055	1,376	50,523	5.0
non-bank financial institutions	26,314	9,359	2,532	9,055	1,277	48,537	4.8
settlement accounts	1,558	329			99	1,986	0.2
Asset-backed securities reclassified	2,578			138		2,716	0.3
Total gross loans and advances to customers at 31 December 2013 (B)	461,673	338,111	28,776	132,190	46,482	1,007,232	100.0
Percentage of B by geographical region	45.8%	33.6%	2.9%	13.1%	4.6%	100.0%	

*For footnotes, see page 202.*

**Credit quality of financial instruments**



*(Audited)*

*A summary of our current policies and practices regarding the credit quality of financial instruments is provided in the Appendix to Risk on page 207.*

We assess credit quality on all financial instruments which are subject to credit risk.

The five classifications describing the credit quality of our lending, debt securities portfolios and derivatives are defined on page 207 (unaudited). Additional credit quality information in respect of our consolidated holdings of ABSs is provided on page 162.

For the purpose of the following disclosure, retail loans which are past due up to 90 days and are not otherwise classified as impaired in accordance with our disclosure convention are not disclosed within the expected loss ( EL ) grade to which they relate, but are separately classified as past due but not impaired.

The overall credit quality of assets remained stable with Strong and Good categories making up 84% of the portfolio, Satisfactory 13%, Sub-standard and Past due but not impaired 2% and Impaired 1%.

HSBC HOLDINGS PLC

133

**Table of Contents****Report of the Directors: Financial Review** (continued)*Distribution of financial instruments by credit quality**(Audited)*

	Neither past due nor impaired				Past due but not impaired US\$m	Impaired US\$m	Total gross amount US\$m	Impairment allowances <sup>9</sup> US\$m
	Strong US\$m	Good US\$m	Satisfactory US\$m	Sub-standard US\$m				
	127,971	1,438	195	353			129,957	
	4,515	46	365	1			4,927	
	27,674						27,674	
	168,521	35,042	24,740	641			228,944	
	13,938	1,641	559	32			16,170	
	111,138	17,786	12,305	303			141,532	
	17,492	4,961	5,016	112			27,581	
	25,953	10,654	6,860	194			43,661	
	3,017	4,476	1,207	331			9,031	
	5			51			56	

	3,011	4,476	1,124	280			8,891	
	1		83				84	
	269,490	58,596	15,962	960			345,008	
	487,734	239,136	196,685	20,802	13,357	29,283	986,997	(12,337)
	320,678	32,601	15,109	1,130	8,876	15,160	393,554	(4,600)
	141,375	192,799	171,748	18,986	3,922	13,795	542,625	(7,441)
	25,681	13,736	9,828	686	559	328	50,818	(296)
	83,766	19,525	7,945	914	1	47	112,198	(49)
	98,470	28,367	33,283	1,593			161,713	
	347,218	27,373	22,600	5,304		2,278	404,773	
	68,966	6,294	4,431	1,826			81,517	
	278,252	21,079	18,169	3,478		2,278	323,256	
	13,015	7,564	12,976	631	210	884	35,280	(16)
	802	43	79		2	465	1,391	(16)
	1,507	4,644	4,281	298	34	11	10,775	
	10,706	2,877	8,616	333	174	408	23,114	
	1,631,391	421,563	315,958	31,530	13,568	32,492	2,446,502	(12,402)

HSBC HOLDINGS PLC

134

**Table of Contents****Report of the Directors: Financial Review** (continued)

	Neither past due nor impaired			Sub- standard US\$m	Past due but not impaired US\$m	Impaired US\$m	Total gross amount US\$m	Impairment allowances <sup>9</sup> US\$m
	Strong US\$m	Good US\$m	Satisfactory US\$m					
at banks ne	162,017	2,877	265	1,440			166,599	
r	5,590	66	286	79			6,021	
g ent s of ess	25,220						25,220	
r and ible	163,444	39,475	34,868	1,514			239,301	
	17,235	3,585	758	6			21,584	
d	107,831	16,498	16,167	1,148			141,644	
ers	15,804	5,546	6,342	193			27,885	
	22,574	13,846	11,601	167			48,188	
d at 10 r and ible	6,608	5,183	671	257			12,719	
	50						50	
d	6,490	5,179	664	256			12,589	
ers	68		7	1			76	
		4					4	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

es <sup>10</sup>	220,711	47,004	13,425	1,125			282,265	
	488,504	243,077	199,821	23,942	15,460	36,428	1,007,232	(15,143)
	326,269	39,024	14,882	1,580	10,175	18,798	410,728	(6,602)
te and	132,943	194,966	174,905	21,281	5,009	16,877	545,981	(8,059)
	29,292	9,087	10,034	1,081	276	753	50,523	(482)
to	91,498	21,131	6,266	1,123	11	75	120,104	(58)
cost	111,543	37,878	28,265	2,004			179,690	
	362,799	27,833	17,556	6,089		2,508	416,785	
	69,364	5,595	1,856	1,296			78,111	
	293,435	22,238	15,700	4,793		2,508	338,674	
ets	12,501	8,028	14,848	1,159	307	592	37,435	(111)
eld	1,129	642	1,050	351	89	156	3,417	(111)
ments	1,976	4,824	4,562	225	19	18	11,624	
es	9,396	2,562	9,236	583	199	418	22,394	
nd								
ber	1,650,435	432,552	316,271	38,732	15,778	39,603	2,493,371	(15,312)
	<i>For footnotes, see page 202.</i>							

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Past due but not impaired gross financial instruments***(Audited)*

Past due but not impaired gross financial instruments are those loans where, although customers have failed to make payments in accordance with the contractual terms

of their facilities, they have not met the impaired loan criteria described on page 137.

Overall, past due but not impaired balances decreased by US\$2.2bn, mainly due to continued run-off and loan sales in the CML portfolio.

**Past due but not impaired gross financial instruments by geographical region***(Audited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Loans and advances to customers held at amortised cost	<b>2,409</b>	<b>4,260</b>	<b>704</b>	<b>4,634</b>	<b>1,350</b>	<b>13,357</b>
personal	<b>1,159</b>	<b>2,880</b>	<b>182</b>	<b>3,759</b>	<b>896</b>	<b>8,876</b>
corporate and commercial financial (non-bank financial institutions)	<b>1,244</b>	<b>1,102</b>	<b>508</b>	<b>623</b>	<b>445</b>	<b>3,922</b>
	<b>6</b>	<b>278</b>	<b>14</b>	<b>252</b>	<b>9</b>	<b>559</b>
Other financial instruments	<b>6</b>	<b>52</b>	<b>31</b>	<b>97</b>	<b>25</b>	<b>211</b>
<b>At 31 December 2014</b>	<b>2,415</b>	<b>4,312</b>	<b>735</b>	<b>4,731</b>	<b>1,375</b>	<b>13,568</b>
Loans and advances to customers held at amortised cost	2,399	4,211	757	6,453	1,640	15,460
personal	1,287	2,764	174	4,817	1,133	10,175
corporate and commercial financial (non-bank financial institutions)	1,092	1,197	580	1,635	505	5,009
	20	250	3	1	2	276
Other financial instruments	45	49	50	101	73	318
At 31 December 2013	2,444	4,260	807	6,554	1,713	15,778

*For footnote, see page 202.*



*Ageing analysis of days for past due but not impaired gross financial instruments**(Audited)*

	<b>Up to 29 days US\$m</b>	<b>30-59 days US\$m</b>	<b>60-89 days US\$m</b>	<b>90-179 days US\$m</b>	<b>180 days and over US\$m</b>	<b>Total US\$m</b>
Loans and advances to customers held at amortised cost	<b>10,427</b>	<b>2,057</b>	<b>801</b>	<b>54</b>	<b>18</b>	<b>13,357</b>
personal	<b>6,477</b>	<b>1,717</b>	<b>676</b>	<b>5</b>	<b>1</b>	<b>8,876</b>
corporate and commercial	<b>3,417</b>	<b>328</b>	<b>114</b>	<b>48</b>	<b>15</b>	<b>3,922</b>
financial (non-bank financial institutions)	<b>533</b>	<b>12</b>	<b>11</b>	<b>1</b>	<b>2</b>	<b>559</b>
Other financial instruments	<b>130</b>	<b>33</b>	<b>18</b>	<b>12</b>	<b>18</b>	<b>211</b>
<b>At 31 December 2014</b>	<b>10,557</b>	<b>2,090</b>	<b>819</b>	<b>66</b>	<b>36</b>	<b>13,568</b>
Loans and advances to customers held at amortised cost	11,689	2,587	1,057	76	51	15,460
personal	7,170	2,124	865	16		10,175
corporate and commercial	4,290	418	190	60	51	5,009
financial (non-bank financial institutions)	229	45	2			276
Other financial instruments	214	55	26	12	11	318
At 31 December 2013	11,903	2,642	1,083	88	62	15,778

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Impaired loans***(Audited)*

Impaired loans and advances are those that meet any of the following criteria:

wholesale loans and advances classified as Customer Risk Rating ( CRR ) 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay their credit obligations in full, without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to HSBC.

retail loans and advances classified as Expected Loss ( EL ) 9 or EL 10. These grades are typically assigned to retail loans and advances more than 90 days past due unless individually they have been assessed as not impaired.

renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

For loans that are assessed for impairment on a collective basis, the evidence to support reclassification as no longer impaired typically comprises a history of payment performance against the original or revised terms, depending on the nature and volume of renegotiation and the credit risk characteristics surrounding the renegotiation. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

*For further details of the CRR and the EL scales see page 207.*

***Movement in impaired loans by geographical region****(Unaudited)*

Europe	Asia <sup>4</sup>	MENA	North America	Latin	Total
--------	-------------------	------	---------------	-------	-------

	US\$m	US\$m	US\$m	US\$m	America US\$m	US\$m
Impaired loans at 1 January 2014	13,228	1,623	2,285	15,123	4,244	36,503
personal	2,938	526	317	13,669	1,348	18,798
corporate and commercial	9,714	1,082	1,765	1,427	2,889	16,877
financial	576	15	203	27	7	828
Classified as impaired during the year	3,367	1,970	346	4,724	3,342	13,749
personal	1,168	857	193	4,360	1,958	8,536
corporate and commercial	2,166	1,113	153	354	1,383	5,169
financial	33			10	1	44
Transferred from impaired to unimpaired during the year	(1,661)	(230)	(320)	(2,609)	(730)	(5,550)
personal	(282)	(184)	(178)	(2,551)	(364)	(3,559)
corporate and commercial	(1,319)	(46)	(53)	(57)	(366)	(1,841)
financial	(60)		(89)	(1)		(150)
Amounts written off	(2,037)	(617)	(111)	(1,369)	(2,048)	(6,182)
personal	(631)	(470)	(77)	(1,007)	(1,371)	(3,556)
corporate and commercial	(1,201)	(147)	(29)	(356)	(673)	(2,406)
financial	(205)		(5)	(6)	(4)	(220)
Net repayments and other	(2,655)	(698)	(219)	(4,175)	(1,443)	(9,190)
personal	(649)	(238)	(13)	(3,645)	(514)	(5,059)
corporate and commercial	(1,975)	(457)	(140)	(506)	(926)	(4,004)
financial	(31)	(3)	(66)	(24)	(3)	(127)
<b>Impaired loans at 31 December 2014</b>	<b>10,242</b>	<b>2,048</b>	<b>1,981</b>	<b>11,694</b>	<b>3,365</b>	<b>29,330</b>
<b>personal</b>	<b>2,544</b>	<b>491</b>	<b>242</b>	<b>10,826</b>	<b>1,057</b>	<b>15,160</b>
<b>corporate and</b>	<b>7,385</b>	<b>1,545</b>	<b>1,696</b>	<b>862</b>	<b>2,307</b>	<b>13,795</b>

<b>commercial financial</b>	<b>313</b>	<b>12</b>	<b>43</b>	<b>6</b>	<b>1</b>	<b>375</b>
Impaired loans as a percentage of gross loans	<b>2.3%</b>	<b>0.5%</b>	<b>4.8%</b>	<b>8.4%</b>	<b>6.1%</b>	<b>2.7%</b>
personal	<b>1.4%</b>	<b>0.4%</b>	<b>3.7%</b>	<b>16.6%</b>	<b>7.8%</b>	<b>3.9%</b>
corporate and commercial	<b>3.5%</b>	<b>0.7%</b>	<b>8.2%</b>	<b>1.5%</b>	<b>7.5%</b>	<b>2.5%</b>
financial	<b>0.7%</b>	<b>0.0%</b>	<b>0.3%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.2%</b>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
Impaired loans at 1 January 2013	11,145	1,624	2,474	20,345	3,188	38,776
personal	2,466	611	368	18,726	1,580	23,751
corporate and commercial financial	8,058 621	967 46	1,872 234	1,592 27	1,604 4	14,093 932
Classified as impaired during the year	4,952	1,424	419	6,168	4,333	17,296
personal	1,176	798	107	5,319	1,872	9,272
corporate and commercial financial	3,726 50	623 3	306 6	837 12	2,453 8	7,945 79
Transferred from impaired to unimpaired during the year	(1,215)	(145)	(166)	(3,198)	(642)	(5,366)
personal	(265)	(137)	(68)	(3,172)	(266)	(3,908)
corporate and commercial financial	(804) (146)	(8) (8)	(85) (13)	(24) (2)	(375) (1)	(1,296) (162)
Amounts written off	(1,411)	(538)	(165)	(1,706)	(1,957)	(5,777)
personal	(423)	(444)	(79)	(1,433)	(1,456)	(3,835)
corporate and commercial financial	(927) (61)	(91) (3)	(75) (11)	(270) (3)	(499) (2)	(1,862) (80)

Net repayments and other	(243)	(742)	(277)	(6,486)	(678)	(8,426)
personal	(16)	(302)	(11)	(5,771)	(382)	(6,482)
corporate						
and commercial	(339)	(409)	(253)	(708)	(294)	(2,003)
financial	112	(31)	(13)	(7)	(2)	59
Impaired loans at 31 December 2013	13,228	1,623	2,285	15,123	4,244	36,503
personal	2,938	526	317	13,669	1,348	18,798
corporate						
and commercial	9,714	1,082	1,765	1,427	2,889	16,877
financial	576	15	203	27	7	828
Impaired loans as a percentage of gross loans	2.7%	0.4%	6.5%	10.9%	7.5%	3.2%
personal	1.5%	0.4%	4.9%	18.8%	9.0%	4.6%
corporate						
and commercial	4.0%	0.5%	8.9%	2.8%	9.6%	3.1%
financial	1.1%	0.0%	2.3%	0.2%	0.1%	0.5%

*For footnotes, see page 202.*

Impaired loans decreased by US\$7.2bn during the year. Personal impaired loans declined mainly due to the continued run off and loan sales in the CML portfolio in North America. In personal lending, Net repayments and other includes US\$2.9bn of CML portfolio assets that were reclassified as held for sale and also sold during the year.

Impaired loans in wholesale lending declined mainly in Europe and, to a lesser extent, in North America and Latin America due to repayments and a reduction in new impaired loans which reflected improvements in the economic conditions in these markets. These decreases were offset by an increase in Asia.

### Renegotiated loans and forbearance

*(Audited)*

*Current policies and procedures regarding renegotiated loans and forbearance are described in the Appendix to Risk on page 208.*

The contractual terms of a loan may be modified for a number of reasons, including changes in market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer.

Forbearance describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties. We classify and report loans on which concessions have been granted under conditions of credit distress as renegotiated loans

when their contractual payment terms have been modified, because we have significant concerns about the borrowers ability to meet contractual payments when due. On renegotiation, where the existing agreement is cancelled and a new agreement is made on substantially different terms, or if the terms of an existing agreement are modified such that the renegotiated loan is substantially a different financial instrument, the loan would be derecognised and recognised as a new loan for accounting purposes. However, the newly recognised financial asset will retain the renegotiated loan classification. Concessions on loans made to customers which do not affect the payment structure or basis of repayment, such as waivers of financial or security covenants, do not directly provide concessionary relief to customers in terms of their ability to service obligations as they fall due and are therefore not included in this classification.

The most significant portfolio of renegotiated loans remained in North America, substantially all of which were retail loans held by HSBC Finance.

The following tables show the gross carrying amounts of the Group's holdings of renegotiated loans and advances to customers by industry sector, geography and credit quality classification.

## HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Renegotiated loans and advances to customers by geographical region**(Audited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
First lien residential mortgages						
neither past due nor impaired	<b>1,605</b>	<b>94</b>	<b>58</b>	<b>13,540</b>	<b>60</b>	<b>15,357</b>
past due but not impaired	<b>529</b>	<b>63</b>	<b>19</b>	<b>3,695</b>	<b>32</b>	<b>4,338</b>
impaired	<b>221</b>	<b>8</b>	<b>1</b>	<b>1,894</b>	<b>5</b>	<b>2,129</b>
	<b>855</b>	<b>23</b>	<b>38</b>	<b>7,951</b>	<b>23</b>	<b>8,890</b>
Other personal lending <sup>7</sup>						
neither past due nor impaired	<b>324</b>	<b>292</b>	<b>27</b>	<b>1,267</b>	<b>326</b>	<b>2,236</b>
past due but not impaired	<b>184</b>	<b>173</b>	<b>16</b>	<b>453</b>	<b>14</b>	<b>840</b>
impaired	<b>40</b>	<b>22</b>	<b>5</b>	<b>214</b>	<b>1</b>	<b>282</b>
	<b>100</b>	<b>97</b>	<b>6</b>	<b>600</b>	<b>311</b>	<b>1,114</b>
Corporate and commercial						
neither past due nor impaired	<b>5,469</b>	<b>501</b>	<b>1,439</b>	<b>427</b>	<b>1,324</b>	<b>9,160</b>
past due but not impaired	<b>1,383</b>	<b>102</b>	<b>483</b>	<b>36</b>	<b>303</b>	<b>2,307</b>
impaired	<b>68</b>		<b>31</b>	<b>1</b>	<b>1</b>	<b>101</b>
	<b>4,018</b>	<b>399</b>	<b>925</b>	<b>390</b>	<b>1,020</b>	<b>6,752</b>
Financial <sup>5</sup>						
neither past due nor impaired	<b>413</b>	<b>4</b>	<b>323</b>	<b>1</b>	<b>1</b>	<b>742</b>
past due but not impaired	<b>219</b>		<b>305</b>			<b>524</b>
impaired	<b>194</b>	<b>4</b>	<b>18</b>	<b>1</b>	<b>1</b>	<b>218</b>



<b>Renegotiated loans at 31 December 2014</b>						
neither past due nor impaired	7,811	891	1,847	15,235	1,711	27,495
past due but not impaired	2,315	338	823	4,184	349	8,009
impaired	329	30	37	2,109	7	2,512
	5,167	523	987	8,942	1,355	16,974
Impairment allowances on renegotiated loans	1,458	170	458	1,499	704	4,289
renegotiated loans as % of total gross loans	1.9%	0.2%	6.1%	11.5%	3.7%	2.8%
First lien residential mortgages	1,820	117	91	16,853	76	18,957
neither past due nor impaired	392	78	47	4,332	32	4,881
past due but not impaired	517	11	3	2,684	4	3,219
impaired	911	28	41	9,837	40	10,857
Other personal lending <sup>7</sup>	431	318	58	1,277	531	2,615
neither past due nor impaired	253	207	33	503	18	1,014
past due but not impaired	39	24	17	284	2	366
impaired	139	87	8	490	511	1,235
Corporate and commercial	7,270	330	1,583	658	2,161	12,002
neither past due nor impaired	1,796	134	677	47	493	3,147
past due but not impaired	193	4	126	34	5	362
impaired	5,281	192	780	577	1,663	8,493
Financial <sup>5</sup>	235	2	362	1	1	601
neither past due nor	93		265			358

impaired past due but not impaired impaired	142	2	97	1	1	243
Renegotiated loans at 31 December 2013	9,756	767	2,094	18,789	2,769	34,175
neither past due nor impaired	2,534	419	1,022	4,882	543	9,400
past due but not impaired impaired	749	39	146	3,002	11	3,947
	6,473	309	926	10,905	2,215	20,828
Impairment allowances on renegotiated loans	1,867	101	460	2,285	1,014	5,727
renegotiated loans as % of total gross loans	2.1%	0.2%	7.3%	14.2%	6.0%	3.4%

*For footnotes, see page 202.*

The following table shows movements in renegotiated loans during the year. Renegotiated loans reduced by US\$6.7bn to US\$27bn in 2014. Renegotiated loans in personal lending reduced by US\$4bn. Included within other movements is US\$1.9bn of CML portfolio assets that were transferred to held for sale. New renegotiated

loans and write-offs reduced as a result of improvements in the US housing market and economic conditions.

Renegotiated loans in wholesale lending decreased by US\$2.7bn. The reductions were mainly concentrated in Europe and Latin America and were the result of increased write-offs and repayments.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Movement in renegotiated loans by geographical region**(Unaudited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Renegotiated loans at 1 January 2014	<b>9,756</b>	<b>767</b>	<b>2,094</b>	<b>18,789</b>	<b>2,769</b>	<b>34,175</b>
personal	<b>2,251</b>	<b>435</b>	<b>149</b>	<b>18,130</b>	<b>607</b>	<b>21,572</b>
corporate and commercial	<b>7,270</b>	<b>330</b>	<b>1,583</b>	<b>658</b>	<b>2,161</b>	<b>12,002</b>
financial	<b>235</b>	<b>2</b>	<b>362</b>	<b>1</b>	<b>1</b>	<b>601</b>
Loans renegotiated in the year without derecognition	<b>1,543</b>	<b>371</b>	<b>296</b>	<b>862</b>	<b>725</b>	<b>3,797</b>
personal	<b>433</b>	<b>83</b>	<b>10</b>	<b>774</b>	<b>310</b>	<b>1,610</b>
corporate and commercial	<b>939</b>	<b>288</b>	<b>286</b>	<b>78</b>	<b>415</b>	<b>2,006</b>
financial	<b>171</b>			<b>10</b>		<b>181</b>
Loans renegotiated in the year resulting in recognition of a new loan	<b>500</b>	<b>5</b>	<b>79</b>		<b>92</b>	<b>676</b>
personal	<b>69</b>	<b>2</b>			<b>28</b>	<b>99</b>
corporate and commercial	<b>381</b>		<b>61</b>		<b>64</b>	<b>506</b>
financial	<b>50</b>	<b>3</b>	<b>18</b>			<b>71</b>
Repayments personal	<b>(2,416)</b>	<b>(246)</b>	<b>(562)</b>	<b>(1,518)</b>	<b>(1,036)</b>	<b>(5,778)</b>
corporate and commercial	<b>(635)</b>	<b>(96)</b>	<b>(47)</b>	<b>(1,319)</b>	<b>(288)</b>	<b>(2,385)</b>
financial	<b>(1,757)</b>	<b>(149)</b>	<b>(445)</b>	<b>(189)</b>	<b>(747)</b>	<b>(3,287)</b>
	<b>(24)</b>	<b>(1)</b>	<b>(70)</b>	<b>(10)</b>	<b>(1)</b>	<b>(106)</b>
	<b>(828)</b>	<b>(42)</b>	<b>(23)</b>	<b>(640)</b>	<b>(510)</b>	<b>(2,043)</b>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Amounts written off						
personal	(88)	(28)	(7)	(568)	(223)	(914)
corporate and						
commercial	(740)	(14)	(16)	(72)	(286)	(1,128)
financial					(1)	(1)
Other	(744)	36	(37)	(2,258)	(329)	(3,332)
personal	(101)	(10)	(20)	(2,210)	(48)	(2,389)
corporate and						
commercial	(624)	46	(30)	(48)	(283)	(939)
financial	(19)		13		2	(4)
<b>At</b>						
<b>31 December</b>						
<b>2014</b>	<b>7,811</b>	<b>891</b>	<b>1,847</b>	<b>15,235</b>	<b>1,711</b>	<b>27,495</b>
personal	1,929	386	85	14,807	386	17,593
corporate						
and						
commercial	5,469	501	1,439	427	1,324	9,160
financial	413	4	323	1	1	742

Renegotiated loans at						
1 January						
2013	9,974	944	2,389	26,162	2,758	42,227
personal	2,817	493	190	25,474	781	29,755
corporate and						
commercial	6,829	447	1,859	685	1,975	11,795
financial	328	4	340	3	2	677
Loans renegotiated in the year without derecognition	2,807	49	101	1,727	1,311	5,995
personal	264	8	16	1,335	507	2,130
corporate and						
commercial	2,541	41	85	391	803	3,861
financial	2			1	1	4
Loans renegotiated in the year resulting in recognition of a new loan	105	113	14		62	294
personal	17	76	14		25	132
corporate and						
commercial	88	37			37	162

financial						
Repayments	(2,139)	(233)	(541)	(1,759)	(707)	(5,379)
personal	(489)	(111)	(64)	(1,387)	(353)	(2,404)
corporate and						
commercial	(1,574)	(121)	(477)	(370)	(354)	(2,896)
financial	(76)	(1)		(2)		(79)
Amounts						
written off	(426)	(25)	(38)	(1,035)	(409)	(1,933)
personal	(99)	(20)	(9)	(995)	(233)	(1,356)
corporate and						
commercial	(303)	(5)	(29)	(40)	(175)	(552)
financial	(24)				(1)	(25)
Other	(565)	(81)	169	(6,306)	(246)	(7,029)
personal	(259)	(11)	2	(6,297)	(120)	(6,685)
corporate and						
commercial	(311)	(69)	145	(8)	(125)	(368)
financial	5	(1)	22	(1)	(1)	24
At						
31 December						
2013	9,756	767	2,094	18,789	2,769	34,175
personal	2,251	435	149	18,130	607	21,572
corporate and						
commercial	7,270	330	1,583	658	2,161	12,002
financial	235	2	362	1	1	601

*For footnote, see page 202.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Impairment of loans and advances***(Audited)*

*A summary of our current policies and practices regarding impairment assessment is provided in the Appendix to Risk on page 212. For an analysis of loan impairment charges and other credit risk provisions by global business, see page 76.*

The tables below analyse the impairment allowances recognised for impaired loans and advances that are either individually or collectively assessed, and collective impairment allowances on loans and advances that are classified as not impaired.

*Loan impairment charge to the income statement by industry sector**(Unaudited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Personal first lien residential mortgages	245	321	25	117	1,095	1,803
other personal <sup>1</sup>	(75)	6	(24)	26	15	(52)
	320	315	49	91	1,080	1,855
Corporate and commercial manufacturing and international trade and services	790	327	6	196	937	2,256
commercial real estate and other property-related	520	197	36	116	382	1,251
other commercial <sup>8</sup>	78	29	(28)	27	176	282
Financial <sup>5</sup>	192	101	(2)	53	379	723
	44	(4)	(32)	(13)	1	(4)
	1,079	644	(1)	300	2,033	4,055

**Total loan impairment charge for the year ended 31 December 2014**

Personal first lien residential mortgages other personal	320	345	46	963	1,522	3,196
Corporate and commercial manufacturing and international trade and services commercial real estate and other property-related other commercial <sup>8</sup> Financial <sup>5</sup>	(11)	(7)	(13)	647	11	627
	331	352	59	316	1,511	2,569
	1,467	152	(13)	253	1,115	2,974
	800	134	37	125	594	1,690
	432	(2)	(5)	79	322	826
	235	20	(45)	49	199	458
	(55)	(14)	(77)	19	5	(122)
<b>Total loan impairment charge for the year ended 31 December 2013</b>	<b>1,732</b>	<b>483</b>	<b>(44)</b>	<b>1,235</b>	<b>2,642</b>	<b>6,048</b>

*Loan impairment charge to the income statement by assessment type**(Unaudited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Individually assessed impairment allowances	<b>617</b>	<b>351</b>	<b>32</b>	<b>190</b>	<b>590</b>	<b>1,780</b>
new allowances	<b>1,112</b>	<b>542</b>	<b>134</b>	<b>298</b>	<b>738</b>	<b>2,824</b>
release of allowances no longer required	<b>(486)</b>	<b>(171)</b>	<b>(95)</b>	<b>(88)</b>	<b>(90)</b>	<b>(930)</b>
recoveries of amounts previously written off	<b>(9)</b>	<b>(20)</b>	<b>(7)</b>	<b>(20)</b>	<b>(58)</b>	<b>(114)</b>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Collectively assessed impairment allowances <sup>12</sup>	462	293	(33)	110	1,443	2,275
new allowances net of allowance releases	757	426	2	205	1,726	3,116
recoveries of amounts previously written off	(295)	(133)	(35)	(95)	(283)	(841)
<b>Total loan impairment charge for the year ended 31 December 2014</b>	<b>1,079</b>	<b>644</b>	<b>(1)</b>	<b>300</b>	<b>2,033</b>	<b>4,055</b>
Individually assessed impairment allowances	1,376	145	(86)	262	623	2,320
new allowances	1,828	316	196	398	702	3,440
release of allowances no longer required	(402)	(145)	(235)	(98)	(31)	(911)
recoveries of amounts previously written off	(50)	(26)	(47)	(38)	(48)	(209)
Collectively assessed impairment allowances <sup>12</sup>	356	338	42	973	2,019	3,728
new allowances net of allowance releases	943	479	82	1,058	2,253	4,815
recoveries of amounts previously written off	(587)	(141)	(40)	(85)	(234)	(1,087)
Total loan impairment charge for the year ended 31 December	1,732	483	(44)	1,235	2,642	6,048



2013

*For footnotes, see page 202.*

Total loan impairment charges of US\$4.1bn were US\$2.0bn lower than in 2013 reflecting reduced impairment charges in both the personal lending and

the corporate and commercial lending portfolios, primarily in North America, Europe and Latin America.

HSBC HOLDINGS PLC

141

**Table of Contents****Report of the Directors: Financial Review** (continued)

In North America, loan impairment charges relating to both first lien mortgages and other personal lending decreased, which reflected reduced levels of both delinquency and new impaired loans in the CML portfolio, and a fall in lending balances from continued run-off and loan sales. This was partly offset by lower favourable market value adjustments of underlying properties as improvements in housing market conditions were less pronounced in 2014 than in 2013.

In Europe, the reduction in loan impairment charges was primarily in corporate and commercial lending, as a result of lower individually assessed impairment allowances reflecting the improved quality of the portfolio and economic conditions. Loan impairment charges also decreased in personal lending, albeit to a lesser extent, due to lower delinquency levels in the improved economic environment and as customers continued to reduce outstanding credit card and loan balances. These factors

were partly offset by an increase in collectively assessed allowances in the corporate and commercial lending sector as we revised certain estimates in our collective corporate loan impairment calculation, and in the financial industry sector reflecting charges compared with releases in 2013.

In Latin America, the reduction in loan impairment charges in the other personal lending and the corporate and commercial portfolios primarily reflected the prior year adverse effect of changes to the impairment model and assumption revisions for restructured loan portfolios in Brazil. Individually assessed allowances were broadly stable. There were lower loan impairment charges in Mexico in the commercial real estate and other property related sector, in particular relating to certain homebuilders. In Brazil individually assessed allowances increased due to an impairment relating to a corporate customer in the other commercial sector.

*Charge for impairment losses as a percentage of average gross loans and advances to customers by geographical region*

(Unaudited)

	Europe %	Asia <sup>4</sup> %	MENA %	North America %	Latin America %	Total %
New allowances net of allowance releases	0.37	0.22	0.14	0.32	5.00	0.53
Recoveries	(0.08)	(0.04)	(0.14)	(0.09)	(0.72)	(0.10)
<b>Total charge for impairment losses at 31 December 2014</b>	<b>0.29</b>	<b>0.18</b>		<b>0.23</b>	<b>4.28</b>	<b>0.43</b>
	<b>0.49</b>	<b>0.13</b>	<b>0.58</b>	<b>0.97</b>	<b>3.59</b>	<b>0.58</b>

Amount written off net of recoveries						
New allowances net of allowance releases	0.65	0.20	0.15	1.00	5.93	0.81
Recoveries	(0.17)	(0.05)	(0.29)	(0.09)	(0.57)	(0.14)
Total charge for impairment losses at 31 December 2013	0.48	0.15	(0.14)	0.91	5.36	0.67
Amount written off net of recoveries	0.42	0.12	0.38	1.10	3.69	0.59

For footnote, see page 202.

*Movement in impairment allowances by industry sector and by geographical region*

(Unaudited)

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
Impairment allowances at 1 January 2014	5,598	1,214	1,583	4,242	2,564	15,201
Amounts written off						
Personal	(724)	(463)	(157)	(1,030)	(1,359)	(3,733)
first lien residential mortgages	(21)	(17)	(4)	(731)	(40)	(813)
other personal	(703)	(446)	(153)	(299)	(1,319)	(2,920)
Corporate and commercial	(1,202)	(146)	(47)	(346)	(684)	(2,425)
manufacturing and international trade and services	(732)	(86)	(41)	(81)	(428)	(1,368)
commercial real estate and other property-related	(342)	(53)	(6)	(153)	(39)	(593)
other commercial	(128)	(7)		(112)	(217)	(464)
Financial <sup>5</sup>	(203)		(8)	(6)	(4)	(221)
Total amounts written off	(2,129)	(609)	(212)	(1,382)	(2,047)	(6,379)
Recoveries of amounts written off in previous years						
Personal	271	143	35	86	283	818
first lien residential mortgages	3	3		40	33	79
other personal	268	140	35	46	250	739
Corporate and commercial	29	9	7	25	58	128
manufacturing and international trade and	19	7	7	6	46	85

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

services						
commercial real estate and other property-related	11			3	1	15
other commercial	(1)	2		16	11	28
Financial <sup>5</sup>	4	1		4		9
Total recoveries of amounts written off in previous years	304	153	42	115	341	955
Charge to income statement	1,079	644	(1)	300	2,033	4,055
Exchange and other movements <sup>13</sup>	(397)	(46)	(6)	(635)	(362)	(1,446)
<b>Impairment allowances at 31 December 2014</b>	<b>4,455</b>	<b>1,356</b>	<b>1,406</b>	<b>2,640</b>	<b>2,529</b>	<b>12,386</b>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Impairment allowances against banks:						
individually assessed	<b>31</b>		<b>18</b>			<b>49</b>
Impairment allowances against customers:						
individually assessed	<b>2,981</b>	<b>812</b>	<b>1,110</b>	<b>276</b>	<b>1,016</b>	<b>6,195</b>
collectively assessed <sup>2</sup>	<b>1,443</b>	<b>544</b>	<b>278</b>	<b>2,364</b>	<b>1,513</b>	<b>6,142</b>
<b>Impairment allowances at 31 December 2014</b>	<b>4,455</b>	<b>1,356</b>	<b>1,406</b>	<b>2,640</b>	<b>2,529</b>	<b>12,386</b>
Impairment allowances at 1 January 2013	5,361	1,219	1,811	5,616	2,162	16,169
Amounts written off						
Personal	(876)	(461)	(107)	(1,330)	(1,593)	(4,367)
first lien residential mortgages	(83)	(7)	(2)	(779)	(25)	(896)
other personal	(793)	(454)	(105)	(551)	(1,568)	(3,471)
Corporate and commercial	(1,264)	(96)	(78)	(277)	(514)	(2,229)
manufacturing and international trade and services	(680)	(73)	(64)	(80)	(386)	(1,283)
commercial real estate and other property-related	(289)	(7)	(2)	(141)	(23)	(462)
other commercial	(295)	(16)	(12)	(56)	(105)	(484)
Financial <sup>5</sup>	(40)	(3)	(10)	(3)	(3)	(59)
Total amounts written off	(2,180)	(560)	(195)	(1,610)	(2,110)	(6,655)
Recoveries of amounts written off in previous years						
Personal	584	153	41	82	237	1,097
first lien residential mortgages	25	4		67	23	119
other personal	559	149	41	15	214	978

Corporate and commercial	52	14	46	41	45	198
manufacturing and international trade and services	19	7	2	6	27	61
commercial real estate and other						
property-related	6	4		18	1	29
other commercial	27	3	44	17	17	108
Financial <sup>5</sup>	1					1
Total recoveries of amounts written off in previous years	637	167	87	123	282	1,296
Charge to income statement	1,732	483	(44)	1,235	2,642	6,048
Exchange and other movements <sup>13</sup>	48	(95)	(76)	(1,122)	(412)	(1,657)
Impairment allowances at 31 December 2013	5,598	1,214	1,583	4,242	2,564	15,201
Impairment allowances against banks:						
individually assessed	35		18	5		58
Impairment allowances against customers:						
individually assessed	4,019	634	1,131	410	878	7,072
collectively assessed	1,544	580	434	3,827	1,686	8,071
Impairment allowances at 31 December 2013	5,598	1,214	1,583	4,242	2,564	15,201

For footnotes, see page 202.

*Movement in impairment allowances on loans and advances to customers and banks*

(Audited)

	Banks individually assessed		Customers		Total US\$m
	US\$m	US\$m	Individually assessed US\$m	Collectively assessed US\$m	
At 1 January 2014	58	7,072	8,071		15,201
Amounts written off	(6)	(2,313)	(4,060)		(6,379)
Recoveries of loans and advances previously written off		114	841		955
Charge to income statement	4	1,776	2,275		4,055
Exchange and other movements <sup>13</sup>	(7)	(454)	(985)		(1,446)
<b>At 31 December 2014</b>	<b>49</b>	<b>6,195</b>	<b>6,142</b>		<b>12,386</b>
Impairment allowances:					
on loans and advances to customers		6,195	6,142		12,337
personal		468	4,132		4,600

corporate and commercial		<b>5,532</b>	<b>1,909</b>	<b>7,441</b>
financial		<b>195</b>	<b>101</b>	<b>296</b>
as a percentage of loans and advances <sup>1</sup>		<b>0.04%</b>	<b>0.63%</b>	<b>1.13%</b>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	Banks individually		Customers	Total US\$m
	Individually assessed US\$m	Individually assessed US\$m	Collectively assessed US\$m	
At 1 January 2013	57	6,572	9,540	16,169
Amounts written off	(4)	(1,937)	(4,714)	(6,655)
Recoveries of loans and advances previously written off		209	1,087	1,296
Charge to income statement	5	2,315	3,728	6,048
Exchange and other movements <sup>13</sup>		(87)	(1,570)	(1,657)
At 31 December 2013	58	7,072	8,071	15,201
Impairment allowances:				
on loans and advances to customers		7,072	8,071	15,143
personal		589	6,013	6,602
corporate and commercial		6,096	1,963	8,059
financial		387	95	482
as a percentage of loans and advances <sup>1</sup>	0.05%	0.70%	0.80%	1.35%

*For footnotes, see page 202.*

**Wholesale lending**

On a reported basis gross loans decreased by US\$11bn, which included adverse foreign exchange movements of US\$32bn, mainly in Europe.

The following commentary is on a constant currency basis.

Wholesale lending grew by US\$21bn in the year. In Asia, balances grew by US\$16bn as we continued to leverage our position in emerging markets. In North America, we also experienced strong growth of US\$10bn as we executed our strategy of expanding our core offerings and proactively targeting companies with international

banking requirements in key growth markets. The fall in lending in Europe of US\$15bn was mainly driven by a reduction in corporate overdraft balances. In the UK, a small number of clients benefited from the use of net interest arrangements across their overdraft and deposit positions. During the year, as we aligned our approach in our Payments and Cash Management business to be more globally consistent, many of these clients increased the frequency with which they settled these balances, reducing their overdraft and deposit balances, which fell by US\$28bn. The Middle East and North Africa and Latin America grew by US\$6bn and US\$4bn, respectively.



*Total wholesale lending**(Unaudited)*

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
Corporate and commercial (A)	210,585	220,799	20,588	57,862	30,722	540,556
manufacturing	39,456	37,767	2,413	15,299	12,051	106,986
international trade and services	76,629	72,814	9,675	13,484	8,189	180,791
commercial real estate	28,187	35,678	579	6,558	2,291	73,293
other						
property-related	7,126	34,379	1,667	8,934	281	52,387
government	2,264	1,195	1,552	164	968	6,143
other commercial	56,923	38,966	4,702	13,423	6,942	120,956
Financial (non-bank financial institutions) (B)	23,103	13,997	3,291	9,034	1,393	50,818
Asset-backed securities reclassified	1,938			131		2,069
Loans and advances to banks (C)	21,978	62,960	10,495	7,405	9,360	112,198
<b>Gross loans at 31 December 2014 (D)</b>	<b>257,604</b>	<b>297,756</b>	<b>34,374</b>	<b>74,432</b>	<b>41,475</b>	<b>705,641</b>
Impairment allowances on wholesale lending						
Corporate and commercial (a)	3,112	1,089	1,171	608	1,461	7,441
manufacturing	529	242	141	152	348	1,412
international trade and services	877	533	536	157	237	2,340
commercial real estate	909	44	147	101	476	1,677
other						
property-related	203	55	219	57	12	546
government	4		1			5
other commercial	590	215	127	141	388	1,461
Financial (non-bank financial institutions) (b)	221	13	21	39	2	296

Loans and advances to banks (c)	<b>31</b>		<b>18</b>			<b>49</b>
<b>Impairment allowances at 31 December 2014 (d)</b>	<b>3,364</b>	<b>1,102</b>	<b>1,210</b>	<b>647</b>	<b>1,463</b>	<b>7,786</b>
(a) as a percentage of (A)	<b>1.48%</b>	<b>0.49%</b>	<b>5.69%</b>	<b>1.05%</b>	<b>4.76%</b>	<b>1.38%</b>
(b) as a percentage of (B)	<b>0.96%</b>	<b>0.09%</b>	<b>0.64%</b>	<b>0.43%</b>	<b>0.14%</b>	<b>0.58%</b>
(c) as a percentage of (C)	<b>0.14%</b>		<b>0.17%</b>			<b>0.04%</b>
(d) as a percentage of (D)	<b>1.31%</b>	<b>0.37%</b>	<b>3.52%</b>	<b>0.87%</b>	<b>3.53%</b>	<b>1.10%</b>

## HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
Corporate and commercial (I)	239,116	203,894	19,760	50,307	30,188	543,265
manufacturing	55,920	30,758	3,180	11,778	12,214	113,850
international trade and services	76,700	79,368	8,629	11,676	8,295	184,668
commercial real estate	31,326	34,560	639	5,900	2,421	74,846
other property-related	7,308	27,147	1,333	8,716	328	44,832
government	3,340	1,021	1,443	499	974	7,277
other commercial	64,522	31,040	4,536	11,738	5,956	117,792
Financial (non-bank financial institutions) (J)	27,872	9,688	2,532	9,055	1,376	50,523
Asset-backed securities reclassified	2,578			138		2,716
Loans and advances to banks (K)	24,273	72,814	6,419	6,420	10,178	120,104
Gross loans at 31 December 2013 (L)	293,839	286,396	28,711	65,920	41,742	716,608
Impairment allowances on wholesale lending						
Corporate and commercial (i)	3,821	918	1,212	769	1,339	8,059
manufacturing	618	246	182	89	384	1,519
international trade and services	1,216	428	502	188	349	2,683
commercial real estate	1,116	22	153	202	396	1,889
other property-related	269	102	236	93	8	708
government	3		10	1		14
other commercial	599	120	129	196	202	1,246
Financial (non-bank financial institutions) (j)	344	17	60	50	11	482
Loans and advances to banks (k)	35		18	5		58
Impairment allowances at 31 December 2013 (l)	4,200	935	1,290	824	1,350	8,599
(i) as a percentage of (I)	1.60%	0.45%	6.13%	1.53%	4.44%	1.48%
(j) as a percentage of (J)	1.23%	0.18%	2.37%	0.55%	0.80%	0.95%
(k) as a percentage of (K)	0.14%		0.28%	0.08%		0.05%

(l) as a percentage of (L) 1.43% 0.33% 4.49% 1.25% 3.23% 1.20%  
 For footnotes, see page 202.

## Commercial real estate

### Commercial real estate lending

(Unaudited)

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
Neither past due nor impaired	25,860	35,430	333	6,136	1,535	69,294
Past due but not impaired	18	170	47	100	28	363
Impaired loans	2,309	78	199	322	728	3,636
<b>Total gross loans and advances at 31 December 2014</b>	<b>28,187</b>	<b>35,678</b>	<b>579</b>	<b>6,558</b>	<b>2,291</b>	<b>73,293</b>
Of which:						
renegotiated loans <sup>4</sup>	1,954	19	183	191	377	2,724
Impairment allowances	909	44	147	101	476	1,677
Neither past due nor impaired	28,044	34,433	402	5,400	2,249	70,528
Past due but not impaired	95	103	18	29	35	280
Impaired loans	3,187	24	219	471	137	4,038
Total gross loans and advances at 31 December 2013	31,326	34,560	639	5,900	2,421	74,846
Of which:						
renegotiated loans <sup>4</sup>	2,590	20	229	280	461	3,580
Impairment allowances	1,116	22	153	202	396	1,889

For footnotes, see page 202.

Commercial real estate lending includes the financing of corporate, institutional and high net worth individuals who are investing primarily in income producing assets and, to a lesser extent, in their construction and development. The business focuses mainly on traditional core asset classes such as retail, offices, light industrial and residential building projects. The portfolio is globally diversified with larger concentrations in Hong Kong, the UK, the US and Canada.

In more developed markets, our exposure mainly comprises the financing of investment assets, the

redevelopment of existing stock and the augmentation of both commercial and residential markets to support economic and population growth. In lesser developed commercial real estate markets our exposures comprise lending for development assets on relatively short tenors with a particular focus on supporting the larger, better capitalised developers involved in residential construction or in assets supporting economic expansion.

Many of these markets are beginning to move away from the rapid construction of recent years with an increasing focus on investment assets consistent with more

HSBC HOLDINGS PLC

145

**Table of Contents****Report of the Directors: Financial Review** (continued)

developed markets. A significant amount of exposure is centred on cities which are key locations of economic, political or cultural importance.

Total commercial real estate was US\$73bn at 31 December 2014, a reduction of US\$1.6bn which included adverse foreign exchange movements of US\$3.3bn, mainly in Europe.

**Refinance risk in commercial real estate**

Commercial real estate lending tends to require the repayment of a significant proportion of the principal at maturity. Typically, a customer will arrange repayment through the acquisition of a new loan to settle the existing debt. Refinance risk is the risk that a customer, being unable to repay the debt on maturity, fails to refinance it at commercial rates. Refinance risk is described in more detail on page 214. We monitor our commercial real estate portfolio closely, assessing those drivers that may indicate potential issues with refinancing. The principal driver is the vintage of the loan, when origination reflected previous market norms which do not apply in the current market. Examples might be higher LTV ratios and/or lower interest cover ratios. The range of refinancing sources in the local market is also an important consideration, with risk increasing when lenders are restricted to banks and when bank liquidity is limited. In addition, underlying fundamentals such as the reliability of tenants, the ability to let and the condition of the property are important, as they influence property values.

For the Group's commercial real estate portfolios as a whole, the behaviour of markets and the quality of assets did not cause undue concern in 2014. In the UK, which was subject to heightened concerns in recent years, the drivers described above are not currently causing sufficient concern to warrant enhanced management attention.

Further details on our UK portfolio are as follows: at 31 December 2014, we had US\$20bn (2013: US\$22bn) of commercial real estate loans of which US\$5.9bn (2013: US\$6.8bn) were due to be refinanced within the next 12 months. Of these balances, cases subject to close monitoring in our Loan Management Unit amounted to US\$2.1bn (2013: US\$2.4bn). US\$1.3bn (2013: US\$1.6bn) were disclosed as impaired with impairment allowances of US\$0.6bn (2013: US\$0.6bn). Where these loans are not considered impaired it is because there is sufficient evidence to indicate that the associated contractual cash flows will be recovered or that the loans will not need to be refinanced on terms we would consider below market norms.

**Collateral on loans and advances**

*Details of the Group's practice regarding the use of collateral are provided in the Appendix to Risk on page 213.*

Collateral held is analysed separately below for commercial real estate and for other corporate, commercial and financial (non-bank) lending. This reflects the greater correlation between collateral performance and principal repayment in the commercial

real estate sector than applies to other lending. In each case, the analysis includes off-balance sheet loan commitments, primarily undrawn credit lines.

The collateral measured in the tables below consists of fixed first charges on real estate and charges over cash and marketable financial instruments. The values in the tables represent the expected market value on an open market basis; no adjustment has been made to the collateral for any expected costs of recovery. Cash is valued at its nominal value and marketable securities at their fair value. The LTV ratios presented are calculated by directly associating loans and advances with the collateral that individually and uniquely supports each facility. When collateral assets are shared by multiple loans and advances, whether specifically or, more generally, by way of an all monies charge, the collateral value is pro-rated across the loans and advances protected by the collateral.

Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

For impaired loans the collateral values cannot be directly compared with impairment allowances recognised. The LTV tables below use open market values with no adjustments. Impairment allowances are calculated on a different basis, by considering other cash flows and adjusting collateral values for costs of realising collateral as explained further on page 212.

#### *Commercial real estate loans and advances*

The value of commercial real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review on the basis of local market conditions. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase. Revaluations may also be sought where customers amend their banking requirements, resulting in the Group extending further funds or other significant rearrangements of exposure or collateral, which may change the customer risk profile. As a result, the real estate collateral values used for CRR 1-7 might date back to the last point at which such considerations applied. For CRR 8 and 9-10 almost all collateral would have been revalued within the last three years.

In Hong Kong, market practice is typically for lending to major property companies to be either secured by guarantees or unsecured. In Europe, facilities of a working capital nature are generally not secured by a first fixed charge and are therefore disclosed as not collateralised.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Commercial real estate loans and advances including loan commitments by level of collateral**(Audited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Rated CRR/EL 1 to 7						
Not collateralised	<b>5,351</b>	<b>16,132</b>	<b>361</b>	<b>87</b>	<b>1,719</b>	<b>23,650</b>
Fully collateralised	<b>25,873</b>	<b>26,323</b>	<b>23</b>	<b>9,093</b>	<b>556</b>	<b>61,868</b>
Partially collateralised (A)	<b>1,384</b>	<b>1,599</b>		<b>1,819</b>	<b>152</b>	<b>4,954</b>
collateral value on A	<b>1,032</b>	<b>901</b>		<b>1,199</b>	<b>47</b>	<b>3,179</b>
	<b>32,608</b>	<b>44,054</b>	<b>384</b>	<b>10,999</b>	<b>2,427</b>	<b>90,472</b>
Rated CRR/EL 8						
Not collateralised	<b>34</b>	<b>7</b>		<b>9</b>	<b>2</b>	<b>52</b>
Fully collateralised	<b>568</b>	<b>23</b>		<b>30</b>	<b>1</b>	<b>622</b>
LTV ratio:						
less than 50%	<b>64</b>			<b>16</b>	<b>1</b>	<b>81</b>
51% to 75%	<b>222</b>	<b>11</b>		<b>10</b>		<b>243</b>
76% to 90%	<b>132</b>	<b>9</b>		<b>4</b>		<b>145</b>
91% to 100%	<b>150</b>	<b>3</b>				<b>153</b>
Partially collateralised (B)	<b>365</b>			<b>7</b>		<b>372</b>
collateral value on B	<b>296</b>			<b>2</b>		<b>298</b>



Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	967	30		46	3	1,046
Rated CRR/EL 9 to 10						
Not collateralised	369	48	6	1	499	923
Fully collateralised	992	15	7	166	178	1,358
LTV ratio:						
less than 50%	78	6	7	28	10	129
51% to 75%	593	2		91	43	729
76% to 90%	167	2		17	53	239
91% to 100%	154	5		30	72	261
Partially collateralised (C)	1,085	15	181	37	50	1,368
collateral value on C	664	5	89	30	13	801
	2,446	78	194	204	727	3,649
<b>At 31 December 2014</b>	<b>36,021</b>	<b>44,162</b>	<b>578</b>	<b>11,249</b>	<b>3,157</b>	<b>95,167</b>
Rated CRR/EL 1 to 7						
Not collateralised	4,865	14,164	192	137	935	20,293
Fully collateralised	24,154	25,317	21	8,627	1,728	59,847
Partially collateralised (D)	2,664	2,377	139	704	484	6,368
collateral value on D	1,827	1,688	24	303	292	4,134
	31,683	41,858	352	9,468	3,147	86,508
Rated CRR/EL 8						
Not collateralised	109	10		1	3	123
Fully collateralised	793		72	68	1	934
LTV ratio:						
less than 50%	139			15		154
51% to 75%	367		72	49	1	489

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

76% to 90%	173			4		177
91% to 100%	114					114
Partially collateralised (E)	360	2		13		375
collateral value on E	281	1		11		293
	1,262	12	72	82	4	1,432
Rated CRR/EL 9 to 10						
Not collateralised	564		7	4	521	1,096
Fully collateralised	1,079	12	31	233	286	1,641
LTV ratio:						
less than 50%	275	2	7	39	32	355
51% to 75%	436	6	7	110	57	616
76% to 90%	209	3	17	62	62	353
91% to 100%	159	1		22	135	317
Partially collateralised (F)	1,815	5	181	240	56	2,297
collateral value on F	1,284	5	89	115	34	1,527
	3,458	17	219	477	863	5,034
At 31 December 2013	36,403	41,887	643	10,027	4,014	92,974
<i>For footnote, see page 202.</i>						

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

Other corporate, commercial and financial (non-bank loans) are analysed separately below. For financing activities in other corporate and commercial lending, collateral value is not strongly correlated to principal repayment performance. Collateral values are generally refreshed when an obligor's general credit performance deteriorates and we have to assess the

likely performance of secondary sources of repayment should it prove necessary to rely on them.

Accordingly, the table below reports values only for customers with CRR 8 to 10, recognising that these loans and advances generally have valuations which are comparatively recent.

*Other corporate, commercial and financial (non-bank) loans and advances including loan commitments by level of collateral rated CRR/EL 8 to 10 only*

(Audited)

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
Rated CRR/EL 8						
Not collateralised	2,051	237	15	320	227	2,850
Fully collateralised	629	56	72	331	11	1,099
LTV ratio:		13				
less than 50%	120	13		186	5	324
51% to 75%	293			72	6	371
76% to 90%	51	9	69	46		175
91% to 100%	165	34	3	27		229
Partially collateralised (A)	105	44	1	148	6	304
collateral value on A	46	17	1	68	4	136
	2,785	337	88	799	244	4,253

Rated CRR/EL 9 to 10						
Not collateralised	4,185	939	813	62	1,420	7,419
Fully collateralised	615	143	147	231	124	1,260
LTV ratio:						
less than 50%	169	68	25	48	48	358
51% to 75%	136	27	19	39	35	256
76% to 90%	168	16	6	35	26	251
91% to 100%	142	32	97	109	15	395
Partially collateralised (B)	624	364	547	251	140	1,926
collateral value on B	341	169	92	141	46	789
	5,424	1,446	1,507	544	1,684	10,605
<b>At 31 December 2014</b>	<b>8,209</b>	<b>1,783</b>	<b>1,595</b>	<b>1,343</b>	<b>1,928</b>	<b>14,858</b>
Rated CRR/EL 8						
Not collateralised	2,411	185	37	328	456	3,417
Fully collateralised	259	51	1	227	70	608
LTV ratio:						
less than 50%	65	38	1	84	11	199
51% to 75%	103	4		47	10	164
76% to 90%	25	8		31	5	69
91% to 100%	66	1		65	44	176
Partially collateralised (C)	435	23	528	345	73	1,404
collateral value on C	17	5	398	89	18	527
	3,105	259	566	900	599	5,429
Rated CRR/EL 9 to 10						
Not collateralised	1,467	685	1,089	26	1,615	4,882
Fully collateralised	1,121	161	49	309	266	1,906

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

LTV ratio:						
less than 50%	124	57	2	24	159	366
51% to 75%	161	21	47	29	49	307
76% to 90%	156	53		46	43	298
91% to 100%	680	30		210	15	935
Partially collateralised (D)	1,192	304	770	359	290	2,915
collateral value on D	606	150	102	149	131	1,138
	3,780	1,150	1,908	694	2,171	9,703
At 31 December 2013	6,885	1,409	2,474	1,594	2,770	15,132
<i>For footnote, see page 202.</i>						

Loans and advances to banks are typically unsecured. Collateral values held for customers rated CRR 9 to 10 (i.e. classified as impaired) are separately disclosed.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Loans and advances to banks including loan commitments by level of collateral**(Audited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Rated CRR/EL 1 to 8						
Not collateralised	<b>22,405</b>	<b>64,210</b>	<b>10,472</b>	<b>7,985</b>	<b>9,406</b>	<b>114,478</b>
Fully collateralised	<b>104</b>	<b>1,587</b>				<b>1,691</b>
Partially collateralised (A)	<b>5</b>					<b>5</b>
collateral value on A	<b>3</b>					<b>3</b>
	<b>22,514</b>	<b>65,797</b>	<b>10,472</b>	<b>7,985</b>	<b>9,406</b>	<b>116,174</b>
Rated CRR/EL 9 to 10						
Not collateralised	<b>102</b>	<b>1</b>	<b>21</b>			<b>124</b>
<b>At 31 December 2014</b>	<b>22,616</b>	<b>65,798</b>	<b>10,493</b>	<b>7,985</b>	<b>9,406</b>	<b>116,298</b>
Rated CRR/EL 1 to 8						
Not collateralised	21,225	72,986	6,373	7,210	9,837	117,631
Fully collateralised	3,614	1,376			266	5,256
Partially collateralised	68	560				628

(B)						
collateral value on B	3	389				392
	24,907	74,922	6,373	7,210	10,103	123,515
Rated CRR/EL 9 to 10						
Not collateralised	153		312	14		479
At 31 December 2013	25,060	74,922	6,685	7,224	10,103	123,994
<i>For footnote, see page 202.</i>						

### Other credit risk exposures

In addition to collateralised lending, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below:

some securities issued by governments, banks and other financial institutions benefit from additional credit enhancement provided by government guarantees that cover the assets.

*Details of government guarantees are included in Notes 12, 15 and 18 on the Financial Statements.*

debt securities issued by banks and financial institutions include ABSs and similar instruments which are supported by underlying pools of financial assets. Credit risk associated with ABSs is reduced through the purchase of credit default swap ( CDS ) protection.

*Disclosure of the Group's holdings of ABSs and associated CDS protection is provided on page 162.*

trading assets include loans and advances held with trading intent. These mainly consist of cash collateral posted to satisfy margin requirements on derivatives, settlement accounts, reverse repos and stock borrowing. There is limited credit risk on cash collateral posted since in the event of default of the counterparty these would be set-off against the related liability. Reverse repos and stock borrowing are by their nature collateralised.

*Collateral accepted as security that the Group is permitted to sell or repledge under these arrangements is described in Note 19 on the Financial Statements.*

the Group's maximum exposure to credit risk includes financial guarantees and similar contracts granted, as well as loan and other credit-related commitments. Depending on the terms of the arrangement, we may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults. For further information on these arrangements, see Note 37 on the Financial Statements.

### Derivatives

HSBC participates in transactions exposing us to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before satisfactorily settling it. It arises principally from OTC derivatives and securities financing transactions and is calculated in both the trading and non-trading books. Transactions vary in value by reference to a market factor such as interest rate, exchange rate or asset price.

The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment ( CVA ).

*For an analysis of CVA, see Note 13 on the Financial Statements.*

The table below reflects by risk type the fair values and gross notional contract amounts of derivatives cleared through an exchange, central counterparty and non-central counterparty.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)*Notional contract amounts and fair values of derivatives by product type**(Unaudited)*

	2014			Notional amount US\$m	2013	
	Notional amount US\$m	Fair value Assets US\$m	Liabilities US\$m		Fair value Assets US\$m	Liabilities US\$m
Foreign exchange	<b>5,573,415</b>	<b>97,312</b>	<b>95,759</b>	5,291,003	80,914	75,798
exchange traded	<b>81,785</b>	<b>229</b>	<b>369</b>	41,384	121	93
central counterparty cleared OTC	<b>18,567</b>	<b>321</b>	<b>349</b>	16,869	415	622
non-central counterparty cleared OTC	<b>5,473,063</b>	<b>96,762</b>	<b>95,041</b>	5,232,750	80,378	75,083
Interest rate	<b>22,328,518</b>	<b>473,243</b>	<b>468,152</b>	27,347,918	458,576	452,531
exchange traded	<b>1,432,333</b>	<b>112</b>	<b>161</b>	857,562	335	225
central counterparty cleared OTC	<b>15,039,001</b>	<b>261,880</b>	<b>264,509</b>	18,753,836	285,390	285,375
non-central counterparty cleared OTC	<b>5,857,184</b>	<b>211,251</b>	<b>203,482</b>	7,736,520	172,851	166,931
Equity	<b>568,932</b>	<b>11,694</b>	<b>13,654</b>	589,903	18,389	22,573
exchange traded	<b>289,140</b>	<b>2,318</b>	<b>3,201</b>	274,880	8,403	2,949
non-central counterparty cleared OTC	<b>279,792</b>	<b>9,376</b>	<b>10,453</b>	315,023	9,986	19,624
Credit	<b>550,197</b>	<b>9,340</b>	<b>10,061</b>	678,256	9,092	8,926
central counterparty cleared OTC	<b>126,115</b>	<b>1,999</b>	<b>2,111</b>	104,532	1,346	1,409
non-central counterparty cleared OTC	<b>424,082</b>	<b>7,341</b>	<b>7,950</b>	573,724	7,746	7,517
Commodity and other	<b>77,565</b>	<b>3,884</b>	<b>3,508</b>	77,842	2,624	1,786
exchange traded	<b>7,015</b>	<b>80</b>	<b>23</b>	6,531	182	6
non-central counterparty cleared OTC	<b>70,550</b>	<b>3,804</b>	<b>3,485</b>	71,311	2,442	1,780

Total OTC derivatives	27,288,354	592,735	587,379	32,804,565	560,554	558,341
total OTC derivatives cleared by central counterparties	15,183,683	264,200	266,968	18,875,237	287,151	287,406
total OTC derivatives not cleared by central counterparties	12,104,671	328,535	320,411	13,929,328	273,403	270,935
Total exchange traded derivatives	1,810,273	2,739	3,755	1,180,357	9,041	3,273
<b>Gross</b>	<b>29,098,627</b>	<b>595,473</b>	<b>591,134</b>	33,984,922	569,595	561,614
Offset		(250,465)	(250,465)		(287,330)	(287,330)
<b>Total at 31 December</b>		<b>345,008</b>	<b>340,669</b>		282,265	274,284

*The purposes for which HSBC uses derivatives are described in Note 16 on the Financial Statements.*

The International Swaps and Derivatives Association ( ISDA ) Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of OTC products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs. It is common, and our preferred practice, for the parties to execute a Credit Support Annex ( CSA ) in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in outstanding positions.

We manage the counterparty exposure arising from market risk on our OTC derivative contracts by using collateral agreements with counterparties and netting agreements. Currently, we do not actively manage our general OTC derivative counterparty exposure in the credit markets, although we may manage individual exposures in certain circumstances.

We have historically placed strict policy restrictions on collateral types and as a consequence the types of collateral received and pledged are, by value, highly liquid and of a strong quality, being predominantly cash.

Where a collateral type is required to be approved outside the collateral policy (which includes collateral that includes wrong way risks), a submission to one of three regional Documentation Approval Committees ( DAC s) for approval is required. These DACs require the participation and sign-off of senior representatives from regional Global Markets Chief Operating Officers, Legal and Risk.

The majority of the counterparties with whom we have a collateral agreement are European. The majority of our CSAs are with financial institutional clients.

As a consequence of our policy, the type of agreement we enter into is predominately ISDA CSAs, the majority of which are written under English law. The table below provides a breakdown of OTC collateral agreements by agreement type:

*OTC collateral agreements by type*

*(Unaudited)*

	<b>Number of agreements</b>
ISDA CSA (English law)	2,434
ISDA CSA (New York law)	1,628
ISDA CSA (Japanese law)	18
French Master Agreement and CSA equivalent <sup>15</sup>	227
German Master Agreement and CSA equivalent <sup>16</sup>	90
Others	205
<b>At 31 December 2014</b>	<b>4,602</b>

*For footnotes, see page 202.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

*See page 130 and Note 32 on the Financial Statements for details regarding legally enforceable right of offset in the event of counterparty default and collateral received in respect of derivatives.*

**Reverse repos – non-trading by geographical region**

Following the change in balance sheet presentation explained on page 347, non-trading reverse repos are presented separately on the face of the balance sheet and are no longer included in Loans

and advances to customers and Loans and advances to banks .

Comparative data have been re-presented accordingly. As a result, any analysis in the Credit Risk section that references loans and advances to customers or banks excludes non-trading reverse repos to customers or banks, respectively. For reference, the amount of non-trading reverse repos to customers and banks is set out below.

**Reverse repos – non-trading by geographical region**

*(Audited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
With customers	<b>25,841</b>	<b>5,409</b>		<b>35,060</b>		<b>66,310</b>
With banks	<b>34,748</b>	<b>22,813</b>	<b>19</b>	<b>29,008</b>	<b>8,815</b>	<b>95,403</b>
<b>At 31 December 2014</b>	<b>60,589</b>	<b>28,222</b>	<b>19</b>	<b>64,068</b>	<b>8,815</b>	<b>161,713</b>
With customers	48,091	6,448		33,676		88,215
With banks	49,631	12,973	24	23,744	5,103	91,475
At 31 December 2013	97,722	19,421	24	57,420	5,103	179,690

*For footnote, see page 202.*

**Personal lending**

We provide a broad range of secured and unsecured personal lending products to meet customer needs. Personal lending includes advances to customers for asset purchases such as residential property where the

loans are secured by the assets being acquired. We also offer loans secured on existing assets, such as first liens on residential property, and unsecured lending products such as overdrafts, credit cards and payroll loans.

### *Total personal lending*

*(Unaudited)*

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
First lien residential mortgages (A)	131,000	93,147	2,647	55,577	4,153	286,524
Of which:						
interest only (including offset)	44,163	956		276		45,395
affordability including ARMs	337	5,248		16,452		22,037
Other personal lending (B)	47,531	36,368	3,924	9,823	9,384	107,030
other	34,567	25,695	2,633	4,328	4,846	72,069
credit cards	12,959	10,289	897	1,050	3,322	28,517
second lien residential mortgages		56	2	4,433		4,491
motor vehicle finance	5	328	392	12	1,216	1,953
<b>Total gross loans at 31 December 2014 (C)</b>	<b>178,531</b>	<b>129,515</b>	<b>6,571</b>	<b>65,400</b>	<b>13,537</b>	<b>393,554</b>
Impairment allowances on personal lending						
First lien residential mortgages (a)	306	46	97	1,644	36	2,129
Other personal lending (b)	786	208	97	350	1,030	2,471
other	438	87	59	43	672	1,299

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

credit cards	347	119	33	36	298	833
second lien residential mortgages				271		271
motor vehicle finance	1	2	5		60	68
<b>Total impairment allowances at 31 December 2014 (c)</b>	<b>1,092</b>	<b>254</b>	<b>194</b>	<b>1,994</b>	<b>1,066</b>	<b>4,600</b>
(a) as a percentage of A	0.2%		3.7%	3.0%	0.9%	0.7%
(b) as a percentage of B	1.7%	0.6%	2.5%	3.6%	11.0%	2.3%
(c) as a percentage of C	0.6%	0.2%	3.0%	3.0%	7.9%	1.2%

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	Europe US\$m	Asia <sup>4</sup> US\$m	MENA US\$m	North America US\$m	Latin America US\$m	Total US\$m
First lien residential mortgages (D)	140,474	92,047	2,451	60,955	3,948	299,875
Of which:						
interest only (including offset)	49,460	1,115		352		50,927
affordability including ARMs	508	5,593		16,274		22,375
Other personal lending (E)	51,633	32,482	4,033	11,735	10,970	110,853
other	37,126	21,636	2,728	5,309	5,651	72,450
credit cards	14,496	10,274	915	1,145	3,526	30,356
second lien residential mortgages		91	2	5,261		5,354
motor vehicle finance	11	481	388	20	1,793	2,693
Total gross loans at 31 December 2013 (F)	192,107	124,529	6,484	72,690	14,918	410,728
Impairment allowances on personal lending						
First lien residential mortgages (d)	439	57	124	2,886	32	3,538
	959	222	169	532	1,182	3,064

Other personal lending (e)						
other	553	93	104	59	881	1,690
credit cards	403	127	61	47	217	855
second lien residential mortgages				426		426
motor vehicle finance	3	2	4		84	93
Total impairment allowances at 31 December 2013 (f)	1,398	279	293	3,418	1,214	6,602
(d) as a percentage of D	0.3%	0.1%	5.1%	4.7%	0.8%	1.2%
(e) as a percentage of E	1.9%	0.7%	4.2%	4.5%	10.8%	2.8%
(f) as a percentage of F	0.7%	0.2%	4.5%	4.7%	8.1%	1.6%

*For footnote, see page 202.*

Total personal lending was US\$394bn at 31 December 2014, down from US\$411bn at the end of 2013 (US\$392bn on a constant currency basis). We continued to run-off our CML portfolio in North America and the balance declined by a further US\$5.7bn during the year.

Personal lending excluding the US CML run-off portfolio grew by US\$7.7bn on a constant currency basis in 2014. This was mainly due to increased mortgage and other lending in Asia and growth in the mortgage portfolio in the US and Brazil. It was partially offset by a reduction in personal lending in UK.

### **Mortgage lending**

*(Unaudited)*

We offer a wide range of mortgage products designed to meet customer needs, including capital repayment, interest-only, affordability and offset mortgages.

Group credit policy prescribes the range of acceptable residential property LTV thresholds with the maximum upper limit for new loans set at between 75% and 95%.

Specific LTV thresholds and debt-to-income ratios are managed at regional and country levels and, although the



parameters must comply with Group policy, strategy and risk appetite, they differ in the various locations in which we operate to reflect the local economic and housing market conditions, regulations, portfolio performance, pricing and other product features.

The commentary that follows is on a constant currency basis

Personal lending excluding the US CML run-off portfolio, mortgage lending balances increased by US\$3.9bn during the year. Mortgage lending in Asia, excluding the reclassification to Other Personal lending discussed on page 153, grew by US\$4.8bn. The increases were primarily attributable to continued growth in Hong Kong (US\$2.9bn) and, to a lesser extent, in Australia (US\$0.5bn),

Malaysia (US\$0.4bn), and Taiwan (US\$0.3bn) as a result of strong demand and competitive customer offerings. The quality of our Asian mortgage book remained high with negligible defaults and impairment allowances. The average LTV ratio on new mortgage lending in Hong Kong was 47% compared with an estimated 29% for the overall portfolio.

In North America, our Canadian mortgage balances increased by US\$0.5bn during the year as a result of a focused mortgage campaign and process improvements. The Premier mortgage portfolio in the US also increased by US\$0.9bn during 2014 as we continued to focus on growth in our core portfolios. Our business in the US exhibited lower collectively assessed impairment charges due to continued improvement in the credit quality of the mortgage portfolio. The US CML portfolio declined by US\$5.7bn in 2014.

Mortgage lending in Brazil increased by US\$0.5bn as a result of improvements to both our process and products offered and overall growth in the mortgage market in the country during the year.

In Europe, there was a marginal decline of US\$1.4bn or 1% due to decreased lending and effects of repayments, mainly in the UK mortgage portfolio.

Interest-only products made up US\$44bn of total UK mortgage lending, including US\$19bn of offset mortgages in First Direct. The LTV ratio on new lending was 60% compared with an average of 43.7% for the total mortgage portfolio. The credit quality of our UK mortgage portfolio remained high and both loan impairment charges and delinquency levels declined in 2014.

We grew our mortgage book in France by US\$0.6bn in the year due to strong demand.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Other personal lending***(Unaudited)*

Other personal lending increased by US\$3.7bn in 2014. This was driven by growth in personal loans and revolving credit facilities in Asia, mainly in Hong Kong (US\$3.1bn). We also reclassified US\$1.7bn of loans in mainland China from Residential mortgages to other personal lending as the supporting collateral over some of the properties either under construction or completed was yet to be fully registered. These increases were partially offset by a reduction in credit card lending of US\$0.7bn in the UK and US\$0.3bn in Turkey, due to repayments. Term lending in North America, primarily Canada, declined by US\$0.7bn during the year. There was also a US\$0.2bn reduction in the auto finance dealers run off portfolio in Brazil.

**HSBC Finance US Consumer and Mortgage Lending – residential mortgages<sup>17</sup>***(Unaudited)*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Residential mortgages:		
first lien	<b>21,915</b>	27,305
Other personal lending:		
second lien	<b>2,509</b>	3,014
<b>Total (A) at 31 December</b>	<b>24,424</b>	30,319
Impairment allowances	<b>1,679</b>	3,028
as a percentage of A	<b>6.9%</b>	10.0%

*For footnote, see page 202.***HSBC Finance**

Mortgage lending balances in HSBC Finance declined by US\$5.7bn during 2014. In addition to the continued loan sales in the CML portfolio, we transferred a further US\$2.9bn to assets held for sale during the year, and expect to sell these in multiple transactions over the next 12 months.

The decrease in impairment allowances reflected lower levels of both new impaired loans and loan balances outstanding as a result of continued liquidation of the portfolio. This included loan sales and loss estimates due

to lower delinquency and loss severity levels than in 2013.

Across the first and second lien residential mortgages in our CML portfolio, two months and over delinquent balances reduced by US\$2.5bn to US\$2.4bn during 2014 reflecting the continued portfolio run-off and loan sales.

*HSBC Finance: foreclosed properties in the US**(Unaudited)*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Number of foreclosed properties at year-end	<b>2,139</b>	4,254
Number of properties added to foreclosed inventory in the period	<b>3,716</b>	9,752
Average (gain)/loss on sale of foreclosed properties <sup>18</sup>	<b>(1%)</b>	1%
Average total loss on foreclosed properties <sup>19</sup>	<b>51%</b>	51%
Average time to sell foreclosed properties (days)	<b>189</b>	154

*For footnotes, see page 202.*

The number of foreclosed properties at 31 December 2014 significantly decreased compared with the end of 2013 as during 2014 more properties were sold than were added to the foreclosed inventory. We added fewer properties to the inventory as many of them were sold prior to taking title as a result of the ongoing sale of receivables from the CML portfolio.

**HSBC Bank USA**

In HSBC Bank USA, mortgage balances grew by US\$0.9bn during 2014 as we implemented our strategy to grow the HSBC Premier customer base. Credit quality improved further during 2014 and balances which were two months and over delinquent in our first lien residential mortgage portfolio declined by US\$0.3bn to US\$1.1bn at December 2014. We also continued to sell all agency eligible new originations in the secondary market as a means of managing our interest rate risk and improving structural liquidity.

*Trends in two months and over contractual delinquency in the US**(Unaudited)*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>In personal lending in the US</b>		
First lien residential mortgages	<b>3,271</b>	5,931
Consumer and Mortgage Lending	<b>2,210</b>	4,595
other mortgage lending	<b>1,061</b>	1,336
Second lien residential mortgages	<b>216</b>	406
Consumer and Mortgage Lending	<b>154</b>	276
other mortgage lending	<b>62</b>	130
Credit card	<b>17</b>	25
Personal non-credit card	<b>7</b>	25
<b>Total at 31 December</b>	<b>3,511</b>	6,387
	<b>%</b>	<b>%</b>
<b>As a percentage of the equivalent loans and receivables balances</b>		
First lien residential mortgages	<b>8.6</b>	14.0
Second lien residential mortgages	<b>5.0</b>	8.1

Credit card	2.4	3.4
Personal non-credit card	1.4	4.9
<b>Total at 31 December</b>	<b>8.1</b>	13.1

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Gross loan portfolio of HSBC Finance real estate secured balances**(Unaudited)*

	<b>Re-aged<sup>20</sup> US\$m</b>	<b>Modified and re-aged US\$m</b>	<b>Modified US\$m</b>	<b>Total renegotiated loans US\$m</b>	<b>Total non- renegotiated loans US\$m</b>	<b>Total gross loans US\$m</b>	<b>Total impairment allowances US\$m</b>	<b>Impairment allowances/ gross loans %</b>
<b>At 31 December 2014</b>	<b>6,637</b>	<b>6,581</b>	<b>587</b>	<b>13,805</b>	<b>10,619</b>	<b>24,424</b>	<b>1,679</b>	<b>7</b>
<b>At 31 December 2013</b>	8,167	8,213	768	17,148	13,171	30,319	3,028	10

*For footnote, see page 202.*

*Number of renegotiated real estate secured accounts remaining in HSBC Finance's portfolio**(Unaudited)*

	<b>Number of renegotiated loans (000s)</b>				<b>Total number of loans (000s)</b>
	<b>Re-aged</b>	<b>Modified and re-aged</b>	<b>Modified</b>	<b>Total</b>	
<b>At 31 December 2014</b>	<b>85</b>	<b>64</b>	<b>6</b>	<b>155</b>	<b>297</b>
<b>At 31 December 2013</b>	102	78	8	188	352

**HSBC Finance loan modifications and re-age programmes**

HSBC Finance maintains loan modification and re-age ( loan renegotiation ) programmes in order to manage customer relationships, improve collection opportunities and, if possible, avoid foreclosure.

Since 2006, HSBC Finance has implemented an extensive loan renegotiation programme, and a significant portion of its loan portfolio has been subject to renegotiation at some stage in the life of the customer relationship as a consequence of the economic conditions in the US and the characteristics of HSBC Finance's customer base.

The volume of loans that qualify for modification has reduced significantly in recent years and we expect this trend to continue. Volumes of new loan modifications are decreasing due to improvements in economic conditions, the

cessation of new real estate secured and personal non-credit card receivables originations, and the continued run-off and loan sales in the CML portfolio.

### **Qualifying criteria**

For an account to qualify for renegotiation it must meet certain criteria, and HSBC Finance retains the right to decline a renegotiation. The extent to which HSBC Finance renegotiates accounts that are eligible under its existing policies varies according to its view of prevailing economic conditions and other factors which may change from year to year. In addition, exceptions to policies and practices may be made in specific situations in response to legal or regulatory agreements or orders.

Renegotiated real estate secured are not eligible for a subsequent renegotiation for 12 months, with a maximum of five renegotiations permitted within a five-year period. Borrowers must be approved for a modification and, to activate it, must generally make

two minimum qualifying monthly payments within 60 days. In certain circumstances where the debt has been restructured in bankruptcy proceedings, fewer or no payments may be required. Real estate secured loans involving a bankruptcy and accounts whose borrowers are subject to a Chapter 13 plan filed with a bankruptcy court generally may be considered current upon receipt of one qualifying payment, while accounts whose borrowers have filed for Chapter 7 bankruptcy protection may be re-aged upon receipt of a signed reaffirmation agreement. In addition, some products accounts may be re-aged without receipt of a payment in certain special circumstances (e.g. in the event of a natural disaster or a hardship programme).

### **2014 compared with 2013**

At 31 December 2014, renegotiated real estate secured accounts in HSBC Finance represented 91% (2013: 91%) of North America's total renegotiated loans. US\$8.0bn of renegotiated real estate secured loans were classified as impaired (2013: US\$10bn). During 2014, the aggregate number of renegotiated loans in HSBC Finance reduced, due to the run-off and loan sales in the CML portfolio, despite renegotiation activity continuing.

Within the constraints of our Group credit policy, HSBC Finance's policies allow for multiple renegotiations under certain circumstances. Consequently, a significant proportion of loans included in the table above have undergone multiple re-ages or modifications. In this regard, multiple modifications have remained consistent at 70% to 75% of total modifications.

The accounts that received second or subsequent renegotiations during the year do not appear in the statistics presented. These statistics treat a loan as an addition to the volume of renegotiated loans on its first renegotiation only.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Types of loan renegotiation programmes in HSBC Finance**

A temporary modification is a change to the contractual terms of a loan that results in HSBC Finance giving up a right to contractual cash flows over a pre-defined period. With a temporary modification the loan is expected to revert back to the original contractual terms, including the interest rate charged, after the modification period. An example is reduced interest payments.

A substantial number of HSBC Finance modifications involve interest rate reductions, which lower the amount of interest income HSBC Finance is contractually entitled to receive in future periods. Historically, modifications were granted for terms as low as six months, although, more recent modifications have a minimum term of two years.

Loans that have been re-aged are classified as impaired with the exception of first-time loan re-ages that were less than 60 days past due at the time of re-age. These remain classified as impaired until they have demonstrated a history of payment performance against their original contracted terms for at least 12 months.

A permanent modification is a change to the contractual terms of a loan that results in HSBC Finance giving up a right to contractual cash flows over the life of the loan. An example is a permanent reduction in the interest rate charged.

borrower's ability to pay, and the loan is disclosed as impaired. The loan remains disclosed as impaired from that date forward until the borrower has demonstrated a history of repayment performance for the period of time required for either modifications or re-ages, as described above.

**Valuation of foreclosed properties in the US**

We obtain real estate by foreclosing on the collateral pledged as security for residential mortgages. Prior to foreclosure, carrying amounts of the loans in excess of fair value less costs to sell are written down to the discounted cash flows expected to be recovered, including from the sale of the property.

Broker price opinions are obtained and updated every 180 days and real estate price trends are reviewed quarterly to reflect any improvement or additional deterioration. Our methodology is regularly validated by comparing the discounted cash flows expected to be recovered based on current market conditions (including estimated cash flows from the sale of the property) to the updated broker price opinion, adjusted for the estimated historical difference between interior and exterior appraisals. The fair values of foreclosed properties are initially determined on the basis of broker price opinions. Within 90 days of foreclosure, a more detailed property valuation is performed reflecting information obtained from a physical interior inspection of the property and additional allowances or write-downs are recorded as appropriate. Updates to the valuation are performed no less than once every 45 days until the property is sold, with declines or increases

recognised through changes to allowances.

Permanent or long-term modifications which are due to an underlying hardship event remain classified as impaired for their full life.

### **Second lien mortgages in the US**

The term re-age describes a renegotiation by which the contractual delinquency status of a loan is reset to current after demonstrating payment performance. The overdue principal and/or interest is deferred and paid at a later date. Loan re-ageing enables customers who have been unable to make a small number of payments to have their loan delinquency status reset to current so that their credit score is not affected by the overdue balances.

The majority of second lien residential mortgages were taken up by customers who held a first lien mortgage issued by a third party. Second lien residential mortgage loans have a risk profile characterised by higher LTV ratios, because in the majority of cases the loans were taken out to complete the refinancing of properties. Loss severity on default of second liens has typically approached 100% of the amount outstanding, as any equity in the property is consumed through the repayment of the first lien loan.

Loans that have been re-aged remain classified as impaired until they have demonstrated a history of payment performance against the original contractual terms for at least 12 months.

Impairment allowances for these loans were determined by applying a roll-rate migration analysis which captures the propensity of these loans to default based on past experience. Once we believe that a second lien residential mortgage loan is likely to progress to write-off, the loss severity assumed in establishing our impairment allowance is close to 100% in the CML portfolios, and more than 80% in HSBC Bank USA.

A temporary or permanent modification may also lead to a re-ageing of a loan although a loan may be re-aged without any modification to its original terms and conditions.

Where loans have been granted multiple concessions, subject to the qualifying criteria discussed above, the concession is deemed to have been made due to concern regarding the

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Collateral and other credit enhancements held***(Audited)***Loans and advances held at amortised cost**

*Details of the Group's practice regarding the use of collateral are provided in the Appendix to Risk on page 213.*

The tables below provide a quantification of the value of fixed charges we hold over specific assets where we have a history of enforcing, and are able to enforce,

collateral in satisfying a debt in the event of the borrower failing to meet its contractual obligations, and where the collateral is cash or can be realised by sale in an established market. The collateral valuation excludes any adjustments for obtaining and selling the collateral and, in particular, loans shown as not collateralised or partially collateralised may also benefit from other forms of credit mitigants.

**Residential mortgage loans including loan commitments by level of collateral***(Audited)*

	<b>Europe US\$m</b>	<b>Asia<sup>4</sup> US\$m</b>	<b>MENA US\$m</b>	<b>North America US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Non-impaired loans and advances						
Fully collateralised	<b>135,875</b>	<b>99,257</b>	<b>2,431</b>	<b>43,317</b>	<b>3,759</b>	<b>284,639</b>
LTV ratio:						
less than 50%	<b>66,075</b>	<b>60,315</b>	<b>1,324</b>	<b>14,003</b>	<b>1,454</b>	<b>143,171</b>
51% to 75%	<b>56,178</b>	<b>31,142</b>	<b>856</b>	<b>20,872</b>	<b>1,777</b>	<b>110,825</b>
76% to 90%	<b>11,856</b>	<b>6,906</b>	<b>212</b>	<b>5,994</b>	<b>480</b>	<b>25,448</b>
91% to 100%	<b>1,766</b>	<b>894</b>	<b>39</b>	<b>2,448</b>	<b>48</b>	<b>5,195</b>
Partially collateralised:						

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

greater than 100% LTV (A)	537	99	60	2,209	167	3,072
collateral value on A	532	81	44	1,999	24	2,680
	136,412	99,356	2,491	45,526	3,926	287,711
Impaired loans and advances						
Fully collateralised	906	256	122	8,618	154	10,056
LTV ratio:						
less than 50%	232	130	53	1,291	103	1,809
51% to 75%	417	90	29	3,462	35	4,033
76% to 90%	163	32	19	2,471	10	2,695
91% to 100%	94	4	21	1,394	6	1,519
Partially collateralised:						
greater than 100% LTV (B)	55	7	31	1,395	2	1,490
collateral value on B	40	5	23	1,181	1	1,250
	961	263	153	10,013	156	11,546
<b>At 31 December 2014</b>	<b>137,373</b>	<b>99,619</b>	<b>2,644</b>	<b>55,539</b>	<b>4,082</b>	<b>299,257</b>
Non-impaired loans and advances						
Fully collateralised	146,326	98,332	2,235	44,125	3,749	294,767
LTV ratio:						
less than 50%	55,028	55,479	749	13,172	1,337	125,765
51% to 75%	66,452	34,370	1,095	20,751	1,715	124,383
76% to 90%	21,603	6,836	348	6,933	606	36,326
91% to 100%	3,243	1,647	43	3,269	91	8,293
Partially collateralised:						
greater than 100% LTV (C)	1,410	362	42	4,150	59	6,023
collateral value on C	852	307	37	3,681	49	4,926

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

	147,736	98,694	2,277	48,275	3,808	300,790
Impaired loans and advances						
Fully collateralised	1,369	254	90	10,128	160	12,001
LTV ratio:						
less than 50%	244	100	15	1,393	97	1,849
51% to 75%	452	96	31	4,250	47	4,876
76% to 90%	320	49	34	2,809	13	3,225
91% to 100%	353	9	10	1,676	3	2,051
Partially collateralised:						
greater than 100% LTV (D)	104	17	6	2,548	8	2,683
collateral value on D	91	4	6	2,272	4	2,377
	1,473	271	96	12,676	168	14,684
At 31 December 2013	149,209	98,965	2,373	60,951	3,976	315,474
<i>For footnote, see page 202.</i>						

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Supplementary information***Gross loans and advances by industry sector over five years**(Unaudited)*

	Currency translation			2013 US\$m	2012 US\$m	2011 US\$m	2010 US\$m
	2014 US\$m	adjustment US\$m	Movement US\$m				
Personal	<b>393,554</b>	<b>(19,092)</b>	<b>1,918</b>	410,728	415,093	393,625	425,320
first lien residential mortgages <sup>6</sup>	<b>286,524</b>	<b>(12,372)</b>	<b>(979)</b>	299,875	301,862	278,963	268,681
other personal	<b>107,030</b>	<b>(6,720)</b>	<b>2,897</b>	110,853	113,231	114,662	156,639
Corporate and commercial	<b>540,556</b>	<b>(24,729)</b>	<b>22,020</b>	543,265	513,229	472,784	445,505
manufacturing	<b>106,986</b>	<b>(5,856)</b>	<b>(1,008)</b>	113,850	112,149	96,054	91,121
international trade and services	<b>180,791</b>	<b>(8,232)</b>	<b>4,355</b>	184,668	169,389	152,709	146,567
commercial real estate	<b>73,293</b>	<b>(3,270)</b>	<b>1,717</b>	74,846	76,760	73,941	71,880
other property-related	<b>52,387</b>	<b>(922)</b>	<b>8,477</b>	44,832	40,532	39,539	34,838
government	<b>6,143</b>	<b>(395)</b>	<b>(739)</b>	7,277	10,785	11,079	8,594
other commercial	<b>120,956</b>	<b>(6,054)</b>	<b>9,218</b>	117,792	103,614	99,462	92,505
Financial	<b>50,818</b>	<b>(2,303)</b>	<b>2,598</b>	50,523	46,871	44,832	41,213
non-bank financial institutions	<b>48,799</b>	<b>(2,180)</b>	<b>2,442</b>	48,537	45,430	43,888	39,651
settlement accounts	<b>2,019</b>	<b>(123)</b>	<b>156</b>	1,986	1,441	944	1,562
Asset-backed securities reclassified	<b>2,069</b>	<b>(147)</b>	<b>(500)</b>	2,716	3,891	5,280	5,892
Total gross loans and advances to customers (A)	<b>986,997</b>	<b>(46,271)</b>	<b>26,036</b>	1,007,232	979,084	916,521	917,930
Gross loans and advances to banks	<b>112,198</b>	<b>(4,925)</b>	<b>(2,981)</b>	120,104	117,142	139,203	142,027
<b>Total gross loans and advances</b>	<b>1,099,195</b>	<b>(51,196)</b>	<b>23,055</b>	1,127,336	1,096,226	1,055,724	1,059,957

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Impaired loans and advances to customers as a percentage of A	<b>29,283</b> <b>3.0%</b>	<b>(1,538)</b>	<b>(5,607)</b>	36,428 3.6%	38,671 3.9%	41,584 4.5%	46,871 4.8%
Impairment allowances on loans and advances to customers as a percentage of A	<b>12,337</b> <b>1.2%</b>	<b>(776)</b>	<b>(2,030)</b>	15,143 1.5%	16,112 1.6%	17,511 1.9%	20,083 2.2%
Loan impairment charge new allowances net of allowance releases recoveries	<b>4,055</b> <b>5,010</b> <b>(955)</b>	<b>(160)</b> <b>(158)</b> <b>(2)</b>	<b>(1,833)</b> <b>(2,176)</b> <b>343</b>	6,048 7,344 (1,296)	8,160 9,306 (1,146)	11,505 12,931 (1,426)	13,548 14,568 (1,020)

For footnotes, see page 202.

The personal lending currency effect on gross loans and advances of US\$19bn was made up as follows: Europe US\$13bn, Asia US\$2.6bn, Latin America US\$1.8bn, North America US\$1.8bn. The wholesale lending currency effect

on gross loans and advances of US\$32bn was made up as follows: Europe US\$21bn, Asia US\$4.8bn, Latin America US\$4.7bn, North America US\$1.5bn and Middle East and North Africa US\$0.3bn.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of reported and constant currency impaired loans, allowances and charges by geographical region**(Unaudited)*

	31 Dec 13 as reported US\$m	Currency translation adjustment <sup>21</sup> US\$m	31 Dec 13 at 31 Dec 14 exchange rates US\$m	Movement constant currency basis US\$m	31 Dec 14 as reported US\$m	Reported change <sup>22</sup> %	Constant currency change <sup>22</sup> %
<b>Impaired loans</b>							
Europe	13,228	(1,011)	12,217	(1,975)	<b>10,242</b>	<b>(23)</b>	<b>(16)</b>
Asia <sup>4</sup>	1,623	(54)	1,569	479	<b>2,048</b>	<b>26</b>	<b>31</b>
Middle East and North Africa	2,285	(8)	2,277	(296)	<b>1,981</b>	<b>(13)</b>	<b>(13)</b>
North America	15,123	(42)	15,081	(3,387)	<b>11,694</b>	<b>(23)</b>	<b>(22)</b>
Latin America	4,244	(425)	3,819	(454)	<b>3,365</b>	<b>(21)</b>	<b>(12)</b>
	<b>36,503</b>	<b>(1,540)</b>	<b>34,963</b>	<b>(5,633)</b>	<b>29,330</b>	<b>(20)</b>	<b>(16)</b>
<b>Impairment allowances</b>							
Europe	5,598	(420)	5,178	(723)	<b>4,455</b>	<b>(20)</b>	<b>(14)</b>
Asia <sup>4</sup>	1,214	(32)	1,182	174	<b>1,356</b>	<b>12</b>	<b>15</b>
Middle East and North Africa	1,583	(4)	1,579	(173)	<b>1,406</b>	<b>(11)</b>	<b>(11)</b>
North America	4,242	(28)	4,214	(1,574)	<b>2,640</b>	<b>(38)</b>	<b>(37)</b>
Latin America	2,564	(294)	2,270	259	<b>2,529</b>	<b>(1)</b>	<b>11</b>
	<b>15,201</b>	<b>(778)</b>	<b>14,423</b>	<b>(2,037)</b>	<b>12,386</b>	<b>(19)</b>	<b>(14)</b>
<b>Loan impairment charge</b>							

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Europe	1,732	62	1,794	(715)	<b>1,079</b>	<b>(38)</b>	<b>(40)</b>
Asia <sup>4</sup>	483	(17)	466	178	<b>644</b>	<b>33</b>	<b>38</b>
Middle East and North Africa	(44)		(44)	43	<b>(1)</b>	<b>98</b>	<b>98</b>
North America	1,235	(15)	1,220	(920)	<b>300</b>	<b>(76)</b>	<b>(75)</b>
Latin America	2,642	(190)	2,452	(419)	<b>2,033</b>	<b>(23)</b>	<b>(17)</b>
	6,048	(160)	5,888	(1,833)	<b>4,055</b>	<b>(33)</b>	<b>(31)</b>

For footnotes, see page 202.

*Reconciliation of reported and constant currency loan impairment charges to the income statement*

(Unaudited)

	31 Dec 13	Currency translation adjustment <sup>21</sup>	31 Dec 13 at 31 Dec 14 exchange rates	Movement constant currency basis	31 Dec 14 as reported US\$m	Reported change <sup>22</sup> %	Constant currency change <sup>22</sup> %
<b>Loan impairment charge</b>							
Europe new allowances	1,732	62	1,794	(715)	<b>1,079</b>	<b>(38)</b>	<b>(40)</b>
releases	3,082	99	3,181	(736)	<b>2,445</b>	<b>(21)</b>	<b>(23)</b>
recoveries	(713)	(11)	(724)	(338)	<b>(1,062)</b>	<b>(49)</b>	<b>(47)</b>
Asia <sup>4</sup> new allowances	(637)	(26)	(663)	359	<b>(304)</b>	<b>52</b>	<b>54</b>
releases	483	(17)	466	178	<b>644</b>	<b>33</b>	<b>38</b>
recoveries	953	(31)	922	193	<b>1,115</b>	<b>17</b>	<b>21</b>
Middle East and North Africa new allowances	(303)	8	(295)	(23)	<b>(318)</b>	<b>(5)</b>	<b>(8)</b>
releases	(167)	6	(161)	8	<b>(153)</b>	<b>8</b>	<b>5</b>
recoveries							
North America new allowances	(44)		(44)	43	<b>(1)</b>	<b>98</b>	<b>98</b>
releases	408	(1)	407	(52)	<b>355</b>	<b>(13)</b>	<b>(13)</b>
recoveries	(365)	2	(363)	49	<b>(314)</b>	<b>14</b>	<b>13</b>
Latin America new allowances	(87)	(1)	(88)	46	<b>(42)</b>	<b>52</b>	<b>52</b>
releases	1,235	(15)	1,220	(920)	<b>300</b>	<b>(76)</b>	<b>(75)</b>
recoveries	1,640	(17)	1,623	(715)	<b>908</b>	<b>(45)</b>	<b>(44)</b>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

releases	(282)	2	(280)	(213)	<b>(493)</b>	<b>(75)</b>	<b>(76)</b>
recoveries	(123)		(123)	8	<b>(115)</b>	<b>7</b>	<b>7</b>
Latin							
America	2,642	(190)	2,452	(419)	<b>2,033</b>	<b>(23)</b>	<b>(17)</b>
new							
allowances	3,262	(243)	3,019	(312)	<b>2,707</b>	<b>(17)</b>	<b>(10)</b>
releases	(338)	34	(304)	(29)	<b>(333)</b>	<b>1</b>	<b>(10)</b>
recoveries	(282)	19	(263)	(78)	<b>(341)</b>	<b>(21)</b>	<b>(30)</b>
Total	6,048	(160)	5,888	(1,833)	<b>4,055</b>	<b>(33)</b>	<b>(31)</b>
new							
allowances	9,345	(193)	9,152	(1,622)	<b>7,530</b>	<b>(19)</b>	<b>(18)</b>
releases	(2,001)	35	(1,966)	(554)	<b>(2,520)</b>	<b>(26)</b>	<b>(28)</b>
recoveries	(1,296)	(2)	(1,298)	343	<b>(955)</b>	<b>26</b>	<b>26</b>

*For footnotes, see page 202.*

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)*Loan impairment charges by industry sector over five years**(Unaudited)*

	<b>2014</b>	2013	2012	2011	2010
	<b>US\$m</b>	US\$m	US\$m	US\$m	US\$m
Loan impairment charge/(release)					
Personal	<b>1,803</b>	3,196	5,362	9,318	11,187
Corporate and commercial	<b>2,256</b>	2,974	2,802	2,114	2,198
Financial <sup>5</sup>	<b>(4)</b>	(122)	(4)	73	163
<b>Year ended 31 December</b>	<b>4,055</b>	6,048	8,160	11,505	13,548

*For footnotes, see page 202.**Charge for impairment losses as a percentage of average gross loans and advances to customers**(Unaudited)*

	<b>2014</b>	2013	2012	2011	2010
	<b>%</b>	%	%	%	%
New allowances net of allowance releases	<b>0.53</b>	0.81	1.00	1.34	1.65
Recoveries	<b>(0.10)</b>	(0.14)	(0.12)	(0.15)	(0.12)
<b>Total charge for impairment losses</b>	<b>0.43</b>	0.67	0.88	1.19	1.53
Amount written off net of recoveries	<b>0.58</b>	0.59	0.93	1.14	2.08

*Movement in impairment allowances over five years**(Unaudited)*

	<b>2014</b>	2013	2012	2011	2010
	<b>US\$m</b>	US\$m	US\$m	US\$m	US\$m
Impairment allowances at 1 January	<b>15,201</b>	16,169	17,636	20,241	25,649
Amounts written off	<b>(6,379)</b>	(6,655)	(9,812)	(12,480)	(19,300)
personal	<b>(3,733)</b>	(4,367)	(6,905)	(10,431)	(16,458)
corporate and commercial	<b>(2,425)</b>	(2,229)	(2,677)	(2,009)	(2,789)
financial	<b>(221)</b>	(59)	(230)	(40)	(53)

Recoveries of amounts written off in previous years	<b>955</b>	1,296	1,146	1,426	1,020
personal	<b>818</b>	1,097	966	1,175	846
corporate and commercial	<b>128</b>	198	172	242	156
financial	<b>9</b>	1	8	9	18
Loan impairment charge	<b>4,055</b>	6,048	8,160	11,505	13,548
Exchange and other movements <sup>13</sup>	<b>(1,446)</b>	(1,657)	(961)	(3,056)	(676)
<b>Impairment allowances at 31 December</b>	<b>12,386</b>	15,201	16,169	17,636	20,241
Impairment allowances individually assessed	<b>6,244</b>	7,130	6,629	6,662	6,615
collectively assessed	<b>6,142</b>	8,071	9,540	10,974	13,626
<b>Impairment allowances at 31 December</b>	<b>12,386</b>	15,201	16,169	17,636	20,241
Amount written off net of recoveries as a percentage of average gross loans and advances to customers	<b>0.6%</b>	0.6%	1.0%	1.2%	2.2%

*For footnotes, see page 202.*

## HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Gross loans and advances to customers by country**(Unaudited)*

	<b>First lien residential mortgages<sup>6</sup></b>	<b>Other personal<sup>7</sup></b>	<b>Property- related</b>	<b>Commercial, international trade and other</b>	<b>Total</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>
Europe	131,000	47,531	35,313	200,313	414,157
UK	123,239	21,023	25,927	156,577	326,766
France	2,914	12,820	7,341	21,834	44,909
Germany	6	212	304	7,275	7,797
Switzerland	298	8,149	225	614	9,286
Turkey	645	3,389	297	4,244	8,575
Other	3,898	1,938	1,219	9,769	16,824
Asia	93,147	36,368	70,057	164,739	364,311
Hong Kong	56,656	22,891	52,208	82,362	214,117
Australia	9,154	815	2,130	6,360	18,459
India	1,235	285	613	5,099	7,232
Indonesia	64	469	202	5,476	6,211
Mainland China	4,238	1,981	6,606	24,875	37,700
Malaysia	5,201	1,750	1,988	5,217	14,156
Singapore	9,521	5,878	4,210	11,951	31,560
Taiwan	3,920	626	118	7,057	11,721
Other	3,158	1,673	1,982	16,342	23,155
Middle East and North Africa (excluding Saudi Arabia)	2,647	3,924	2,246	21,633	30,450
Egypt	1	510	98	2,272	2,881
UAE	2,263	1,782	1,545	13,814	19,404
Other	383	1,632	603	5,547	8,165
North America	55,577	9,823	15,492	51,535	132,427
US	37,937	5,482	11,461	38,632	93,512
Canada	16,236	4,085	3,708	11,825	35,854
Other	1,404	256	323	1,078	3,061
Latin America	4,153	9,384	2,572	29,543	45,652

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Argentina	15	1,169	93	2,119	3,396
Brazil	2,067	5,531	1,077	16,814	25,489
Mexico	1,967	2,642	1,336	9,503	15,448
Other	104	42	66	1,107	1,319
<b>At 31 December 2014</b>					
	<b>286,524</b>	<b>107,030</b>	<b>125,680</b>	<b>467,763</b>	<b>986,997</b>
Europe	140,474	51,633	38,634	230,932	461,673
UK	132,174	22,913	28,127	185,534	368,748
France	2,661	13,840	8,442	23,962	48,905
Germany	7	218	127	6,361	6,713
Switzerland	364	8,616	269	320	9,569
Turkey	833	4,002	305	4,059	9,199
Other	4,435	2,044	1,364	10,696	18,539
Asia	92,047	32,482	61,707	151,875	338,111
Hong Kong	53,762	19,794	44,904	75,547	194,007
Australia	9,468	1,236	2,511	7,138	20,353
India	1,080	297	425	4,231	6,033
Indonesia	69	447	78	5,361	5,955
Mainland China	4,880	300	5,808	22,149	33,137
Malaysia	5,140	1,994	1,997	5,420	14,551
Singapore	10,283	5,754	3,953	12,188	32,178
Taiwan	3,797	660	158	5,198	9,813
Other	3,568	2,000	1,873	14,643	22,084
Middle East and North Africa (excluding Saudi Arabia)	2,451	4,033	1,972	20,320	28,776
Egypt	1	477	146	2,232	2,856
UAE	2,082	1,842	1,331	12,344	17,599
Other	368	1,714	495	5,744	8,321
North America	60,955	11,735	14,616	44,884	132,190
US	42,317	6,257	10,174	30,952	89,700
Canada	17,036	5,116	3,912	13,079	39,143
Other	1,602	362	530	853	3,347
Latin America	3,948	10,970	2,749	28,815	46,482
Argentina	20	1,425	62	2,103	3,610
Brazil	1,811	6,466	1,268	17,132	26,677
Mexico	2,117	3,079	1,398	8,994	15,588
Other			21	586	607
At 31 December 2013	299,875	110,853	119,678	476,826	1,007,232

For footnotes, see page 202.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

The above tables analyse loans and advances by industry sector and by the location of the principal operations of the lending subsidiary or, in the case of the operations of The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East and HSBC Bank USA, by the location of the lending branch.

**HSBC Holdings**

*(Audited)*

Risk in HSBC Holdings is overseen by the HSBC Holdings Asset and Liability Management Committee ( HALCO ). The major risks faced by HSBC Holdings are credit risk, liquidity risk and market risk (in the form of interest rate risk and foreign exchange risk), of which the most significant is credit risk.

Credit risk in HSBC Holdings primarily arises from transactions with Group subsidiaries and from guarantees issued in support of obligations assumed

by certain Group operations in the normal conduct of their business. It is reviewed and managed within regulatory and internal limits for exposures by our Global Risk function, which provides high-level centralised oversight and management of credit risks worldwide.

HSBC Holdings' maximum exposure to credit risk at 31 December 2014 is shown below. Its financial assets principally represent claims on Group subsidiaries in Europe and North America.

All the derivative transactions are with HSBC undertakings that are banking counterparties (2013: 100%) and for which HSBC Holdings has in place master netting arrangements. Since 2012, the credit risk exposure has been managed on a net basis and the remaining net exposure is specifically collateralised in the form of cash.

**HSBC Holdings' maximum exposure to credit risk**

*(Audited)*

	2014			2013		
	Maximum exposure US\$m	Offset US\$m	Exposure to credit risk (net) US\$m	Maximum exposure US\$m	Offset US\$m	Exposure to credit risk (net) US\$m
Cash at bank and in hand:						
balances with HSBC undertakings	249		249	407		407
Derivatives	2,771	(2,610)	161	2,789	(2,755)	34

Loans and advances to HSBC undertakings	43,910		43,910	53,344	53,344
Financial investments in HSBC undertakings	4,073		4,073	1,210	1,210
Financial guarantees and similar contracts	52,023		52,023	52,836	52,836
Loan and other credit-related commitments	16		16	1,245	1,245
<b>At 31 December</b>	<b>103,042</b>	<b>(2,610)</b>	<b>100,432</b>	111,831	(2,755) 109,076

The credit quality of loans and advances and financial investments, both of which consist of intra-Group lending, is assessed as strong or good, with 100% of the exposure being neither past due nor impaired (2013: 100%).

### Securitisation exposures and other structured products

(Audited)

This section contains information about our exposure to asset-backed securities (ABSs), some of which are held through consolidated structured entities and are summarised in the table below.

*A summary of the nature of HSBC's exposures is provided in the Appendix to Risk on page 214.*

#### Overall exposure of HSBC

(Audited)

	Carrying amount <sup>23</sup>	
	2014	2013
	US\$bn	US\$bn
Asset-backed securities	48.9	50.1
fair value through profit or loss	3.6	3.1
available for sale <sup>4</sup>	29.7	42.7
held to maturity <sup>4</sup>	13.4	1.1
loans and receivables	2.2	3.2
<b>At 31 December</b>	<b>48.9</b>	<b>50.2</b>

*For footnotes, see page 202.*

The following table summarises the carrying amount of our ABS exposure by categories of collateral and includes assets held in the GB&M legacy credit portfolio with a carrying value of US\$23bn (2013: US\$28bn).

At 31 December 2014, the available-for-sale reserve in respect of ABSs was a deficit of US\$777m (2013: deficit of US\$1,643m). For 2014, the impairment write-back in respect of ABSs was US\$276m (2013: write-back of US\$289m).

HSBC HOLDINGS PLC

161



**Table of Contents****Report of the Directors: Financial Review** (continued)*Carrying amount of HSBC's consolidated holdings of ABSs<sup>23</sup>**(Audited)*

	Trading US\$m	Available for sale US\$m	Designated at fair value Held to maturity US\$m	through profit or loss US\$m	Loans and receivables US\$m	Total US\$m	Of which held through consolidated SEs US\$m
Mortgage-related assets:							
Sub-prime residential	122	3,081			308	3,511	2,075
US Alt-A residential	96	3,022	11		110	3,239	2,411
US Government agency and sponsored enterprises:							
MBSs	82	10,401	13,436			23,919	
Other residential	928	1,220			330	2,478	652
Commercial property	654	3,627			516	4,797	2,854
Leveraged finance-related assets	172	3,660			218	4,050	2,526
Student loan-related assets	242	3,545			119	3,906	3,284
Other assets	1,264	1,114		19	646	3,043	758
<b>At 31 December 2014</b>	<b>3,560</b>	<b>29,670</b>	<b>13,447</b>	<b>19</b>	<b>2,247</b>	<b>48,943</b>	<b>14,560</b>
Mortgage-related assets:							
Sub-prime residential	178	2,977			403	3,558	2,782
US Alt-A residential	101	3,538	18		134	3,791	2,926
US Government agency and sponsored enterprises:							
MBSs	178	18,661	1,110			19,949	
Other residential	618	1,925			399	2,942	1,513
Commercial property	133	5,667		104	669	6,573	5,146
Leveraged finance-related assets	294	5,011			251	5,556	4,310
Student loan-related assets	196	3,705			121	4,022	3,495
Other assets	1,271	1,265		34	1,186	3,756	989
<b>At 31 December 2013</b>	<b>2,969</b>	<b>42,749</b>	<b>1,128</b>	<b>138</b>	<b>3,163</b>	<b>50,147</b>	<b>21,161</b>

*For footnote, see page 202.*

## **Representations and warranties related to mortgage sales and securitisation activities**

*(Unaudited)*

We have been involved in various activities related to the sale and securitisation of residential mortgages that are not recognised on our balance sheet. These activities include:

the purchase of US\$24bn of third-party originated mortgages by HSBC Bank USA and their securitisation by HSBC Securities (USA) Inc. ( HSI ) between 2005 and 2007;

HSI acting as underwriter for the third-party issuance of private label mortgage-backed securities ( MBS s) with an original issuance value of US\$37bn, most of which were sub-prime; and

the origination and sale by HSBC Bank USA of mortgage loans, primarily to government-sponsored entities. In selling and securitising mortgage loans, various representations and warranties may be made to purchasers of the mortgage loans and MBSs. When purchasing and securitising mortgages originated by third parties and underwriting third-party MBSs, the obligation to repurchase loans in the event of a breach of loan level representations and warranties resides predominantly with the organisation that originated the loan.

Participants in the US mortgage securitisation market that purchased and repackaged whole loans, such as

servicers, originators, underwriters, trustees or sponsors of securitisations, have been the subject of lawsuits and governmental and regulatory investigations and inquiries.

At 31 December 2014, a liability of US\$27m (2013: US\$99m) was recognised in respect of various representations and warranties regarding the origination and sale by HSBC Bank USA of mortgage loans, primarily to government sponsored entities. These relate to, among other things, the ownership of the loans, the validity of the liens, the loan selection and origination process and compliance with the origination criteria established by the agencies. In the event of a breach of its representations and warranties, HSBC Bank USA may be obliged to repurchase the loans with identified defects or to indemnify the buyers. The estimated liability was based on the level of outstanding repurchase demands, the level of outstanding requests for loan files and the expected future repurchase demands in respect of mortgages sold to date which were either two or more payments delinquent or might become delinquent at an estimated conversion rate. Repurchase demands of US\$3m were outstanding at 2014 (2013: US\$44m).

*For further information on legal proceedings and regulatory matters, see Note 40 on the Financial Statements.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

Upon receipt of a repurchase demand, we perform a detailed evaluation of the request. In many cases, we ultimately are not required to repurchase a loan as we are able to resolve the purported defect. From initial inquiry to ultimate resolution, a typical case takes roughly 12 months. Acceptance of a repurchase demand will involve either a) repurchase of the loan at the unpaid principal balance plus accrued interest or b) reimbursement for any realised loss on the sale of a property ( make-whole payment).

To date, repurchase demands we have received primarily relate to prime loans sourced during 2004 through 2008 from the legacy broker channel which we exited from in late 2008.

The outstanding repurchase demands and movement in repurchase liabilities are as follows:

*Outstanding repurchase demands received from GSEs and other third parties*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
GSEs	<b>2</b>	41
Others	<b>1</b>	3
<b>At 31 December</b>	<b>3</b>	44

*Movement in repurchase liability for loans sold to GSEs and other third parties*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
At 1 January	<b>99</b>	219
Increase/(decrease) in liability recorded through earnings	<b>(41)</b>	21
Realised losses	<b>(31)</b>	(141)
<b>At 31 December</b>	<b>27</b>	99

Because the level of mortgage loan repurchase losses are dependent upon economic factors, investor demand strategies and other external risk factors such as housing market trends that may change, the estimate of the liability for a mortgage loan repurchase requires significant judgement. Because these estimates are influenced by factors

outside our control, there is uncertainty inherent in them, making it reasonably possible that the estimates could change.

### Risk elements in the loan portfolio

*(Unaudited)*

The disclosure of credit risk elements in this section reflects US accounting practice and classifications. The purpose of the disclosure is to present within the US disclosure framework those elements of the loan portfolios with a greater risk of loss. The three main classifications of credit risk elements presented are:

impaired loans;

unimpaired loans contractually more than 90 days past due as to interest or principal; and

troubled debt restructurings not included in the above.

### Interest foregone on impaired and restructured loans

Interest income that would have been recognised under the original terms of impaired and restructured loans amounted to approximately US\$2.2bn in 2014 (2013: US\$2.5bn). The table below analyses this by geographic region.

	US\$m	US\$m
Europe	218	214
Asia	113	92
Middle East and North Africa	135	147
North America	1,350	1,667
Latin America	411	421
<b>Year ended 31 December</b>	<b>2,227</b>	<b>2,541</b>

### Interest recognised on impaired and restructured loans

Interest income from such loans of approximately US\$1.6bn was recorded in 2014 (2013: US\$1.7bn). The table below analyses this by geographical region.

	2014 US\$m	2013 US\$m
Europe	112	97
Asia	38	42
Middle East and North Africa	40	28
North America	995	1,087
Latin America	284	410
<b>Year ended 31 December</b>	<b>1,469</b>	<b>1,664</b>

## **Impaired loans**

In the following tables, we present information on our impaired loans and advances in accordance with the classification approach described on page 137 .

A loan is impaired, and an impairment allowance is recognised, when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated. In accordance with IFRSs, we recognise interest income on assets after they have been written down as a result of an impairment loss.

HSBC HOLDINGS PLC

162a

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

The balance of impaired loans at 31 December 2014 was US\$7.2bn lower than at 31 December 2013. This reduction occurred primarily in North America due to the continued run-off of the CML portfolio, partly offset by increases in individually assessed impaired balances in Asia.

#### **Unimpaired loans more than 90 days past due**

Examples of unimpaired loans more than 90 days past due include individually assessed mortgages that are in arrears more than 90 days where there are no other indicators of impairment, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

The amount of unimpaired loans more than 90 days past due at 31 December 2014 was US\$72m, US\$55m lower than at 31 December 2013.

#### **Troubled debt restructurings**

Under US GAAP, a troubled debt restructuring ( TDR ) is a loan the terms of which have been modified for economic or legal reasons related to the borrower's financial difficulties to grant a concession to the borrower that the lender would not otherwise consider. A modification which results in a delay in payment that is considered insignificant is not regarded as a concession for the purposes of this disclosure. The SEC requires separate disclosure of any loans which meet the definition of a TDR that are not included in the previous two loan categories. These are classified as TDRs in the table on page 162(a). Loans that have been identified as a TDR under the US guidance retain this designation until maturity or derecognition.

The balance of TDRs not included as impaired loans at 31 December 2014 was US\$253m lower than at 31 December 2013. The decrease was mainly in North America and reflects the continued run off and loan sales in the CML portfolio. This was partly offset by an increase in the Middle East and North Africa and Europe.

#### **Potential problem loans**

Potential problem loans are loans where information on possible credit problems among borrowers causes management to seriously doubt their ability to comply with the loan repayment terms. The following concentrations of credit risk have a higher risk of containing potential problem loans.

Total Personal lending on page 151 includes disclosure about certain homogeneous groups of loans, including interest-only mortgages and ARMs, which are collectively assessed for impairment. Collectively assessed loans and advances approach, as described on page 137, although typically not classified as impaired until more than 90 days past due, are assessed collectively for losses that have been incurred but have not yet been individually identified. This policy is further described on pages 212 and 351.

Renegotiated loans and forbearance on page 138 includes disclosure about the credit quality of loans whose contractual terms have been changed at some point in the life of the loan because of significant concerns about the borrower's ability to make contractual payments when due. Renegotiated loans are classified as impaired when:

there has been a change in contractual cash flow as a result of a concession which the lender would otherwise not consider; and

it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full.

This presentation applies unless the concession is insignificant and there are no other indicators of impairment. The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-repayment of future cash flows, and there are no other indicators of impairment. Refer to page 155 for further details on renegotiated loans within HSBC Finance.

Renegotiated loans that are not classified as impaired may have a higher risk of becoming delinquent in the future, and may therefore be potential problem loans. Further information regarding the credit quality classification of renegotiated loans can be found on page 209 .

Areas of special interest on page 126 includes information on Oil and Gas, Russia and Greece.

Refinancing risk in the commercial real estate sector is a separate area of focus and is covered on page 146.

HSBC HOLDINGS PLC

162b

**Table of Contents****Report of the Directors: Financial Review** (continued)*Analysis of risk elements in the loan portfolio by geographical region**(Unaudited)*

	<b>2014</b>	2013	2012	2011	2010
	<b>US\$m</b>	US\$m	US\$m	US\$m	US\$m
Impaired loans					
Europe	<b>10,242</b>	13,228	11,145	11,819	11,500
Asia	<b>2,048</b>	1,623	1,624	1,678	1,989
Middle East and North Africa	<b>1,981</b>	2,285	2,474	2,445	2,549
North America	<b>11,694</b>	15,123	20,345	22,758	27,902
Latin America	<b>3,365</b>	4,244	3,188	3,039	3,124
	<b>29,330</b>	36,503	38,776	41,739	47,064
Unimpaired loans contractually more than 90 days past due as to principal or interest					
Europe	<b>6</b>	25	33	41	65
Asia	<b>1</b>	33	14	24	47
Middle East and North Africa	<b>59</b>	56	108	214	263
North America	<b>3</b>	13	69	74	265
Latin America	<b>3</b>			10	3
	<b>72</b>	127	224	363	643
Troubled debt restructurings (not included in the classifications above)					
Europe	<b>1,652</b>	1,427	1,306	753	591
Asia	<b>267</b>	277	236	230	403
Middle East and North Africa	<b>778</b>	406	593	444	141
North America	<b>3,932</b>	4,643	3,813	2,300	1,970
Latin America	<b>353</b>	482	1,001	1,037	1,274
	<b>6,982</b>	7,235	6,949	4,764	4,379
Trading loans classified as in default					
North America	<b>4</b>	133	166	230	412
Risk elements on loans <sup>61</sup>					
Europe	<b>11,900</b>	14,680	12,484	12,613	12,157
Asia	<b>2,316</b>	1,933	1,874	1,932	2,439
Middle East and North Africa	<b>2,818</b>	2,747	3,175	3,103	2,953
North America	<b>15,633</b>	19,912	24,393	25,362	30,549
Latin America	<b>3,721</b>	4,726	4,189	4,086	4,401
	<b>36,388</b>	43,998	46,115	47,096	52,499



Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Assets held for resale <sup>62</sup>					
Europe	<b>29</b>	46	51	60	47
Asia	<b>14</b>	10	19	14	7
Middle East and North Africa					2
North America	<b>186</b>	370	319	359	1,084
Latin America	<b>16</b>	27	55	69	121
	<b>245</b>	453	444	502	1,261
Total risk elements					
Europe	<b>11,929</b>	14,726	12,535	12,673	12,204
Asia	<b>2,330</b>	1,943	1,893	1,946	2,446
Middle East and North Africa	<b>2,818</b>	2,747	3,175	3,103	2,955
North America	<b>15,819</b>	20,282	24,712	25,721	31,633
Latin America	<b>3,737</b>	4,753	4,244	4,155	4,522
<b>At 31 December</b>	<b>36,633</b>	44,451	46,559	47,598	53,760
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Loan impairment allowances as a percentage of risk elements on loans <sup>63</sup>	<b>34.0</b>	34.7	35.2	37.6	38.9

*For footnotes, see page 202.*

HSBC HOLDINGS PLC

162c

**Table of Contents****Report of the Directors: Financial Review** (continued)**Country distribution of outstandings and cross-border exposures***(Unaudited)*

We control the risk associated with cross-border lending through a centralised structure of internal country limits. Exposures to individual countries and cross-border exposure in the aggregate are kept under continual review.

The following table summarises the aggregate of our in-country foreign currency and cross-border outstandings by type of borrower to countries which individually

represent in excess of 0.75% of our total assets. The classification is based on the country of residence of the borrower but also recognises the transfer of country risk in respect of third-party guarantees, eligible collateral held and residence of the head office when the borrower is a branch. In accordance with the Bank of England Country Exposure Report (Form CE) guidelines, outstandings comprise loans and advances (excluding settlement accounts), amounts receivable under finance leases, acceptances, commercial bills, certificates of deposit (CDs) and debt and equity securities (net of short positions), and exclude accrued interest and intra-HSBC exposures.

*In-country foreign currency and cross-border amounts outstanding**(Unaudited)*

	<b>Government and official</b>		<b>Other</b>	<b>Total</b>
	<b>Banks</b>	<b>institutions</b>	<b>Other</b>	<b>Total</b>
	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>
<b>At 31 December 2014</b>				
US	6.8	30.3	32.4	69.5
Mainland China	26.5	5.7	28.5	60.7
UK	24.0	8.3	41.8	74.2
Germany	7.7	26.6	6.7	41.0
Hong Kong	8.1	0.4	29.0	37.5
Japan <sup>64</sup>	9.0	15.7	12.2	36.9
France	7.3	3.1	11.6	22.1
<b>At 31 December 2013</b>				
US	10.0	2.3	42.5	54.8

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

UK	5.9	34.3	24.5	64.7
Mainland China	28.8	6.9	19.3	55.0
Germany	10.0	12.9	31.9	54.8
France	12.8	21.1	5.6	39.5
Hong Kong	10.9	0.7	26.5	38.1
Japan <sup>64</sup>	7.2	14.8	7.0	29.0
Ireland <sup>64</sup>	6.2	8.7	11.2	26.1
At 31 December 2012				
UK	5.9	37.9	14.7	58.5
US	18.0	2.8	34.7	55.5
Mainland China	23.4	3.3	16.0	42.7
Japan	11.6	15.9	10.2	37.7
France	12.8	11.3	13.2	37.3
Hong Kong	8.3	1.0	21.3	30.6
Germany	6.7	16.8	1.6	25.1
Ireland	0.8	0.1	19.5	20.4

*For footnote, see page 202.*

HSBC HOLDINGS PLC

162d

**Table of Contents****Report of the Directors: Financial Review (continued)****Liquidity and funding**

	Page	App <sup>1</sup>	Tables	Page
<b><u>Liquidity and funding</u></b>	164	215		
<u>Primary sources of funding</u>		215		
<b><u>Liquidity and funding in 2014</u></b>	164			
<u>Customer deposit markets</u>	164			
<u>Wholesale senior funding markets</u>	164			
<b><u>Liquidity regulation</u></b>	164			
<b><u>Management of liquidity and funding risk</u></b>	165			
<u>Inherent liquidity risk categorisation</u>		215		
<u>Core deposits</u>		216		
<u>Advances to core funding ratio</u>	165	216	<i>Advances to core funding ratios</i>	165
<u>Stressed coverage ratios</u>	165		<i>Stressed one-month and three-month coverage ratios</i>	165
		216		
<u>Stressed scenario analysis</u>		216		
<u>Liquid assets of HSBC's principal operating entities</u>	166		<i>Liquid assets of HSBC's principal entities</i>	166
<u>Net contractual cash flows</u>	166	217	<i>Net cash inflows/(outflows) for inter-bank loans and intra-group deposits and reverse repo, repo and short positions</i>	167
		217		
<u>Wholesale debt monitoring</u>		218		
<u>Liquidity behaviouralisation</u>		218		
<u>Funds transfer pricing</u>		219		
<b><u>Contingent liquidity risk arising from committed lending facilities</u></b>	167		<i>The Group's contractual undrawn exposures monitored under the contingent liquidity risk limit structure</i>	167
<b><u>Sources of funding</u></b>	168			
<u>Repos and stock lending</u>		219	<i>Funding sources and uses</i>	168
<u>Cross-border intra-Group and cross-currency liquidity and funding risk</u>	169		<i>Advances to core funding ratios by material currency</i>	169
<u>Wholesale term debt maturity profile</u>	169		<i>Wholesale funding cash flows payable by HSBC under financial liabilities by remaining contractual maturities</i>	170

-	<b><u>Encumbered and unencumbered assets</u></b>	171		<i><u>Summary of assets available to support potential future funding and collateral needs (on and off-balance sheet)</u></i>	171
-			220		
-	<b><u>Collateral</u></b>	171			
-	<u>The effect of active collateral management</u>		220		
-	<u>Off-balance sheet collateral received and pledged for reverse repo, stock borrowing and derivative transactions</u>	171			
-	<u>Analysis of on-balance sheet encumbered and unencumbered assets</u>	171		<i><u>Analysis of on-balance sheet encumbered and unencumbered assets</u></i>	172
-	<u>Additional contractual obligations</u>	173			
-	<b><u>Contractual maturity of financial liabilities</u></b>	173		<i><u>Cash flows payable by HSBC under financial liabilities by remaining contractual maturities</u></i>	173
-	<b><u>Management of cross-currency liquidity and funding risk</u></b>		221		
-	<b><u>HSBC Holdings</u></b>	174		<i><u>Cash flows payable by HSBC Holdings under financial liabilities by remaining contractual maturities</u></i>	174
-			221		
-	1 <i>Appendix to Risk risk policies and practices.</i>				

HSBC HOLDINGS PLC

---

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Liquidity and funding**

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. The risk arises from mismatches in the timing of cash flows.

There were no material changes to our policies and practices for the management of liquidity and funding risks in 2014.

Following the change in balance sheet presentation explained on page 347, the advances to deposits ratio now excludes non-trading reverse repos and repos with customers. The change had no effect on the 31 December 2013 ratio as disclosed.

*A summary of our current policies and practices regarding liquidity and funding is provided in the Appendix to Risk on page 215.*

**Our liquidity and funding risk management framework**

The objective of our liquidity framework is to allow us to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations.

Our liquidity and funding risk management framework requires:

liquidity to be managed by operating entities on a stand-alone basis with no implicit reliance on the Group or central banks;

all operating entities to comply with their limits for the advances to core funding ratio; and

all operating entities to maintain a positive stressed cash flow position out to three months under prescribed Group stress scenarios.

## Liquidity and funding in 2014

*(Unaudited)*

The liquidity position of the Group strengthened in 2014, and we continued to enjoy strong inflows of customer deposits and maintained good access to wholesale markets. Customer accounts increased by 4% (US\$47bn) on a constant currency basis. On a reported basis, customer account balances decreased marginally by 1% (US\$11bn). Loans and advances to customers increased by 3% (US\$28bn) on a constant currency basis. On a reported basis, loans and advances to customers decreased by 2% (US\$17bn). These changes resulted in a small decrease in our advances to deposits ratio to 72% (2013:73%)

HSBC UK recorded a decrease in its advances to core funding ( ACF ) ratio to 97% at 31 December 2014 (2013: 100%), mainly because core deposits increased more than advances, and due to the disposal of legacy assets.

The Hongkong and Shanghai Banking Corporation recorded an increase in its ACF ratio to 75% at 31 December 2014 (2013: 72%), mainly because advances increased more than core deposits.

HSBC USA recorded an increase in its ACF ratio to 100% at 31 December 2014 (2013: 85%), mainly because of growth in customer advances.

*HSBC UK, The Hongkong and Shanghai Banking Corporation and HSBC USA are defined in footnotes 26 to 28 on page 202. The ACF ratio is discussed on page 216.*

## Customer deposit markets

*(On constant currency basis)*

### Retail Banking and Wealth Management

RBWM customer account balances increased by 4%, driven by our two home markets of the UK and Hong Kong and the majority of our priority growth markets.

### Commercial Banking

Customer accounts increased by 7% in 2014, driven by growth in Payments and Cash Management accounts in our two home markets.

### Global Banking and Markets

Customer accounts increased by 2% in 2014, mainly from a rise in Payments and Cash Management accounts.

### Global Private Banking

GPB customer account balances decreased by 10% compared with the end of 2013 following the continued repositioning of the GPB business and a client portfolio disposal.

## Wholesale senior funding markets

Conditions in the bank wholesale debt markets were generally positive in 2014, supporting increased primary market issuance volumes across the capital structure from banks when compared with 2013. Periods of volatility remained, however, particularly during the latter months of the year when concerns around the decline in the oil price and growth in Europe combined with a variety of other factors to leave the outlook uncertain, with market confidence affected as a result.

In 2014, we issued the equivalent of US\$20bn (2013: US\$16bn) of senior term debt securities in the public capital markets in a range of currencies and maturities from a number of Group entities.

### **Liquidity regulation**

*(Unaudited)*

The European adoption of the Basel Committee framework (legislative texts known as the Capital Requirements Regulation and Directive (CRR/CRD IV)) was published in June 2013, and required the reporting of the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) to European regulators from January 2014, which was subsequently delayed until 30 June 2014. A significant level of interpretation has been required to report and calculate the LCR as defined in the CRR text as certain areas were only addressed by the finalisation of the LCR delegated act in January 2015, which will not become a regulatory standard until 1 October 2015. The European calibration of NSFR is still pending following the Basel Committee's final recommendation in October 2014.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Management of liquidity and funding risk***(Audited)*

Our liquidity and funding risk management framework ( LFRF ) employs two key measures to define, monitor and control the liquidity and funding risk of each of our operating entities. The ACF ratio is used to monitor the structural long-term funding position, and the stressed coverage ratio, incorporating Group-defined stress scenarios, is used to monitor the resilience to severe liquidity stresses.

The three principal entities listed in the tables below represented 66% (2013: 66%) of the Group's customer accounts. Including the other principal entities, the percentage was 95% (2013: 94%).

**Advances to core funding ratio**

The table to the right shows the extent to which loans and advances to customers in our principal banking entities were financed by reliable and stable sources of funding.

ACF limits set for principal operating entities at 31 December 2014 ranged between 80% and 120%.

Core funding represents the core component of customer deposits and any term professional funding with a residual contractual maturity beyond one year. Capital is excluded from our definition of core funding.

**Stressed coverage ratios**

The ratios tabulated below express stressed cash inflows as a percentage of stressed cash outflows over both one-month and three-month time horizons. Operating entities are required to maintain a ratio of 100% or greater out to three months.

Inflows included in the numerator of the stressed coverage ratio are generated from liquid assets net of assumed haircuts, and cash inflows related to assets contractually maturing within the time period.

In general, customer advances are assumed to be renewed and as a result do not generate a cash inflow.

**Advances to core funding ratios<sup>25</sup>***(Audited)*

At 31 December	
<b>2014</b>	2013
%	%

<b>HSBC UK<sup>26</sup></b>			
Year-end		<b>97</b>	100
Maximum		<b>102</b>	107
Minimum		<b>97</b>	100
Average		<b>100</b>	104
<b>The Hongkong and Shanghai Banking Corporation<sup>27</sup></b>			
Year-end		<b>75</b>	72
Maximum		<b>75</b>	77
Minimum		<b>72</b>	70
Average		<b>74</b>	74
<b>HSBC USA<sup>28</sup></b>			
Year-end		<b>100</b>	85
Maximum		<b>100</b>	85
Minimum		<b>85</b>	78
Average		<b>95</b>	82
<b>Total of HSBC's other principal entities<sup>29</sup></b>			
Year-end		<b>92</b>	93
Maximum		<b>94</b>	93
Minimum		<b>92</b>	89
Average		<b>93</b>	91

For footnotes, see page 202.

The one-month stressed coverage ratio for HSBC UK increased as certain assets previously treated as realisable under stress between 1 and 3 months were reassessed as being either realisable within 1 month or beyond 3 months. The three-month stressed coverage ratio remained broadly unchanged.

The stressed coverage ratios for the other entities remained broadly unchanged.

*Stressed one-month and three-month coverage ratios<sup>25</sup>*

(Audited)

Stressed one-month coverage ratios at 31 December      Stressed three-month coverage ratios at 31 December

	Stressed one-month coverage ratios at 31 December		Stressed three-month coverage ratios at 31 December	
	2014 %	2013 %	2014 %	2013 %
<b>HSBC UK<sup>26</sup></b>				
Year-end	<b>117</b>	106	<b>109</b>	109
Maximum	<b>117</b>	114	<b>109</b>	109
Minimum	<b>102</b>	100	<b>103</b>	101
Average	<b>107</b>	106	<b>104</b>	103
<b>The Hongkong and Shanghai Banking Corporation<sup>27</sup></b>				
Year-end	<b>117</b>	119	<b>112</b>	114
Maximum	<b>119</b>	131	<b>114</b>	126
Minimum	<b>114</b>	113	<b>111</b>	109
Average	<b>116</b>	119	<b>112</b>	114
<b>HSBC USA<sup>28</sup></b>				

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Year-end	<b>111</b>	114	<b>104</b>	110
Maximum	<b>122</b>	126	<b>111</b>	119
Minimum	<b>108</b>	110	<b>104</b>	109
Average	<b>115</b>	115	<b>107</b>	112
Total of HSBC's other principal entities <sup>29</sup>				
Year-end	<b>121</b>	121	<b>108</b>	114
Maximum	<b>121</b>	128	<b>115</b>	119
Minimum	<b>114</b>	113	<b>108</b>	109
Average	<b>117</b>	120	<b>110</b>	113

*For footnotes, see page 202.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Liquid assets of HSBC's principal operating entities**

The table below shows the estimated liquidity value (before assumed haircuts) of assets categorised as liquid and used for the purposes of calculating the three-month stressed coverage ratios, as defined under the LFRF.

The level of liquid assets reported reflects the stock of unencumbered liquid assets at the reporting date, adjusted for the effect of reverse repo, repo and collateral swaps maturing within three months as the liquidity value of these transactions is reflected as a contractual cash flow reported in the net contractual cash flow table.

Like reverse repo transactions with residual contractual maturities within three months, unsecured interbank loans maturing within three months are not included in liquid assets, but are treated as contractual cash inflows.

Liquid assets are held and managed on a stand-alone operating entity basis. Most of the liquid assets shown are held directly by each operating entity's Balance Sheet Management function, primarily for the purpose of managing liquidity risk, in line with the LFRF.

Liquid assets also include any unencumbered liquid assets held outside Balance Sheet Management for any other purpose. The LFRF gives ultimate control of all unencumbered assets and sources of liquidity to Balance Sheet Management.

*For a summary of our liquid asset policy and definitions of the classifications shown in the table below, see the Appendix to Risk on page 217.*

**Liquid assets of HSBC's principal entities**

(Audited)

	Estimated liquidity value <sup>30</sup>	
	31 December 2014 US\$m	31 December 2013 US\$m
HSBC UK <sup>26</sup>		
Level 1	131,756	168,877
Level 2	4,688	1,076
Level 3	66,011	63,509
	<b>202,455</b>	233,462
The Hongkong and Shanghai Banking Corporation <sup>27</sup>		

Level 1	<b>109,683</b>	108,713
Level 2	<b>4,854</b>	5,191
Level 3	<b>7,043</b>	7,106
	<b>121,580</b>	121,010
<b>HSBC USA<sup>28</sup></b>		
Level 1	<b>51,969</b>	43,446
Level 2	<b>15,184</b>	12,709
Level 3	<b>197</b>	5,044
Other	<b>9,492</b>	8,000
	<b>76,842</b>	69,199
<b>Total of HSBC's other principal entities<sup>29</sup></b>		
Level 1	<b>141,659</b>	144,774
Level 2	<b>10,419</b>	12,419
Level 3	<b>13,038</b>	13,663
	<b>165,116</b>	170,856

*For footnotes, see page 202.*

All assets held within the liquid asset portfolio are unencumbered.

Liquid assets held by HSBC UK decreased as a result of switching from central bank reserves to short-term reverse repo placements. A corresponding improvement can be seen in HSBC UK's net repo cash flow shown in the net contractual cash flow table.

Liquid assets held by The Hongkong and Shanghai Banking Corporation remained broadly unchanged.

Liquid assets held by HSBC USA increased, mainly due to a reduction in short-term repos and the reclassification of some assets as liquid in line with the LFRF.

### **Net contractual cash flows**

The following table quantifies the contractual cash flows from interbank and intra-Group loans and deposits, and reverse repo, repo (including intra-Group transactions) and short positions for the principal entities shown. These contractual cash inflows and outflows are reflected gross in the numerator and denominator, respectively, of the one and three-month stressed coverage ratios and should be considered alongside the level of liquid assets.

Outflows included in the denominator of the stressed coverage ratios include the principal outflows associated with the contractual maturity of wholesale debt securities reported in the table headed "Wholesale funding cash flows payable by HSBC under financial liabilities by remaining contractual maturities" on page 170.

*For a summary of our policy and definitions of the classifications shown in the table below, see the Appendix to Risk on page 218.*



**Table of Contents****Report of the Directors: Financial Review** (continued)*Net cash inflows/(outflows) for interbank and intra-Group loans and deposits and reverse repo, repo and short positions**(Audited)*

	At 31 December 2014		At 31 December 2013	
	Cash flows within 1 month US\$m	Cash flows from 1 to 3 months US\$m	Cash flows within 1 month US\$m	Cash flows from 1 to 3 months US\$m
<b>Interbank and intra-Group loans and deposits</b>				
HSBC UK <sup>26</sup>	(14,110)	(2,846)	(19,033)	(5,272)
The Hongkong and Shanghai Banking Corporation <sup>27</sup>	(1,277)	6,862	2,314	7,487
HSBC USA <sup>28</sup>	(18,353)	1,648	(24,268)	729
Total of HSBC's other principal entities <sup>29</sup>	(1,322)	6,158	4,295	10,149
<b>Reverse repo, repo, stock borrowing, stock lending and outright short positions (including intra-Group)</b>				
HSBC UK <sup>26</sup>	(16,070)	11,551	(39,064)	149
The Hongkong and Shanghai Banking Corporation <sup>27</sup>	8,139	8,189	12,662	4,297
HSBC USA <sup>28</sup>	(4,928)		(11,001)	
Total of HSBC's other principal entities <sup>29</sup>	(22,110)	(11,120)	(40,223)	9,551

*For footnotes, see page 202.***Contingent liquidity risk arising from committed lending facilities***(Audited)*

The Group's operating entities provide commitments to various counterparties. In terms of liquidity risk, the most significant risk relates to committed lending facilities which, whilst undrawn, give rise to contingent liquidity risk as they could be drawn during a period of liquidity stress. Commitments are given to customers and committed lending facilities are provided to consolidated multi-seller conduits established to enable clients to access flexible market-based sources of finance (see page 443), consolidated securities investment conduits and third-party sponsored conduits.

The consolidated securities investment conduits include Solitaire Funding Limited ( Solitaire ) and Mazarin Funding Limited ( Mazarin ). They issue asset-backed commercial paper secured against the portfolio of securities held by them. At 31 December 2014, HSBC

UK had undrawn committed lending facilities to these conduits of US\$11bn (2013: US\$15bn), of which Solitaire

represented US\$9.5bn (2013: US\$11bn) and the remaining US\$1.6bn (2013: US\$4bn) pertained to Mazarin. Although HSBC UK provides a liquidity facility, Solitaire and Mazarin have no need to draw on it so long as HSBC purchases the commercial paper issued, which it intends to do for the foreseeable future. At 31 December 2014, the commercial paper issued by Solitaire and Mazarin was entirely held by HSBC UK. Since HSBC controls the size of the portfolio of securities held by these conduits, no contingent liquidity risk exposure arises as a result of these undrawn committed lending facilities.

The table below shows the level of undrawn commitments to customers outstanding for the five largest single facilities and the largest market sector, and the extent to which they are undrawn.

*The Group's contractual undrawn exposures at 31 December monitored under the contingent liquidity risk limit structure*

(Audited)

	HSBC UK <sup>26</sup>		HSBC USA <sup>28</sup>		HSBC Canada		The Hongkong and Shanghai Banking Corporation <sup>27</sup>	
	2014	2013	2014	2013	2014	2013	2014	2013
	US\$bn	US\$bn	US\$bn	US\$bn	US\$bn	US\$bn	US\$bn	US\$bn
<b>Commitments to conduits</b>								
Consolidated multi-seller conduits								
total lines	9.8	10.1	2.3	2.5	0.2	1.0		
largest individual lines	0.9	0.7	0.5	0.5	0.2	0.7		
Consolidated securities investment conduits								
total lines	11.1	14.8						
Third party conduits – total lines			0.1	0.7				
<b>Commitments to customers</b>								
five largest <sup>31</sup>	2.6	4.4	7.1	6.3	1.7	1.5	1.5	2.4
largest market sector <sup>32</sup>	16.6	9.5	10.0	8.2	3.5	3.4	3.2	2.7

For footnotes, see page 202.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Sources of funding***(Audited)*

Our primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. We issue wholesale securities (secured and unsecured) to supplement our customer deposits and change the currency mix, maturity profile or location of our liabilities.

The Funding sources and uses table below, which provides a consolidated view of how our balance sheet is funded, should be read in light of the LFRF, which requires operating entities to manage liquidity and funding risk on a stand-alone basis.

The table analyses our consolidated balance sheet according to the assets that primarily arise from

operating activities and the sources of funding primarily supporting these activities. The assets and liabilities that do not arise from operating activities are presented as a net balancing source or deployment of funds.

The level of customer accounts continued to exceed the level of loans and advances to customers. The positive funding gap was predominantly deployed in liquid assets – cash and balances with central banks and financial investments – as required by the LFRF.

Loans and other receivables due from banks continued to exceed deposits taken from banks. The Group remained a net unsecured lender to the banking sector.

*For a summary of sources and utilisation of repos and stock lending, see the Appendix to Risk on page 219.*

**Funding sources and uses**<sup>33</sup>*(Audited)*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>Sources</b>		
Customer accounts <sup>1</sup>	<b>1,350,642</b>	1,361,297
Deposits by banks <sup>1</sup>	<b>77,426</b>	86,507
Repurchase agreements – non-trading	<b>107,432</b>	164,220
Debt securities issued	<b>95,947</b>	104,080
Subordinated liabilities	<b>26,664</b>	28,976
Financial liabilities designated at fair value	<b>76,153</b>	89,084
Liabilities under insurance contracts	<b>73,861</b>	74,181
Trading liabilities	<b>190,572</b>	207,025

repos	3,798	17,421
stock lending	12,032	12,218
settlement accounts	17,454	17,428
other trading liabilities	157,288	159,958
Total equity	199,979	190,459
<b>At 31 December</b>	<b>2,198,676</b>	<b>2,305,829</b>

*For footnote, see page 202.*

	2014 US\$m	2013 US\$m
<b>Uses</b>		
Loans and advances to customers <sup>1</sup>	974,660	992,089
Loans and advances to banks <sup>1</sup>	112,149	120,046
Repurchase agreements non-trading	161,713	179,690
Trading assets	304,193	303,192
reverse repos	1,297	10,120
stock borrowing	7,969	10,318
settlement accounts	21,327	19,435
other trading assets	273,600	263,319
Financial investments	415,467	425,925
Cash and balances with central banks	129,957	166,599
Net deployment in other balance sheet assets and liabilities	100,537	118,288
<b>At 31 December</b>	<b>2,198,676</b>	<b>2,305,829</b>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Cross-border, intra-Group and cross-currency liquidity and funding risk***(Unaudited)*

The stand-alone operating entity approach to liquidity and funding mandated by the LFRF restricts the exposure of our operating entities to the risks that can arise from extensive reliance on cross-border funding. Operating entities manage their funding sources locally, focusing predominantly on the local customer deposit base. The RBWM, CMB and GPB customer relationships that give rise to core deposits within an operating entity generally reflect a local customer relationship with that operating entity. Access to public debt markets is co-ordinated globally by the Global Head of Balance Sheet Management and the Group Treasurer with Group ALCO monitoring all planned public debt issuance on a monthly basis. As a general principle, operating entities are only permitted to issue in their local currency and are encouraged to focus on local private placements. The public issuance of debt instruments in foreign currency is tightly controlled and generally restricted to HSBC Holdings and HSBC Bank.

A central principle of our stand-alone approach to LFRF is that operating entities place no future reliance on other Group entities. However, operating entities may, at their discretion, utilise their respective committed facilities from other Group entities if necessary. In addition, intra-Group large exposure limits are applied by national regulators to individual legal entities locally, which restricts the unsecured exposures of legal entities to the rest of the Group to a percentage of the lender's regulatory capital.

Our LFRF also considers the ability of each entity to continue to access foreign exchange markets under stress when a surplus in one currency is used to meet a deficit in another currency, for example, by using the foreign currency swap markets. Where appropriate, operating entities are required to monitor stressed coverage ratios and ACF ratios for non-local currencies and set limits for them. Foreign currency swap markets in currency pairs settled through the Continuous Link Settlement Bank are considered to be extremely deep and liquid and it is assumed that capacity to access these markets is not exposed to idiosyncratic risks. The table below shows the ACF ratios by material currencies for the year ended 31 December 2014.

***Advances to core funding ratios by material currency***<sup>25</sup>*(Unaudited)*

	<b>At 31 December 2014</b>
	%
HSBC UK <sup>26</sup>	
Local currency (sterling)	<b>98</b>
US dollars	<b>100</b>
Euros	<b>99</b>
Consolidated	<b>97</b>

The Hongkong and Shanghai Banking Corporation<sup>27</sup>

Local currency (Hong Kong dollars)

US dollars

Consolidated

HSBC USA<sup>28</sup>

Local currency (US dollars)

Consolidated

Total of HSBC's other principal entities<sup>29</sup>

Local currency

US dollars

Consolidated

*For footnotes, see page 202.*

	<b>81</b>
	<b>74</b>
	<b>75</b>
	<b>100</b>
	<b>100</b>
	<b>97</b>
	<b>101</b>
	<b>92</b>

For all HSBC's operating entities, the only significant foreign currencies that exceed 5% of Group balance sheet liabilities are the Hong Kong dollar, euro, sterling and US dollar.

### Wholesale term debt maturity profile

*(Unaudited)*

The maturity profile of our wholesale term debt obligations is set out in the table on page 170, Wholesale funding principal cash flows payable by HSBC under financial liabilities by remaining contractual maturities .

The balances in the table do not agree directly with those in the consolidated balance sheet as the table presents gross cash flows relating to principal payments and not the balance sheet carrying value, which includes debt securities and subordinated liabilities measured at fair value.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Wholesale funding cash flows payable by HSBC under financial liabilities by remaining contractual maturities**(Unaudited)*

	Due not more than 1 month US\$m	Due over 1 month but not more than 3 months US\$m	Due over 3 months but not more than 6 months US\$m	Due over 6 months but not more than 9 months US\$m	Due over 9 months but not more than 1 year US\$m	Due over 1 year but not more than 2 years US\$m	Due over 2 years but not more than 5 years US\$m	Due over 5 years US\$m	Total US\$m
Debt securities issued	17,336	17,161	19,030	9,352	9,055	27,312	40,855	31,928	172,029
unsecured CDs and CP	5,637	9,337	9,237	4,793	3,010	3,506	4,158	185	39,863
unsecured senior MTNs	1,300	5,679	7,684	2,922	4,794	17,676	23,523	20,715	84,293
unsecured senior structured notes	1,363	1,082	2,049	1,149	979	4,757	8,444	6,789	26,612
secured covered bonds				205			2,765	2,942	5,912
secured ABCP	8,602								8,602
secured ABS	212	1,063	60	283	272	915	1,562		4,367
others	222					458	403	1,297	2,380
Subordinated liabilities		150		3	185	113	5,556	40,487	46,494
subordinated debt securities		150		3	185	113	5,556	34,750	40,757
preferred securities							5,737	5,737	
<b>At 31 December 2014</b>	<b>17,336</b>	<b>17,311</b>	<b>19,030</b>	<b>9,355</b>	<b>9,240</b>	<b>27,425</b>	<b>46,411</b>	<b>72,415</b>	<b>218,523</b>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Debt securities issued	25,426	9,752	17,942	11,659	10,587	31,839	46,934	31,066	185,205
unsecured CDs and CP	7,589	7,206	9,867	3,239	5,043	4,449	2,749		40,142
unsecured senior MTNs	6,284	71	5,448	4,221	3,062	21,428	33,091	21,433	95,038
unsecured senior structured notes	987	1,423	1,952	1,689	1,718	3,712	6,036	5,021	22,538
secured covered bonds				1,250		225	2,747	3,317	7,539
secured ABCP	10,383								10,383
secured ABS	74	1,052	675	1,260	764	1,861	2,311		7,997
others	109					164		1,295	1,568
Subordinated liabilities		28	1,171	144	6	1,460	3,374	41,801	47,984
subordinated debt securities		28	1,171	144	6	460	3,374	34,899	40,082
preferred securities						1,000		6,902	7,902
At 31 December 2013	25,426	9,780	19,113	11,803	10,593	33,299	50,308	72,867	233,189

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Encumbered and unencumbered assets***(Unaudited)*

The table on page 172, Analysis of on-balance sheet encumbered and unencumbered assets, summarises the total on and off-balance sheet assets that are capable of supporting future funding and collateral needs and shows the extent to which these assets are currently pledged for this purpose. The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the Group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. An asset is therefore categorised as unencumbered if it has not been pledged against an existing liability. Unencumbered assets are further analysed into four separate sub-categories; readily realisable assets, other realisable assets, reverse repo/stock borrowing receivables and derivative assets and cannot be pledged as collateral.

At 31 December 2014, the Group held US\$1,770bn of unencumbered assets that could be used to support potential future funding and collateral needs, representing 85% of the total assets that can support funding and collateral needs (on and off-balance sheet). Of this amount, US\$765bn (US\$684bn on-balance sheet) were assessed to be readily realisable.

**Summary of assets available to support potential future funding and collateral needs (on and off-balance sheet)***(Unaudited)*

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
Total on-balance sheet assets	<b>2,634</b>	2,671
Less:		
Reverse repo/stock borrowing receivables and derivative assets	<b>(518)</b>	(482)
Other assets that cannot be pledged as collateral	<b>(281)</b>	(255)
Total on-balance sheet assets that can support funding and collateral needs	<b>1,835</b>	1,934
Add off-balance sheet assets:		
Fair value of collateral received from reverse repo/stock borrowing/derivatives that is available to sell or repledge	<b>257</b>	265

Total assets that can support funding and collateral needs (on and off-balance sheet)	<b>2,092</b>	2,199
Less:		
On-balance sheet assets pledged	<b>(146)</b>	(187)
Off-balance sheet collateral received from reverse repo/stock borrowing/derivatives which has been repledged or sold	<b>(176)</b>	(187)
<b>Assets available to support future funding and collateral needs at 31 December</b>	<b>1,770</b>	1,825

*For a summary of our policy on collateral management and definition of encumbrance, see the Appendix to Risk on page 213.*

## **Collateral**

*(Unaudited)*

### **Off-balance sheet collateral received and pledged for reverse repo, stock borrowing and derivative transactions**

The fair value of assets accepted as collateral that we are permitted to sell or repledge in the absence of default was US\$257bn at 31 December 2014 (2013: US\$265bn). The fair value of any such collateral sold or repledged was US\$176bn (2013: US\$187bn). We are obliged to return equivalent securities. These transactions are conducted under terms that are usual and customary to standard reverse repo, stock borrowing and derivative transactions.

The fair value of collateral received and repledged in relation to reverse repos, stock borrowing and

derivatives is reported on a gross basis. The related balance sheet receivables and payables are reported on a net basis where required under IFRSs offset criteria.

As a consequence of reverse repo, stock borrowing and derivative transactions where the collateral received could be but had not been sold or repledged, we held US\$81bn (2013: US\$78bn) of unencumbered collateral available to support potential future funding and collateral needs at 31 December 2014.

### **Analysis of on-balance sheet encumbered and unencumbered assets**

The table below presents an analysis of on-balance sheet holdings only, and shows the amounts of balance sheet assets on a liquidity and funding basis that are encumbered. The table therefore excludes any available off-balance sheet holdings received in respect of reverse repos, stock borrowing or derivatives.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)*Analysis of on-balance sheet encumbered and unencumbered assets**(Unaudited)*

	Encumbered		Unencumbered			Total
	Assets pledged as collateral US\$m	Readily realisable assets US\$m	Other realisable assets US\$m	Reverse repos/stock borrowing receivables and derivative assets US\$m	Cannot be pledged as collateral US\$m	US\$m
Cash and balances at central banks		123,990	425		5,542	129,957
Items in the course of collection from other banks					4,927	4,927
Hong Kong Government certificates of indebtedness					27,674	27,674
Trading assets	59,162	182,305	17,869	9,266	35,591	304,193
Treasury and other eligible bills	1,994	14,122	4		50	16,170
debt securities	46,311	94,941	23		257	141,532
equity securities	10,857	62,855	1,497		40	75,249
loans and advances to banks		2,530	4,818	2,781	17,452	27,581
loans and advances to customers		7,857	11,527	6,485	17,792	43,661
Financial assets designated at fair value		177	2,330		26,530	29,037
Treasury and other eligible bills			52		4	56
debt securities		177	1,058		7,656	8,891
equity securities			1,139		18,867	20,006
loans and advances to banks and customers			81		3	84
Derivatives				345,008		345,008
Loans and advances to banks	178	3,573	74,231	762	33,405	112,149
Loans and advances to customers	24,329	92,238	840,241	1,170	16,682	974,660
Reverse repurchase agreements non-trading				161,713		161,713
Financial investments	61,785	275,732	22,780		55,170	415,467
Treasury and other eligible bills	3,176	75,896	2,167		278	81,517
debt securities	58,609	192,411	18,266		53,970	323,256
equity securities		7,425	2,347		922	10,694
	294	6,334	29,780		38,768	75,176

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Prepayments, accrued income and other assets						
Current tax assets					1,309	1,309
Interest in associates and joint ventures		22	17,875		284	18,181
Goodwill and intangible assets					27,577	27,577
Deferred tax					7,111	7,111
<b>At 31 December 2014</b>	<b>145,748</b>	<b>684,371</b>	<b>1,005,531</b>	<b>517,919</b>	<b>280,570</b>	<b>2,634,139</b>
Cash and balances at central banks		161,240	269		5,090	166,599
Items in the course of collection from other banks					6,021	6,021
Hong Kong Government certificates of indebtedness					25,220	25,220
Trading assets	99,326	142,211	14,654	20,438	26,563	303,192
Treasury and other eligible bills	3,402	17,976	206			21,584
debt securities	83,563	57,850			231	141,644
equity securities	8,373	55,156	363			63,892
loans and advances to banks	1,796	2,813	6,151	5,263	11,861	27,884
loans and advances to customers	2,192	8,416	7,934	15,175	14,471	48,188
Financial assets designated at fair value	19	2,706	1,883		33,822	38,430
Treasury and other eligible bills					50	50
debt securities	19	826	776		10,968	12,589
equity securities		1,874	1,103		22,734	25,711
loans and advances to banks and customers		6	4		70	80
Derivatives				282,265		282,265
Loans and advances to banks	162	8,342	80,231		31,311	120,046
Loans and advances to customers	32,218	102,203	854,724	65	2,879	992,089
Reverse repurchase agreements non-trading				179,690		179,690
Financial investments	54,473	289,093	31,096		51,263	425,925
Treasury and other eligible bills	2,985	72,849	2,052		226	78,112
debt securities	51,488	210,516	25,720		50,949	338,673
equity securities		5,728	3,324		88	9,140
Prepayments, accrued income and other assets	1,028	16,788	24,619		34,407	76,842
Current tax assets					985	985
Interest in associates and joint ventures		12	16,356		272	16,640
Goodwill and intangible assets					29,918	29,918
Deferred tax					7,456	7,456
<b>At 31 December 2013</b>	<b>187,226</b>	<b>722,595</b>	<b>1,023,832</b>	<b>482,458</b>	<b>255,207</b>	<b>2,671,318</b>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

The US\$24bn (2013: US\$32bn) of loans and advances to customers reported in the table above as encumbered have been pledged predominantly to support the issuance of secured debt instruments such as covered bonds and ABSs, including asset-backed commercial paper issued by consolidated multi-seller conduits. It also includes those pledged in relation to any other form of secured borrowing.

In total, the Group pledged US\$121bn (2013: US\$150bn) of negotiable securities, predominantly as a result of market-making in securities financing to our clients.

**Additional contractual obligations**

Under the terms of our current collateral obligations under derivative contracts (which are ISDA compliant CSA contracts and contracts entered for pension obligations, and exclude the contracts entered for special purpose vehicles and additional termination events) and based on the positions at 31 December 2014, we estimate that we could be required to post additional collateral of up to US\$0.5bn (2013: US\$0.7bn) in the event of a one-notch downgrade in credit ratings, which would increase to US\$1.2bn (2013: US\$1.2bn) in the event of a two-notch downgrade.

**Contractual maturity of financial liabilities**

*(Audited)*

The balances in the table below do not agree directly with those in our consolidated balance sheet as the table incorporates, on an undiscounted basis, all cash flows relating to principal and future coupon payments (except for trading liabilities and derivatives not treated as hedging derivatives). Undiscounted cash flows payable in relation to hedging derivative liabilities are classified according to their contractual maturities. Trading liabilities and derivatives not treated as hedging derivatives are included in the On demand time bucket and not by contractual maturity.

*A maturity analysis of repos and debt securities in issue included in trading liabilities is presented in Note 31 on the Financial Statements.*

In addition, loans and other credit-related commitments and financial guarantees and similar contracts are generally not recognised on our balance sheet. The undiscounted cash flows potentially payable under financial guarantees and similar contracts are classified on the basis of the earliest date they can be called.

***Cash flows payable by HSBC under financial liabilities by remaining contractual maturities***

*(Audited)*

On	Due within	Due between 3	Due between	Due after
----	------------	---------------	-------------	-----------

	demand US\$m	3 months US\$m	and 12 months US\$m	1 and 5 years US\$m	5 years US\$m
Deposits by banks	52,682	17,337	3,600	3,580	390
Customer accounts	1,088,769	187,207	61,687	15,826	390
Repurchase agreements non-trading	8,727	91,542	6,180	23	1,057
Trading liabilities	190,572				
Financial liabilities designated at fair value	365	2,201	9,192	28,260	39,397
Derivatives	335,168	375	1,257	4,231	1,517
Debt securities in issue	9	32,513	30,194	37,842	7,710
Subordinated liabilities		737	1,256	10,003	42,328
Other financial liabilities	41,517	23,228	4,740	1,893	988
	<b>1,717,809</b>	<b>355,140</b>	<b>118,106</b>	<b>101,658</b>	<b>93,777</b>
Loan and other credit-related commitments	406,561	101,156	64,582	62,312	16,769
Financial guarantees and similar contracts	13,166	6,306	13,753	9,575	4,278
<b>At 31 December 2014</b>	<b>2,137,536</b>	<b>462,602</b>	<b>196,441</b>	<b>173,545</b>	<b>114,824</b>
Deposits by banks	56,198	22,965	3,734	2,819	686
Customer accounts	1,097,159	196,048	57,243	15,520	726
Repurchase agreements non-trading	37,117	112,621	14,177		
Trading liabilities	207,025				
Financial liabilities designated at fair value	18,689	1,967	3,223	39,554	64,144
Derivatives	269,554	456	1,684	6,099	1,638
Debt securities in issue	2,528	35,401	33,695	46,141	6,526
Subordinated liabilities	55	391	2,687	11,871	44,969
Other financial liabilities	31,996	30,706	6,564	2,376	1,300
	1,720,321	400,555	123,007	124,380	119,989
Loan and other credit-related commitments	377,352	79,599	55,124	59,747	16,872
Financial guarantees and similar contracts	18,039	4,796	12,040	7,479	3,988
At 31 December 2013	2,115,712	484,950	190,171	191,606	140,849

## HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**HSBC Holdings***(Audited)*

Liquidity risk in HSBC Holdings is overseen by HALCO. Liquidity risk arises because of HSBC Holdings' obligation to make payments to debt holders as they fall due. The liquidity risk related to these cash flows is managed by matching debt obligations with internal loan cash flows and by maintaining an appropriate liquidity buffer that is monitored by HALCO.

At 31 December 2014, the Group had US\$9.2bn of CRD IV compliant non-common equity capital instruments, of which US\$3.5bn were classified as tier 2 and US\$5.7bn were classified as additional tier 1 (for details on the additional tier 1 instruments issued during the year see Note 35 on the Financial Statements). The balances in the table below do not agree directly

with those on the balance sheet of HSBC Holdings as the table incorporates, on an undiscounted basis, all cash flows relating to principal and future coupon payments (except for derivatives not treated as hedging derivatives). Undiscounted cash flows payable in relation to hedging derivative liabilities are classified according to their contractual maturities. Derivatives not treated as hedging derivatives are included in the 'On demand' time bucket.

In addition, loan commitments and financial guarantees and similar contracts are generally not recognised on our balance sheet. The undiscounted cash flows potentially payable under financial guarantees and similar contracts are classified on the basis of the earliest date on which they can be called.

*Cash flows payable by HSBC Holdings under financial liabilities by remaining contractual maturities**(Audited)*

	Due between				
	On demand	Due within 3 months	3 and 12 months	Due between 1 and 5 years	Due after 5 years
	US\$m	US\$m	US\$m	US\$m	US\$m
Amounts owed to HSBC undertakings	1,441	985	42	449	
Financial liabilities designated at fair value		210	642	6,345	19,005

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Derivatives	<b>1,066</b>			<b>103</b>	
Debt securities in issue		<b>16</b>	<b>50</b>	<b>263</b>	<b>1,303</b>
Subordinated liabilities		<b>252</b>	<b>770</b>	<b>5,815</b>	<b>28,961</b>
Other financial liabilities		<b>1,132</b>	<b>158</b>		
	<b>2,507</b>	<b>2,595</b>	<b>1,662</b>	<b>12,975</b>	<b>49,269</b>
Loan commitments	<b>16</b>				
Financial guarantees and similar contracts	<b>52,023</b>				
<b>At 31 December 2014</b>	<b>54,546</b>	<b>2,595</b>	<b>1,662</b>	<b>12,975</b>	<b>49,269</b>
Amounts owed to HSBC undertakings	2,053	1,759	2,315	857	5,654
Financial liabilities designated at fair value		299	671	4,921	26,518
Derivatives	704				
Debt securities in issue		37	1,780	279	1,451
Subordinated liabilities		225	676	5,699	24,812
Other financial liabilities		885	284		
	2,757	3,205	5,726	11,756	58,435
Loan commitments	1,245				
Financial guarantees and similar contracts	52,836				
At 31 December 2013	56,838	3,205	5,726	11,756	58,435

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review (continued)****Market risk**

	Page	App <sup>1</sup>	Tables	Page
<b><u>Market risk in 2014</u></b>	176			
<u>Exposure to market risk</u>	176	221		
<u>Overview of market risk in global businesses</u>		221	<i>Types of risk by global business</i>	176
<u>Market risk governance</u>		222		
<b><u>Market risk measures</u></b>		223		
<u>Monitoring and limiting market risk exposures</u>	176	223		
<u>Sensitivity analysis</u>	176	223		
<u>Value at risk</u>	176	223		
<u>Stress testing</u>	176	224	<u>Market risk stress testing</u>	176
<b><u>Trading portfolios</u></b>	176	225		
<u>Value at risk of the trading portfolios</u>	176		<i>Daily VaR (trading portfolios)</i>	176
			<i>Trading VaR</i>	177
<u>Back-testing</u>			<i>Back-testing of trading VaR against hypothetical profit and loss for the Group</i>	177
	177	224		
<u>Gap risk</u>		225		
<u>De-peg risk</u>		225		
<u>ABS/MBS exposures</u>		225		
<b><u>Non-trading portfolios</u></b>	178	225		
<u>Value at risk of the non-trading portfolios</u>	178		<i>Daily VaR (non-trading portfolios)</i>	178
			<i>Non-trading VaR</i>	178
<u>Credit spread risk for available-for-sale debt securities (including SICs)</u>	178	226		
<u>Equity securities classified as available for</u>	179	226	<i>Fair value of equity securities</i>	179

sale

—	<b><u>Market risk balance sheet linkages</u></b>		<i>Balances included and not included in trading VaR</i>	
—		179		179
—			<i>Market risk linkages to the accounting balance sheet</i>	180
—	<b><u>Structural foreign exchange exposures</u></b>	181	226	
—	<b><u>Non-trading interest rate risk</u></b>	181	226	
—	<u>Interest rate risk behaviouralisation</u>	181	226	
—	<u>Balance Sheet Management</u>		227	
—	<u>Third-party assets in Balance Sheet Management</u>	181		<i>Third-party assets in Balance Sheet Management</i> 181
—	<b><u>Sensitivity of net interest income</u></b>			
—		181	227	<i>Sensitivity of projected net interest income</i> 182
—				<i>Sensitivity of reported reserves to interest rate movements</i> 183
—	<b><u>Defined benefit pension schemes</u></b>	183	228	<i>HSBC's defined benefit pension schemes</i> 183
—	<b><u>Additional market risk measures applicable only to the parent company</u></b>			
—	<u>Foreign exchange risk</u>	183	228	<i>HSBC Holdings' foreign exchange VaR</i> 183
—	<u>Sensitivity of net interest income</u>			<i>Sensitivity of HSBC Holdings net interest income to interest rate movements</i> 184
—	<u>Interest rate repricing gap table</u>	184		<i>Repricing gap analysis of HSBC Holdings</i> 185
—	1 Appendix to Risk risk policies and practices.	185		

HSBC HOLDINGS PLC



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

There were no material changes to our policies and practices for the management of market risk in 2014.

**Exposure to market risk**

Exposure to market risk is separated into two portfolios:

*Trading portfolios* comprise positions arising from market-making and warehousing of customer-derived positions. The interest rate risk on fixed-rate securities issued by HSBC Holdings is not included in Group VaR. The management of this risk is described on page 222.

*Non-trading portfolios* comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from our insurance operations (see page 225).

**Monitoring and limiting market risk exposures**

Our objective is to manage and control market risk exposures while maintaining a market profile consistent with our risk appetite.

We use a range of tools to monitor and limit market risk exposures, including:

*Sensitivity analysis* includes the sensitivity of net interest income and the sensitivity of structural foreign exchange, which are used to monitor the market risk positions within each risk type;

*Value at risk* ( VaR ) is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence; and

In recognition of VaR's limitations we augment VaR with *stress testing* to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables. Examples of scenarios reflecting current market concerns are the slowdown in mainland China and the potential effects of a sovereign debt default, including its wider contagion effects.

*A summary of our market risk management framework including current policies is provided in the Appendix to Risk on page 221.*

## **Market risk in 2014**

*(Unaudited)*

Global financial markets were characterised by low inflation and weak global growth, leading monetary authorities to maintain accommodative policies, using measures such as low interest rates and asset purchases.

With US data showing GDP growth, the US Federal Reserve's asset purchase programme came to an end. Despite this, US dollar bond yields fell further. Market focus switched to actions that the ECB can take to address the issues of low growth and deflation. A sustained period of deflation would have a severe detrimental impact on countries already in recession and with high debt to GDP ratios. 2014 can be characterised as a period of benign rates and equity markets in the G7 group of countries.

Against this backdrop, we maintained an overall defensive risk profile in our trading businesses. Defensive positions are characterised by low net open positions or the purchase of volatility protection via options trades. The lower trading VaR from defensive positioning was offset by an increase caused by lower diversification and regulatory changes to the calibrations used in calculating VaR. Non-trading VaR declined during the year as low interest rates, especially in US dollars, caused the duration of non-trading assets to decrease.

## **Trading portfolios**

*(Audited)*

### **Value at risk of the trading portfolios**

Trading VaR predominantly resides within Global Markets. This was higher at 31 December 2014 than at 31 December 2013 due to an increase in interest rate trading VaR, the removal of diversification effects within risk not in VaR ( RNIV ) and lower portfolio diversification benefit across asset classes.

The daily levels of total trading VaR over the last year are set out in the graph below.

HSBC HOLDINGS PLC

176

**Table of Contents****Report of the Directors: Financial Review** (continued)*Daily VaR (trading portfolios), 99% 1 day (US\$m)**(Unaudited)*

The Group trading VaR for the year is shown in the table below.

*Trading VaR, 99% 1 day*<sup>34</sup>*(Audited)*

	Foreign exchange and commodity US\$m	Interest rate US\$m	Equity US\$m	Credit spread US\$m	Portfolio diversification incl RNIV <sup>35</sup> US\$m	Total <sup>36</sup> US\$m
<b>At 31 December 2014</b>	<b>9.8</b>	<b>45.4</b>	<b>7.3</b>	<b>12.5</b>	<b>(14.3)</b>	<b>60.7</b>
Average	16.9	39.5	6.9	13.7	(17.8)	59.2
Maximum	34.2	50.6	15.6	20.9		77.8
At 31 December 2013	16.0	33.4	9.2	14.2	(20.7)	52.1
Average	15.2	33.4	5.1	16.5	(20.3)	49.9
Maximum	26.4	71.9	14.1	25.5		81.3

*For footnotes, see page 202.*

**Back-testing***(Unaudited)*

In 2014, the Group experienced one loss exception and two profit exceptions.

The loss exception was due primarily to losses from increased volatility in foreign exchange currencies and interest rates in some developed markets combined with flattening yield curves.

The profit exceptions were driven by the tightening of spreads, and exposures to emerging market foreign exchange and interest rates. There is no evidence of model errors or control failures.

The graph below shows the daily trading VaR against hypothetical profit and loss for the Group during 2014. It excludes exceptions that were exempted by the PRA for regulatory capital purposes.

*Back-testing of trading VaR against hypothetical profit and loss for the Group (US\$m)*

*(Unaudited)*

HSBC HOLDINGS PLC

177

**Table of Contents****Report of the Directors: Financial Review** (continued)**Non-trading portfolios***(Audited)***Value at risk of the non-trading portfolios**

Non-trading VaR of the Group includes contributions from all global businesses. There is no commodity risk in the non-trading portfolios. The decrease of non-trading VaR during 2014 was due primarily to the shortening of the duration in the non-trading book from lower interest rates, especially in US dollars. The credit spread risks component also added to a lower non-trading VaR as a result of the reduction in the overall position combined

with lower volatilities and credit spread baselines utilised in the VaR calculations. This movement included the reduction in credit spread risks relating to the Group's holdings of available-for-sale debt securities (excluding those held in insurance operations which are discussed further on page 194.

In the year, the decline in non-trading interest rate and credit spread VaR components was offset by a decrease in diversification benefit.

The daily levels of total non-trading VaR over the last year are set out in the graph below.

**Daily VaR (non-trading portfolios), 99% 1 day (US\$m)***(Unaudited)*

The Group non-trading VaR for the year is shown in the table below.

**Non-trading VaR, 99% 1 day***(Audited)*

	<b>Interest</b>	<b>Credit</b>	<b>Portfolio</b>	
	<b>rate</b>	<b>spread</b>	<b>diversification</b>	<b>Total</b>
	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>
<b>At 31 December 2014</b>	<b>88.2</b>	<b>62.5</b>	<b>(28.5)</b>	<b>122.2</b>

Average	<b>103.3</b>	<b>73.3</b>	<b>(37.4)</b>	<b>139.2</b>
Maximum	<b>147.7</b>	<b>91.9</b>		<b>189.0</b>
At 31 December 2013	150.6	80.4	(76.4)	154.6
Average	145.7	106.6	(82.1)	170.2
Maximum	221.7	135.7		252.3

The management of interest rate risk in the banking book is described further in Non-trading interest rate risk below, including the role of Balance Sheet Management ( BSM ).

Non-trading VaR excludes equity risk on available-for-sale securities, structural foreign exchange risk and interest rate risk on fixed rate securities issued by HSBC Holdings, the management of which is described in the relevant sections below. These sections together describe the scope of HSBC's management of market risks in non-trading books.

#### Credit spread risk for available-for-sale debt securities (including SICs)

The effect of movements in VaR credit spreads on our available-for-sale debt securities was US\$81m (2013: US\$113m) at 31 December 2014. This sensitivity includes the gross exposure for the securities investment conduits ( SICs ) consolidated within our balance sheet based on credit spread VaR. This sensitivity excludes losses which would have been absorbed by the capital note holders.

The decrease in this sensitivity at 31 December 2014 compared with 31 December 2013 was due mainly to reducing the overall positions and lower volatilities and credit spread baselines observed during the year.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Equity securities classified as available for sale***Fair value of equity securities**(Audited)*

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
Private equity holdings <sup>37</sup>	<b>2.0</b>	2.7
Investment to facilitate ongoing business <sup>38</sup>	<b>1.2</b>	1.2
Other strategic investments	<b>7.5</b>	5.2
<b>At 31 December</b>	<b>10.7</b>	9.1

*For footnotes, see page 202.*

The fair value of equity securities classified as available for sale can fluctuate considerably. The table above sets out the maximum possible loss on shareholders' equity

from available-for-sale equity securities. The increase in other strategic investments was largely due to the increase in the market value of the Industrial Bank investment offsetting the decrease in private equity holdings from the disposal of various direct and private equity fund investments.

**Market risk balance sheet linkages***(Unaudited)*

The information below and on page 180 aims to facilitate an understanding of linkages between line items in the balance sheet and positions included in our market risk disclosures, in line with recommendations made by the Enhanced Disclosure Task Force.

*Balances included and not included in trading VaR**(Unaudited)*

<b>Balance</b>	<b>Balances</b>	<b>Balances not</b>	<b>Primary</b>
<b>sheet</b>	<b>included in</b>	<b>included in</b>	<b>market risk</b>
<b>sheet</b>	<b>trading VaR</b>	<b>trading VaR</b>	<b>sensitivities</b>



	US\$m	US\$m	US\$m	
<b>At 31 December 2014</b>				
<b>Assets</b>				
Cash and balances at central banks	129,957		129,957	B
Trading assets	304,193	276,419	27,774	A
Financial assets designated at fair value	29,037		29,037	A
Derivatives	345,008	333,880	11,128	A
Loans and advances to banks	112,149		112,149	B
Loans and advances to customers	974,660		974,660	B
Reverse repurchase agreements non-trading	161,713		161,713	C
Financial investments	415,467		415,467	A
<b>Liabilities</b>				
Deposits by banks	77,426		77,426	B
Customer accounts	1,350,642		1,350,642	B
Repurchase agreements non-trading	107,432		107,432	C
Trading liabilities	190,572	170,576	19,996	A
Financial liabilities designated at fair value	76,153		76,153	A
Derivatives	340,669	334,199	6,470	A
Debt securities in issue	95,947		95,947	C

The table represents account lines where there is some exposure to market risk according to the following asset classes:

A Foreign exchange, interest rate, equity and credit spread.

B Foreign exchange and interest rate.

C Foreign exchange, interest rate and credit spread.

The table above splits the assets and liabilities into two categories:

those that are included in the trading book and are measured by VaR; and

those that are not in the trading book and/or are not measured by VaR.

The breakdown of financial instruments included and not included in trading VaR provides a linkage with market risk to the extent that it is reflected in our risk framework. However, it is important to highlight that

the table does not reflect how we manage market risk, since we do not discriminate between assets and liabilities in our VaR model.

The assets and liabilities included in trading VaR give rise to a large proportion of the income included in net trading income. As set out on page 49, HSBC's net trading income in 2014 was US\$6,760 (2013: US\$8,690m). Adjustments to trading income such as valuation adjustments do not feed the trading VaR model.



**Table of Contents****Report of the Directors: Financial Review** (continued)*Market risk linkages to the accounting balance sheet***Trading assets and liabilities**

The Group's trading assets and liabilities are in almost all cases originated by GB&M. The assets and liabilities are classified as held for trading if they have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These assets and liabilities are treated as traded risk for the purposes of market risk management, other than a limited number of exceptions, primarily in Global Banking where the short-term acquisition and disposal of the assets are linked to other non-trading related activities such as loan origination.

**Financial assets designated at fair value**

Financial assets designated at fair value within HSBC are predominantly held within the Insurance entities. The majority of these assets are linked to policyholder liabilities for either unit-linked or insurance and investment contracts with DPF. The risks of these assets largely offset the market risk on the liabilities under the policyholder contracts, and are risk managed on a non-trading basis.

**Financial liabilities designated at fair value**

These arise when the derivative was entered into in order to manage risk arising from non-traded exposures. They include non-qualifying hedging derivatives and derivatives qualifying for fair value and cash flow hedge accounting. The use of non-qualifying hedges whose primary risks relate to interest rate and foreign exchange exposure is described on page 181. Details of derivatives in fair value and cash flow hedge accounting relationships are given in Note 16 on the Financial Statements. Our primary risks in respect of these instruments relate to interest rate and foreign exchange risks.

**Loans and advances to customers**

The primary risk on assets within loans and advances to customers is the credit risk of the borrower. The risk of these assets is treated as non-trading risk for market risk management purposes.

**Financial investments**

Financial investments include assets held on an available-for-sale and held-to-maturity basis. An analysis of the Group's holdings of these securities by accounting classification and issuer type is provided in Note 18 on the Financial Statements and by business activity on page 60. The majority of these securities are mainly held within Balance Sheet Management ( BSM ) in GB&M. The positions which are originated in order

Financial liabilities designated at fair value within HSBC are primarily fixed-rate securities issued by HSBC entities for funding purposes. An accounting mismatch would arise if the debt securities were accounted for at amortised cost because the derivatives which economically hedge market risks on the securities would be accounted for at fair value with changes recognised in the income statement. The market risks of these liabilities are treated as non-traded risk, the principal risks being interest rate and/or foreign exchange risks. We also incur liabilities to customers under investment contracts, where the liabilities on unit-linked contracts are based on the fair value of assets within the unit-linked funds. The exposures on these funds are treated as non-traded risk and the principal risks are those of the underlying assets in the funds.

#### **Derivative assets and liabilities**

We undertake derivative activity for three primary purposes; to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge our own risks. Most of our derivative exposures arise from sales and trading activities within GB&M and are treated as traded risk for market risk management purposes.

Within derivative assets and liabilities there are portfolios of derivatives which are not risk managed on a trading intent basis and are treated as non-traded risk for VaR measurement

to manage structural interest rate and liquidity risk are treated as non-trading risk for the purposes of market risk management. Available-for-sale security holdings within insurance entities are treated as non-trading risk and are largely held to back non-linked insurance policyholder liabilities.

The other main holdings of available-for-sale assets are the ABSs within GB&M's legacy credit business, which are treated as non-trading risk for market risk management purposes, the principal risk being the credit risk of the obligor.

The Group's held-to-maturity securities are principally held within the Insurance business. Risks of held-to-maturity assets are treated as non-trading for risk management purposes.

#### **Repurchase (repo) and reverse repurchase (reverse repo) agreements non-trading**

Reverse repo agreements, classified as assets, are a form of collateralised lending. HSBC lends cash for the term of the reverse repo in exchange for receiving collateral (normally in the form of bonds).

Repo agreements, classified as liabilities, are the opposite of reverse repo, allowing HSBC to obtain funding by providing collateral to the lender.

Both transaction types are treated as non-trading risk for market risk management and the primary risk is counterparty credit risk.

*For information on the accounting policies applied to financial instruments at fair value, see Note 13 on the Financial Statements.*

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Structural foreign exchange exposures**

*(Unaudited)*

*For our policies and procedures for managing structural foreign exchange exposures, see page 226 of the Appendix to Risk.*

*For details of structural foreign exchange exposures see Note 33 on the Financial Statements.*

**Non-trading interest rate risk**

*(Unaudited)*

*For our policies regarding the funds transfer pricing process for non-trading interest rate risk and liquidity and funding risk, see pages 226 and 219, respectively, of the Appendix to Risk.*

Asset, Liability and Capital Management (ALCM) is responsible for measuring and controlling non-trading interest rate risk under the supervision of the Risk Management Meeting. Its primary responsibilities are:

to define the rules governing the transfer of non-trading interest rate risk from the global businesses to BSM;

to define the rules governing the interest rate risk behaviouralisation applied to non-trading assets/liabilities (see below);

to ensure that all market interest rate risk that can be neutralised is transferred from the global businesses to BSM; and

to define the rules and metrics for monitoring the residual interest rate risk in the global businesses, including any market risk that cannot be neutralised.

The different types of non-trading interest rate risk and the controls which we use to quantify and limit exposure to these risks can be categorised as follows:

risk which is transferred to BSM and managed by BSM within a defined market risk mandate, predominantly through the use of fixed rate liquid assets (government bonds) held in available-for-sale portfolios and/or interest rate derivatives which are part of fair value hedging or cash flow hedging relationships. This non-trading interest

rate risk is reflected in non-trading VaR, as well as in our net interest income (see below) or economic value of equity ( EVE ) sensitivity;

risk which remains outside BSM because it cannot be hedged or which arises due to our behaviouralised transfer pricing assumptions. This risk is not reflected in non-trading VaR, but is captured by our net interest income or EVE sensitivity and corresponding limits are part of our global and regional risk appetite statements for non-trading interest rate risk. A typical example would be margin compression created by unusually low rates in key currencies;

basis risk which is transferred to BSM when it can be hedged. Any residual basis risk remaining in the global businesses is reported to ALCO. This risk is not reflected in non-trading VaR, but is captured by our net interest income or EVE sensitivity. A typical example would be a managed rate savings product transfer-priced using a Libor-based interest rate curve; and

model risks which cannot be captured by non-trading VaR, net interest income or EVE sensitivity, but are controlled by our stress testing framework. A typical example would be prepayment risk on residential mortgages or pipeline risk.

### Interest rate risk behaviouralisation

*For our policies regarding interest risk behaviouralisation, see page 226 of the Appendix to Risk.*

### Third-party assets in Balance Sheet Management

*(Unaudited)*

*For our BSM governance framework, see page 227 of the Appendix to Risk.*

Third-party assets in BSM decreased by 9% during 2014. Deposits with central banks reduced by US\$31bn, predominantly in Europe due to a combination of reduced repo activity and a decrease in balances with the ECB as deposit rates became negative. Loans and advances to banks decreased by US\$6bn, mainly in Hong Kong and the rest of Asia. Financial investments reduced by US\$8bn due to foreign exchange movements, net sales and maturities in Hong Kong and the Americas, partially offset by the increased deployment of funds into securities in Asia.

### Third-party assets in Balance Sheet Management

*(Unaudited)*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
Cash and balances at central banks	<b>103,008</b>	134,086
Trading assets	<b>4,610</b>	5,547
Financial assets designated at fair value		72
Loans and advances <sup>1</sup> :		
to banks	<b>53,842</b>	59,355
to customers	<b>1,931</b>	2,146
Reverse repurchase agreements	<b>59,172</b>	58,968
Financial investments	<b>306,763</b>	314,427
Other	<b>2,470</b>	3,700
<b>At 31 December</b>	<b>531,796</b>	578,301

*For footnote, see page 202.*

## **Sensitivity of net interest income**

*(Unaudited)*

The table below sets out the effect on our future accounting net interest income (excluding insurance) of an incremental 25 basis points parallel rise or fall in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 January 2015. The sensitivities shown represent the change in the base case projected net interest income that would be expected under the two rate scenarios assuming that all other non-interest rate risk variables remain constant, and there are no management actions. In deriving our base case net interest income projections the re-pricing rate of assets and liabilities used is derived from current yield curves. The interest rate sensitivities are indicative and based on simplified scenarios. The limitations of this analysis are discussed in the Appendix to Risk on page 227.

HSBC HOLDINGS PLC

181



---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Assuming no management response, a sequence of such rises ( up-shock ) would increase planned net interest income for 2015 by US\$885m (2014: US\$938m), while a sequence of such falls ( down-shock ) would decrease planned net interest income by US\$2,089m (2014: US\$1,734m).

The net interest income ( NII ) sensitivity of the Group can be split into three key components; the structural sensitivity arising from the four global businesses excluding BSM and Markets, the sensitivity of the funding of the trading book (Markets) and the sensitivity of BSM.

The structural sensitivity is positive in a rising rate environment and negative in a falling rate environment. The sensitivity of the funding of the trading book is negative in a rising rate environment and positive in a falling rate environment, and in terms of the impact on profit the change in net interest income would be expected to be offset by a similar change in net trading income. The sensitivity of BSM will depend on its position. Typically, assuming no management response, the sensitivity of BSM is negative in a rising rate environment and positive in a falling rate environment.

The NII sensitivity figures below also incorporate the effect of any interest rate behaviouralisation applied and the effect of any assumed repricing across products under the specific interest rate scenario. They do not incorporate the effect of any management decision to change the HSBC balance sheet composition.

*See page 227 in the Risk Appendix for more information about interest rate behaviouralisation and the role of BSM.*

The NII sensitivity in BSM arises from a combination of the techniques that BSM use to mitigate the transferred interest rate risk and the methods they use to optimise net revenues in line with their defined risk mandate. The figures in the table below do not incorporate the effect of any management decisions within BSM, but in reality it is likely that there would be some short-term adjustment in BSM positioning to offset the NII effects of the specific interest rate scenario where necessary.

The NII sensitivity arising from the funding of the trading book is comprised of the expense of funding trading assets, while the revenue from these trading assets is reported in net trading income. This leads to an asymmetry in the NII sensitivity figures which is cancelled out in our global business results, where we include both net interest income and net trading income. It is likely, therefore, that the overall effect on profit before tax of the funding of the trading book will be much less pronounced than shown in the figures below.

The up-shock sensitivity remained broadly unchanged in 2014. The down-shock sensitivity increased predominantly due to a change in BSM's interest rate risk profile in US dollars.

*Sensitivity of projected net interest income*<sup>39</sup>

*(Unaudited)*

	Rest of Americas	Hong Kong	Rest of Asia	Sterling	Euro	Total
US dollar bloc	US dollar bloc	dollar bloc	dollar bloc	US dollar bloc	US dollar bloc	US dollar bloc
US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m

**Change in 2015 projected net interest income arising from a shift in yield curves of:**

+25 basis points at the beginning of each quarter

25 basis points at the beginning of each quarter

209	(9)	245	265	321	(146)	885
(521)	(1)	(494)	(259)	(783)	(31)	(2,089)

Change in 2014 projected net interest income arising from a shift in yield curves of:

+25 basis points at the beginning of each quarter

25 basis points at the beginning of each quarter

(107)	12	327	236	598	(128)	938
(291)	(23)	(412)	(233)	(761)	(14)	(1,734)

*For footnote, see page 202.*

We monitor the sensitivity of reported reserves to interest rate movements on a monthly basis by assessing the expected reduction in valuation of available-for-sale portfolios and cash flow hedges due to parallel movements of plus or minus 100bps in all yield curves. These particular exposures form only a part

of our overall interest rate exposures. The accounting treatment of our remaining interest rate exposures, while economically largely offsetting the exposures shown in the below table, does not require revaluation movements to go to reserves.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

The table below describes the sensitivity of our reported reserves to the stipulated movements in yield curves and the maximum and minimum month-end figures during the year. The sensitivities are indicative and based on

simplified scenarios. The change in sensitivity of reported reserves is predominantly due to a reduction in the available-for-sale securities portfolio.

*Sensitivity of reported reserves to interest rate movements**(Unaudited)*

	Maximum impact US\$m	Minimum impact US\$m
<b>At 31 December 2014</b>		
+ 100 basis point parallel move in all yield curves	(3,696)	(3,696)
As a percentage of total shareholders' equity	(1.9%)	(1.9%)
100 basis point parallel move in all yield curves	3,250	3,250
As a percentage of total shareholders' equity	1.7%	1.7%
<b>At 31 December 2013</b>		
+ 100 basis point parallel move in all yield curves	(5,762)	(5,507)
As a percentage of total shareholders' equity	(3.2%)	(3.0%)
100 basis point parallel move in all yield curves	5,634	4,910
As a percentage of total shareholders' equity	3.1%	2.7%

**Defined benefit pension schemes***(Audited)*

Market risk arises within our defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows.

*HSBC's defined benefit pension schemes**(Audited)*

	<b>2014</b>	2013
	<b>US\$bn</b>	US\$bn
Liabilities (present value)	<b>42.1</b>	40.5
	<b>%</b>	%
Assets:		
Equities	<b>18</b>	18
Debt securities	<b>68</b>	70
Other (including property)	<b>14</b>	12
<b>At 31 December</b>	<b>100</b>	100

*For details of our defined benefit schemes, see Note 6 on the Financial Statements, and for pension risk management see page 200.*

### **Additional market risk measures applicable only to the parent company**

*(Audited)*

The principal tools used in the management of market risk are VaR for foreign exchange rate risk and the projected sensitivity of HSBC Holdings net interest income to future changes in yield curves and interest rate gap repricing tables for interest rate risk.

#### **Foreign exchange risk**

Total foreign exchange VaR arising within HSBC Holdings in 2014 was as follows:

#### *HSBC Holdings foreign exchange VaR*

*(Audited)*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>At 31 December</b>		
Average	<b>29.3</b>	54.1
Minimum	<b>42.1</b>	51.1
Maximum	<b>29.3</b>	46.7
	<b>50.0</b>	64.1

The foreign exchange risk largely arises from loans to subsidiaries of a capital nature that are not denominated in the functional currency of either the provider or the recipient and which are accounted for as financial assets. Changes in the carrying amount of these loans due to foreign exchange rate differences are taken directly to HSBC Holdings income statement. These loans, and most of the associated foreign exchange exposures, are eliminated on consolidation.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Sensitivity of net interest income***(Audited)*

HSBC Holdings monitors net interest income sensitivity over a five year time horizon reflecting the longer-term perspective on interest rate risk management appropriate to a financial services holding company. These sensitivities assume that any issuance where HSBC Holdings has an option to reimburse at a future call date is called at this date. The table below sets out the effect on HSBC Holdings' future net interest income over a five

year time horizon of incremental 25 basis point parallel falls or rises in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 January 2015.

Assuming no management actions, a sequence of such rises would increase planned net interest income for the next five years by US\$600m (2013: increase of US\$602m), while a sequence of such falls would decrease planned net interest income by US\$539m (2013: decrease of US\$464m).

**Sensitivity of HSBC Holdings' net interest income to interest rate movements**<sup>39</sup>*(Audited)*

	US dollar bloc US\$m	Sterling bloc US\$m	Euro bloc US\$m	Total US\$m
<b>Change in projected net interest income as at 31 December arising from a shift in yield curves</b>				
<b>2014</b>				
of + 25 basis points at the beginning of each quarter				
0-1 year	78	9	2	89
2-3 years	281	17	34	332
4-5 years	138	17	24	179
of - 25 basis points at the beginning of each quarter				
0-1 year	(58)	(9)	(1)	(68)
2-3 years	(276)	(16)	(12)	(304)
4-5 years	(138)	(17)	(12)	(167)
<b>2013</b>				
of + 25 basis points at the beginning of each quarter				
0-1 year	104	(14)	2	92

2-3 years	382	(93)	38	327
4-5 years	245	(101)	38	182
of 25 basis points at the beginning of each quarter				
0-1 year	(53)	13	(2)	(42)
2-3 years	(300)	91	(33)	(242)
4-5 years	(243)	101	(38)	(180)

*For footnote, see page 202.*

The interest rate sensitivities tabulated above are indicative and based on simplified scenarios. The figures represent hypothetical movements in net interest income based on our projected yield curve scenarios, HSBC Holdings' current interest rate risk profile and assumed changes to that profile during the next five years. Changes to assumptions concerning the risk profile over the next five years can have a significant impact on the net interest income sensitivity for that period. However, the figures do not take into account

the effect of actions that could be taken to mitigate this interest rate risk.

### Interest rate repricing gap table

The interest rate risk on the fixed-rate securities issued by HSBC Holdings is not included within the Group VaR but is managed on a repricing gap basis. The interest rate repricing gap table below analyses the full-term structure of interest rate mismatches within HSBC Holdings' balance sheet.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Repricing gap analysis of HSBC Holdings**(Audited)*

	<b>Total US\$m</b>	<b>Up to 1 year US\$m</b>	<b>From over 1 to 5 years US\$m</b>	<b>From over 5 to 10 years US\$m</b>	<b>More than 10 years US\$m</b>	<b>Non-interest bearing US\$m</b>
Cash at bank and in hand: balances with HSBC undertakings	249					249
Derivatives	2,771					2,771
Loans and advances to HSBC undertakings	43,910	41,603	290	1,093		924
Financial investments in HSBC undertakings	4,073	3,010		731		332
Investments in subsidiaries	96,264					96,264
Other assets	597					597
<b>Total assets</b>	<b>147,864</b>	<b>44,613</b>	<b>290</b>	<b>1,824</b>		<b>101,137</b>
Amounts owed to HSBC undertakings	(2,892)	(1,877)				(1,015)
Financial liabilities designated at fair values	(18,679)	(850)	(5,472)	(5,400)	(4,263)	(2,694)
Derivatives	(1,169)					(1,169)
Debt securities in issue	(1,009)			(1,013)		4
Other liabilities	(1,415)					(1,415)
Subordinated liabilities	(17,255)	(779)	(3,766)	(2,000)	(10,195)	(515)
<b>Total equity</b>	<b>(105,445)</b>					<b>(105,445)</b>
<b>Total liabilities and equity</b>	<b>(147,864)</b>	<b>(3,506)</b>	<b>(9,238)</b>	<b>(8,413)</b>	<b>(14,458)</b>	<b>(112,249)</b>
Off-balance sheet items attracting interest rate sensitivity		(21,525)	7,295	7,400	5,763	1,067
<b>Net interest rate risk gap at 31 December 2014</b>		<b>19,582</b>	<b>(1,653)</b>	<b>811</b>	<b>(8,695)</b>	<b>(10,045)</b>
Cumulative interest rate gap		19,582	17,929	18,740	10,045	
Cash at bank and in hand: balances with HSBC undertakings	407	357				50
Derivatives	2,789					2,789

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Loans and advances to HSBC undertakings	53,344	49,979	290	1,239	645	1,191
Financial investments in HSBC undertakings	1,210	300		731		179
Investments in subsidiaries	92,695					92,695
Other assets	391					391
Total assets	150,836	50,636	290	1,970	645	97,295
Amounts owed to HSBC undertakings	(11,685)	(10,865)				(820)
Financial liabilities designated at fair values	(21,027)	(1,928)	(4,655)	(7,810)	(4,325)	(2,309)
Derivatives	(704)					(704)
Debt securities in issue	(2,791)	(1,722)			(1,069)	
Other liabilities	(1,375)					(1,375)
Subordinated liabilities	(14,167)		(3,030)	(2,066)	(8,912)	(159)
Total equity	(99,087)					(99,087)
Total liabilities and equity	(150,836)	(14,515)	(7,685)	(9,876)	(14,306)	(104,454)
Off-balance sheet items attracting interest rate sensitivity		(18,620)	4,382	9,876	4,421	(59)
Net interest rate risk gap at 31 December 2013		17,501	(3,013)	1,970	(9,240)	(7,218)
Cumulative interest rate gap		17,501	14,488	16,458	7,218	

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review (continued)****Operational risk***(Unaudited)*

	Page	App <sup>1</sup>	Tables	Page
<b><u>Operational risk</u></b>	186	228		
<b><u>Operational risk management framework</u></b>	186		<u>Three lines of defence</u>	186
			<u>Operational risk management framework</u>	187
<b><u>Operational risk in 2014</u></b>	187			
<u>Frequency and amount of operational risk losses</u>	188		<u>Frequency of operational risk incidents by risk category</u>	189
			<u>Distribution of operational risk losses in US dollars by risk category</u>	228
<b><u>Compliance risk</u></b>	189	229		
<u>Legal risk</u>		229		
<u>Global security and fraud risk</u>		230		
<u>Systems risk</u>		231		
<u>Vendor risk management</u>		231		

<sup>1</sup> Appendix to Risk *risk policies and practices.*

Operational risk is relevant to every aspect of our business and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from breaches of regulation and law, unauthorised activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

Responsibility for minimising operational risk lies with HSBC's management and staff. Each regional, global business, country, business unit and functional head is required to maintain oversight over the operational risks and internal controls of the business and operational activities for which they are responsible.

*A summary of our current policies and practices regarding operational risk is provided in the Appendix to Risk on page 228.*

### **Operational risk management framework**

The Group Operational Risk function and the operational risk management framework ( ORMF ) directs business management in discharging their responsibilities.

The ORMF defines minimum standards and processes, and the governance structure for operational risk and internal control across the Group. To implement the ORMF a three lines of defence model is used for the management of risk, as described below:

#### *Three lines of defence*

A diagrammatic representation of the ORMF is presented on page 187.

Activity to embed the use of our operational risk management framework continued in 2014. At the same time, we are streamlining operational risk management processes and harmonising framework components and risk management processes. This is expected to lead to a stronger operational risk management culture and more forward-looking risk insights to enable businesses to determine whether material risks are being managed within the Group's risk appetite and whether further action is required. In addition, the Security and Fraud Risk and Financial Crime Compliance functions have built a Financial Intelligence Unit ( FIU ) which provides intelligence on the potential risks of financial crime posed by customers and business prospects to enable better risk management decision-making. The FIU provides context and expertise to identify, assess and understand financial crime risks holistically in clients, sectors and markets.

Articulating our risk appetite for material operational risks helps the organisation understand the level of risk HSBC is willing to accept. The Group operational risk appetite statement is approved annually by the GRC. The Group risk appetite statement, which includes operational risk appetite metrics, was approved by the HSBC Holdings Board. Monitoring operational risk exposure against risk appetite on a regular basis and implementing our risk acceptance process drives risk awareness in a forward-looking manner. It assists management in determining whether further action is required.

Operational risk and control assessments ( RCAs ) are performed by individual business units and functions. The risk and control assessment process is designed to provide business areas and functions with a forward looking view of operational risks and an assessment of the effectiveness of controls, and a tracking mechanism for action plans so that they can proactively manage operational risks within acceptable levels. Risk and control assessments are reviewed and updated at least annually.



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

*Operational risk management framework*

*RCAs are used to inform the evaluation of the effectiveness of controls over top risks.*

*Key Indicators are used to help monitor the risks and controls.*

*Scenarios provide management with a quantified view of our top and emerging operational risks.*

*Internal incidents are used to forecast typical losses.*

*External sources are used to inform the assessment of extreme scenarios.*

Appropriate means of mitigation and controls are considered. These include:

making specific changes to strengthen the internal control environment;

investigating whether cost-effective insurance cover is available to mitigate the risk; and

other means of protecting us from loss.

In addition, an enhanced scenario analysis process has been implemented across material legal entities to improve the quantification and management of material risks.

**Operational risk in 2014**

During 2014, our operational risk profile continued to be dominated by compliance and legal risks as referred to under *Top and emerging risks* on page 118. Losses were realised relating to events that occurred in previous years. These events included the possible historical mis-selling of payment protection insurance ( PPI ) products in the UK (see Note 29 on the Financial Statements). A number of mitigating actions continue to be taken to prevent future

mis-selling incidents.

The incidence of regulatory and other proceedings against financial service firms is increasing. Proposed changes relating to capital and liquidity requirements, remuneration and/or taxes could increase our cost of doing business, reducing future profitability. We remain subject to a number of regulatory proceedings including investigations and reviews by various national regulatory, competition and enforcement authorities relating to certain past submissions made by panel banks and the process for making submissions in connection with the

setting of Libor and other interbank offered and benchmark interest rates. There are also investigations into foreign exchange, precious metals and credit default swap-related activities in progress. In response, we have undertaken a number of initiatives, including the restructuring of our Compliance sub-functions, enhancing our governance and oversight, measures to implement Global Standards as described on page 26 and other measures put in place designed to ensure we have the appropriate people, processes and procedures to manage emerging risks and new products and business.

*For further details see Compliance risk on page 189 and for details of the investigations and legal proceedings see Note 40 on the Financial Statements.*

In November 2014, the UK FCA and the US Commodity Futures Trading Commission ( CFTC ) each announced having concluded regulatory settlements with a number of banks, including HSBC Bank plc, in connection with their respective investigations of trading and other conduct involving foreign exchange benchmark rates. Under the settlement terms, HSBC Bank plc agreed to pay a financial penalty to the FCA and a civil monetary penalty to the CFTC and to undertake various remedial actions. For further information, see Note 40 on the Financial Statements.

We have undertaken a review of our compliance with the fixed-sum unsecured loan agreement requirements of the UK Consumer Credit Act ( CCA ). A liability has been recognised within Accruals, deferred income and other liabilities for the repayment of interest to customers where annual statements did not remind them of their right to partially prepay the loan, notwithstanding that the customer loan documentation did include this right.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

There is uncertainty as to whether other technical requirements of the CCA have been met, for which we have assessed an additional contingent liability. For further details see Note 40 on the Financial Statements.

We have settled claims by the US Federal Housing Finance Agency in relation to the purchase of mortgage backed securities by the Federal National Mortgage Associations ( Fannie Mae ) and the Federal Home Loan Mortgage Association ( Freddie Mac ) between 2005 and 2007. For further information, see Note 40 on the Financial Statements.

Other operational risks included:

*fraud risks*: the threat of fraud perpetrated by or against our customers, especially in retail and commercial banking, may grow during adverse economic conditions. We increased monitoring, analysed root causes and reviewed internal controls to enhance our defences against external attacks and reduce the level of loss in these areas. In addition, Group Security and Fraud Risk worked closely with the global businesses to continually assess these threats as they evolved and adapt our controls to mitigate these risks;

*level of change creating operational complexity*: the Global Risk function is engaged with business management in business transformation initiatives to ensure robust internal controls are maintained, including through participation in all relevant management committees. The Global Transactions Team has developed an enhanced risk management framework to be applied to the management of disposal risks;

*information security*: the security of our information and technology infrastructure is crucial for maintaining our banking services and protecting our customers and the HSBC brand. A failure of the control framework which protects this could have implications for the wider financial sector and result in direct financial loss and/or the loss of customer data and other sensitive information which could undermine both our reputation and our ability to retain the trust of our customers. Programmes of work have been ongoing to strengthen internal security controls to prevent unauthorised access to our systems which may affect live services or facilitate data loss or fraud.

In common with other banks and multinational organisations, we continue to be a target of increasingly sophisticated cyber-attacks such as distributed denial of service attacks which can affect the availability of customer-facing websites. In addition, reliance on standard internet technologies, protocols and services means we are subject to wide-scale remediation when flaws are reported in these technologies. Lessons learnt from attacks experienced within the industry and information sharing with other financial institutions, government agencies and external intelligence

providers allows us to develop a better understanding of our own susceptibilities and to develop scenarios to test against. They will continue to be a focus of ongoing initiatives to strengthen the control environment. Significant investment has already been made in enhancing controls around data access, the heightened monitoring of potential cyber-attacks and continued training to raise staff awareness. This is an area that will require continual investment in our operational processes and contingency plans;

*vendor risk management*: we continue to focus on the management of vendor risks including making good progress with the implementation of the supplier performance management programme with our most important suppliers. Additional focus is put on the screening of suppliers to enable HSBC to identify if any suppliers are on a sanctions list and to exit such relationships. Vendor risk management is a core element of third party risk management; and

*compliance with regulatory agreements and orders*: Failure to implement our obligations under the DPAs could have a material adverse effect on our results and operations. Legal proceedings are discussed in Note 40 on the Financial Statements and further details regarding compliance risk are set out below. Other operational risks are also monitored and managed through the use of the ORMF.

*Further information on the nature of these risks is provided in Top and emerging risks on page 118.*

### Frequency and amount of operational risk losses

The profile of operational risk incidents and associated losses is summarised below, showing the distribution of operational risk incidents in terms of their frequency of occurrence and total loss amount in US dollars.

Operational losses rose in 2014, driven by UK customer redress programme charges and settlements relating to legal and regulatory matters.

As in 2013, the operational risk incident profile in 2014 comprised both high frequency, low impact events and high impact events that occurred much less frequently. For example, losses due to external fraud incidents such as credit card fraud occurred more often than other types of event, but the amounts involved were often small in value. By contrast, operational risk incidents in the compliance category were relatively low frequency events, but the total cost was significant.

The number of fraud cases was broadly unchanged during 2014 due to the continued strong control environment.

Losses due to significant historical events, including the possible mis-selling of PPI products in the UK and the incidence of regulatory matters described in Note 40 on the Financial Statements remained substantial in 2014.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

*Frequency of operational risk incidents by risk category (individual loss >US\$10k)*

*Distribution of operational risk losses in US dollars by risk category*

**Compliance risk**

*(Unaudited)*

Compliance risk is the risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.

In 2014, we completed the restructuring of our Compliance sub-function within Global Risk into two new sub-functions: Financial Crime Compliance and Regulatory Compliance, appropriately supported by shared Compliance Chief Operating Officer, Assurance and Reputational Risk Management teams. We continue to ensure that the Compliance sub-functions, through

their operation and the execution of the Group strategy, including measures to implement Global Standards, are well positioned to meet increased levels of regulation and scrutiny from regulators and law enforcement agencies. In addition, the measures we have put in place are designed to ensure we have the appropriate people, processes and procedures to manage emerging risks and new products and business.

Enhanced global AML and sanctions policies, incorporating risk appetite, were approved by the Board in January 2014. The policies adopt and seek to enforce the highest or most effective standards globally, including a globally consistent approach to knowing our customers.

The policies are being implemented in phases through the development and application of procedures required to embed them in our day to day business operations globally. The overriding policy objective is for every employee to engage in only the right kind of business, conducted in the right way .

HSBC has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two-year period of that agreement in December 2014. Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA. For further information, see Regulatory commitments and consent orders on page 120.

In May 2014, the Board approved a globally consistent approach to the management of regulatory conduct designed to ensure we deliver fair outcomes for our customers and conduct orderly and transparent operations in financial



markets. Implementation of the global conduct approach is managed through the global lines of business and functions and covers all our business and operational activities. Examples of these activities are disclosed in *Conduct of business* on page 121.

It is clear that the level of inherent compliance risk that we face will continue to remain high for the foreseeable future. However, we consider that good progress is being made and will continue to be made in ensuring that we are well placed to effectively manage those risks.

HSBC HOLDINGS PLC

189

**Table of Contents****Report of the Directors: Financial Review (continued)****Risk management of insurance operations***(Audited)*

	Page	App <sup>1</sup>	Tables	Page
<b><u>HSBC's bancassurance model</u></b>	190			
- <u>Overview of insurance products</u>		231		
- <u>Nature and extent of risks</u>		232		
- <b><u>Risk management of insurance operations in 2014</u></b>	191			
- <b><u>Asset and liability matching</u></b>	191		<i>Balance sheet of insurance manufacturing subsidiaries:</i>	
-			<i>    <u>by type of contract</u></i>	191
-			<i>    <u>by geographical region</u></i>	193
-			<i><u>Movement in total equity of insurance operations</u></i>	193
- <b><u>Financial risks</u></b>	194		<i><u>Financial assets held by insurance manufacturing subsidiaries</u></i>	194
- <u>Market risk</u>	194	232	<i><u>Financial return guarantees</u></i>	195
-			<i><u>Sensitivity of HSBC's insurance manufacturing subsidiaries to market risk factors</u></i>	195
- <u>Credit risk</u>	196		<i><u>Treasury bills, other eligible bills and debt securities in HSBC's insurance manufacturing subsidiaries</u></i>	196
-		234	<i><u>Reinsurers' share of liabilities under insurance contracts</u></i>	197
- <u>Liquidity risk</u>	197		<i><u>Expected maturity of insurance contract liabilities</u></i>	197
-		234	<i><u>Remaining contractual maturity of investment contract liabilities</u></i>	197
- <b><u>Insurance risk</u></b>	198	235	<i><u>Analysis of insurance risk liabilities under insurance contracts</u></i>	198
-	198		<i><u>Sensitivity analysis</u></i>	198

**Sensitivities to non-economic assumptions**

*1 Appendix to Risk policies and practices.*

The majority of the risk in our insurance business derives from manufacturing activities and can be categorised as insurance risk and financial risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (HSBC). Financial risks include market risk, credit risk and liquidity risk.

There were no material changes to our policies and practices for the management of risks arising in the insurance operations in 2014.

*A summary of HSBC's policies and practice regarding the risk management of insurance operations and the main contracts we manufacture is provided in the Appendix to Risk on page 231.*

**HSBC's bancassurance model**

*(Unaudited)*

We operate an integrated bancassurance model which provides insurance products principally for customers with whom we have a banking relationship. Insurance products are sold through all global businesses, but predominantly by RBWM and CMB through our branches and direct channels worldwide.

The insurance contracts we sell relate to the underlying needs of our banking customers, which we can identify from our point-of-sale contacts and customer knowledge. The majority of sales are of savings and investment products and term and credit life contracts.

By focusing largely on personal and SME lines of business we are able to optimise volumes and diversify individual insurance risks.

Where we have operational scale and risk appetite, mostly in life insurance, these insurance products are manufactured by HSBC subsidiaries. Manufacturing insurance allows us to retain the risks and rewards associated with writing insurance contracts by keeping part of the underwriting profit, investment income and distribution commission within the Group.

Where we do not have the risk appetite or operational scale to be an effective insurance manufacturer, we engage with a handful of leading external insurance companies in order to provide insurance products to our customers through our banking network and direct channels. These arrangements are generally structured with our exclusive strategic partners and earn the Group a combination of commissions, fees and a share of profits.

We distribute insurance products in all of our geographical regions. We have core life insurance manufacturing entities, the majority of which are direct subsidiaries of legal banking entities, in seven countries (Argentina, Brazil, Mexico, France, the UK, Hong Kong and Singapore). There are also life insurance manufacturing subsidiaries in mainland China, Malaysia and Malta.



**Table of Contents****Report of the Directors: Financial Review** (continued)**Risk management of insurance operations in 2014**

We measure the risk profile of our insurance manufacturing businesses using an economic capital approach, where assets and liabilities are measured on a market value basis and a capital requirement is held to ensure that there is less than a 1 in 200 chance of insolvency over the next year, given the risks that the businesses are exposed to. In 2014 we aligned the measurement approach for market, credit and insurance risks in the economic capital model to the new pan-European Solvency II insurance capital regulations, which are applicable from 2016.

The risk profile of our life insurance manufacturing businesses did not change materially during 2014 and liabilities to policyholders on these contracts remained constant at US\$74bn (2013: US\$74bn). However, a notable change arose in the UK where HSBC Life (UK) Ltd entered into an agreement to sell its pensions business.

The full effect will only be recognised once regulatory approval is received and the portfolio is transferred to the purchaser.

**Asset and liability matching**

*(Audited)*

A principal tool used to manage exposures to both financial and insurance risk, in particular for life insurance contracts, is asset and liability matching. In many markets in which we operate it is neither possible nor appropriate to follow a perfect asset and liability matching strategy. For long-dated non-linked contracts, in particular, this results in a duration mismatch between assets and liabilities. We therefore structure portfolios to support projected liabilities from non-linked contracts.

The tables below show the composition of assets and liabilities by contract and by geographical region and demonstrate that there were sufficient assets to cover the liabilities to policyholders in each case at the end of 2014.

**Balance sheet of insurance manufacturing subsidiaries by type of contract**

*(Audited)*

With DPF US\$m	Insurance contracts			Investment contracts			Other assets <sup>42</sup> US\$m	Total US\$m
	Unit- linked US\$m	Annuities US\$m	Other <sup>40</sup> US\$m	With DPF <sup>41</sup> US\$m	Unit- linked US\$m	Other US\$m		
29,040	11,278	1,517	6,253	24,238	2,561	4,322	5,732	84,941

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Financial assets									
trading assets			3						3
financial assets designated at fair value	4,304	11,111	533	782	6,346	2,223	1,684	1,713	28,696
derivatives	12	1		1	101	1	10	73	199
financial investments	21,152		886	5,167	15,677		1,807	3,812	48,501
other financial assets	3,572	166	95	303	2,114	337	821	134	7,542
Reinsurance assets	190	262		617				2	1,071
PVIF <sup>43</sup>								5,307	5,307
Other assets and investment properties	698	328	23	107	831	7	26	7,383	9,403
<b>Total assets</b>	<b>29,928</b>	<b>11,868</b>	<b>1,540</b>	<b>6,977</b>	<b>25,069</b>	<b>2,568</b>	<b>4,348</b>	<b>18,424</b>	<b>100,722</b>
Liabilities under investment contracts						2,542	4,155		6,697
designated at fair value						2,542	3,770		6,312
carried at amortised cost							385		385
Liabilities under insurance contracts	29,479	11,820	1,473	6,021	25,068				73,861
Deferred tax <sup>44</sup>	12		11	18				1,180	1,221
Other liabilities								8,577	8,577
<b>Total liabilities</b>	<b>29,491</b>	<b>11,820</b>	<b>1,484</b>	<b>6,039</b>	<b>25,068</b>	<b>2,542</b>	<b>4,155</b>	<b>9,757</b>	<b>90,356</b>
<b>Total equity</b>								<b>10,366</b>	<b>10,366</b>
<b>Total liabilities and equity at 31 December 2014<sup>45</sup></b>	<b>29,491</b>	<b>11,820</b>	<b>1,484</b>	<b>6,039</b>	<b>25,068</b>	<b>2,542</b>	<b>4,155</b>	<b>20,123</b>	<b>100,722</b>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	Insurance contracts				Investment contracts			Other assets <sup>42</sup> US\$m	Total US\$m
	With DPF US\$m	Unit- linked US\$m	Annuities US\$m	Other <sup>40</sup> US\$m	With DPF <sup>41</sup> US\$m	Unit- linked US\$m	Other US\$m		
Financial assets	26,382	13,348	1,651	4,728	25,676	9,720	4,375	5,846	91,726
trading assets			3						3
financial assets									
designated at fair value	3,850	13,131	532	761	6,867	9,293	1,706	1,757	37,897
derivatives	1	3			215	5		55	279
financial investments	19,491		959	3,780	16,556		1,853	3,745	46,384
other financial assets	3,040	214	157	187	2,038	422	816	289	7,163
Reinsurance assets	182	291	522	439				2	1,436
PVIF <sup>43</sup>								5,335	5,335
Other assets and investment properties	757	284	23	113	791	19	31	546	2,564
Total assets	27,321	13,923	2,196	5,280	26,467	9,739	4,406	11,729	101,061
Liabilities under investment contracts						9,730	4,209		13,939
designated at fair value						9,730	3,761		13,491
carried at amortised cost							448		448
Liabilities under insurance contracts	26,920	13,804	2,158	4,872	26,427				74,181
Deferred	12		17	1				1,163	1,193

tax <sup>44</sup>									
Other liabilities								2,048	2,048
Total liabilities	26,932	13,804	2,175	4,873	26,427	9,730	4,209	3,211	91,361
Total equity								9,700	9,700
Total liabilities and equity at 31 December 2013 <sup>45</sup>	26,932	13,804	2,175	4,873	26,427	9,730	4,209	12,911	101,061

*For footnotes, see page 202.*

Our most significant life insurance products are investment contracts with DPF issued in France, insurance contracts with DPF issued in Hong Kong and unit-linked contracts issued in Latin America, Hong Kong and the UK.

Our exposure to financial risks arising in the above balance sheet varies depending on the type of contract issued. For unit-linked contracts, the policyholder bears the majority of the exposure to financial risks whereas, for non-linked contracts, the majority of financial risks are borne by the shareholder (HSBC). For contracts with DPF, the shareholder is exposed to financial risks to the extent that the exposure cannot be managed by utilising any discretionary participation (or bonus) features within the policy contracts issued.

As noted above, during the year HSBC entered into an agreement to sell its UK pensions business, and the related balances are reported as a disposal group held for sale under IFRS 5 (and are therefore included within the Other assets column in the table above). The disposal group comprises US\$6.8bn of total liabilities, being liabilities under unit-linked investment contracts, unit-linked insurance contracts and annuity contracts. It also comprises US\$6.8bn of total assets, being financial and reinsurance assets backing the liabilities, and the associated PVIF on these contracts. The transfer is subject to regulatory approvals and is expected to complete in the second half of 2015. As part of the transaction we also entered into a reinsurance agreement transferring certain risks and rewards of the business to the purchaser from 1 January 2014 until completion of the transaction. A gain of US\$42m was recognised on entering into this reinsurance agreement.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)*Balance sheet of insurance manufacturing subsidiaries by geographical region<sup>46</sup>**(Audited)*

	<b>Europe US\$m</b>	<b>Asia<sup>6</sup> US\$m</b>	<b>Latin America US\$m</b>	<b>Total US\$m</b>
Financial assets	<b>30,178</b>	<b>47,443</b>	<b>7,320</b>	<b>84,941</b>
trading assets			3	3
financial assets designated at fair value	<b>10,610</b>	<b>12,497</b>	<b>5,589</b>	<b>28,696</b>
derivatives	172	27		199
financial investments	<b>16,947</b>	<b>30,010</b>	<b>1,544</b>	<b>48,501</b>
other financial assets	<b>2,449</b>	<b>4,909</b>	<b>184</b>	<b>7,542</b>
Reinsurance assets	<b>308</b>	<b>748</b>	<b>15</b>	<b>1,071</b>
PVIF <sup>43</sup>	<b>711</b>	<b>4,175</b>	<b>421</b>	<b>5,307</b>
Other assets and investment properties	<b>7,650</b>	<b>1,145</b>	<b>608</b>	<b>9,403</b>
<b>Total assets</b>	<b>38,847</b>	<b>53,511</b>	<b>8,364</b>	<b>100,722</b>
Liabilities under investment contracts:				
designated at fair value	<b>1,585</b>	<b>4,727</b>		<b>6,312</b>
carried at amortised cost			385	385
Liabilities under insurance contracts	<b>27,312</b>	<b>39,990</b>	<b>6,559</b>	<b>73,861</b>
Deferred tax <sup>44</sup>	273	806	142	1,221
Other liabilities	<b>7,932</b>	<b>460</b>	<b>185</b>	<b>8,577</b>
<b>Total liabilities</b>	<b>37,102</b>	<b>45,983</b>	<b>7,271</b>	<b>90,356</b>
<b>Total equity</b>	<b>1,745</b>	<b>7,528</b>	<b>1,093</b>	<b>10,366</b>
<b>Total liabilities and equity at 31 December 2014<sup>45</sup></b>	<b>38,847</b>	<b>53,511</b>	<b>8,364</b>	<b>100,722</b>
Financial assets	41,557	42,352	7,817	91,726
trading assets			3	3
financial assets designated at fair value	20,742	11,420	5,735	37,897
derivatives	272	7		279
financial investments	18,080	26,505	1,799	46,384
other financial assets	2,463	4,420	280	7,163
Reinsurance assets	823	596	17	1,436
PVIF <sup>43</sup>	1,156	3,730	449	5,335
Other assets and investment properties	868	1,101	595	2,564
Total assets	44,404	47,779	8,878	101,061
Liabilities under investment contracts:				
designated at fair value	8,760	4,731		13,491

carried at amortised cost			448	448
Liabilities under insurance contracts	31,786	35,619	6,776	74,181
Deferred tax <sup>44</sup>	407	645	141	1,193
Other liabilities	1,474	371	203	2,048
Total liabilities	42,427	41,366	7,568	91,361
Total equity	1,977	6,413	1,310	9,700
Total liabilities and equity at 31 December 2013 <sup>45</sup>	44,404	47,779	8,878	101,061

*For footnotes, see page 202.*

*Movement in total equity of insurance operations*

*(Audited)*

	Total equity	
	2014	2013
	US\$m	US\$m
At 1 January	9,700	9,989
Change in PVIF of long-term insurance business <sup>43</sup>	261	525
Return on net assets	1,835	848
Capital transactions	(673)	(590)
Disposals of subsidiaries/portfolios	1	(675)
Exchange differences and other	(758)	(397)
<b>At 31 December</b>	<b>10,366</b>	<b>9,700</b>

*For footnote, see page 202.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Financial risks***(Audited)*

*Details on the nature of financial risks and how they are managed are provided in the Appendix to Risk on page 232.*

Financial risks can be categorised into:

*market risk* risk arising from changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, credit spreads, foreign exchange rates and equity prices;

*credit risk* the risk of financial loss following the failure of third parties to meet their obligations; and

*liquidity risk* the risk of not being able to make payments to policyholders as they fall due as there are insufficient assets that can be realised as cash.

The following table analyses the assets held in our insurance manufacturing subsidiaries at 31 December 2014 by type of contract, and provides a view of the exposure to financial risk. For unit-linked contracts, which pay benefits to policyholders determined by reference to the value of the investments supporting the policies, we typically designate assets at fair value; for non-linked contracts, the classification of the assets is driven by the nature of the underlying contract.

**Financial assets held by insurance manufacturing subsidiaries***(Audited)*

	<b>Unit-linked contracts<sup>47</sup></b> US\$m	<b>Non-linked contracts<sup>48</sup></b> US\$m	<b>Other assets<sup>49</sup></b> US\$m	<b>Total</b> US\$m
Trading assets				
Debt securities		3		3
Financial assets designated at fair value	13,334	13,649	1,713	28,696
Treasury bills		40	16	56
Debt securities	4,589	3,507	618	8,714
Equity securities	8,745	10,102	1,079	19,926
Financial investments				
Held-to-maturity: debt securities		21,789	2,494	24,283

Available-for-sale:		22,899	1,319	24,218
debt securities		22,899	1,290	24,189
equity securities			29	29
Derivatives	2	124	73	199
Other financial assets <sup>49</sup>	503	6,905	134	7,542
<b>Total financial assets at 31 December 2014<sup>45</sup></b>	<b>13,839</b>	<b>65,369</b>	<b>5,733</b>	<b>84,941</b>
Trading assets				
Debt securities		3		3
Financial assets designated at fair value	22,424	13,716	1,757	37,897
Treasury bills			50	50
Debt securities	7,809	3,910	546	12,265
Equity securities	14,615	9,806	1,161	25,582
Financial investments				
Held-to-maturity: debt securities		21,784	2,142	23,926
Available-for-sale:		20,855	1,603	22,458
debt securities		20,855	1,594	22,449
equity securities			9	9
Derivatives	8	216	55	279
Other financial assets <sup>49</sup>	636	6,238	289	7,163
Total financial assets at 31 December 2013 <sup>45</sup>	23,068	62,812	5,846	91,726

*For footnotes, see page 202.*

Approximately 67% of financial assets were invested in debt securities at 31 December 2014 (2013: 64%) with 24% (2013: 28%) invested in equity securities.

Under unit-linked contracts, premium income less charges levied is invested in a portfolio of assets. We manage the financial risks of this product on behalf of the policyholders by holding appropriate assets in segregated funds or portfolios to which the liabilities are linked. These assets represented 16% (2013: 25%) of the total financial assets of our insurance manufacturing subsidiaries at the end of 2014. The reduction of US\$9.3bn in the value of assets backing unit-linked contracts is largely due to the classification of US\$6.3bn of assets relating to the UK pensions business as held for

sale (see page 192) and the transfer of US\$2.9bn assets backing other unit-linked investment contracts to a third party during the year.

The remaining financial risks are managed either solely on behalf of the shareholder, or jointly on behalf of the shareholder and policyholders where DPF exist.

### Market risk

*(Audited)*

Market risk arises when mismatches occur between product liabilities and the investment assets which back them. For example, mismatches between asset and liability yields and maturities give rise to interest rate risk.

HSBC HOLDINGS PLC

194

**Table of Contents****Report of the Directors: Financial Review** (continued)

Our current portfolio of assets includes debt securities issued at a time when yields were higher than those observed in the current market. As a result, yields on extant holdings of debt securities exceed those available on current issues.

Long-term insurance or investment products may incorporate benefits that are guaranteed. Fixed guaranteed benefits, for example for annuities in payment, are reserved for as part of the calculation of liabilities under insurance contracts.

The risk of shareholder capital being required to meet liabilities to policyholders increases in products that offer guaranteed financial returns where current yields fall below guaranteed levels for a prolonged period. Reserves are held against the cost of guarantees, calculated by stochastic modelling. Where local rules require, these reserves are held through policyholder liabilities. Any remainder is accounted for as a deduction

to PVIF on the relevant product. The table below shows the total reserve held for the cost of guarantees, the range of investment returns on assets supporting these products and the implied investment return that would enable the business to meet the guarantees.

The financial guarantees offered on some portfolios exceeded the current yield on the assets that back them. The cost of guarantees increased to US\$777m (2013: US\$575m) primarily because of falling yields in France throughout 2014. As these yields fell, the cost of guarantees on closed portfolios reported in the 2.1%-4.0% and 4.1%-5.0% categories increased, driven by reduced reinvestment yield assumptions. In addition, there was a closed portfolio in Hong Kong with a guaranteed rate of 5.0% compared with the current yield of 4.1%. We reduced short-term bonus rates paid to policyholders on certain DPF contracts to manage the immediate strain on the business.

*Financial return guarantees*<sup>45,50</sup>*(Audited)*

	2014					2013				
	Investment returns implied by guarantee		Current yields		Cost of guarantees	Investment returns implied by guarantee		Current yields		Cost of guarantees
	%		%		US\$m	%		%		US\$m
Capital	0.0	0.0	3.5	3.5	81	0.0	0.0	4.4	4.4	57
Nominal annual return	0.1	2.0	3.6	3.6	6	0.1	2.0	4.1	4.1	9
Nominal annual return <sup>51</sup>	2.1	4.0	3.5	4.1	646	2.1	4.0	4.2	4.4	471

Nominal annual return	4.1	5.0	3.5	4.1	30	4.1	5.0	4.1	4.4	25
Real annual return <sup>52</sup>	0.0	6.0	4.7	7.5	14	0.0	6.0	6.4	6.4	13
<b>At 31 December</b>					<b>777</b>					<b>575</b>

For footnotes, see page 202.

In addition to the above, a deduction from PVIF of US\$53m (2013: US\$134m) is made in respect of the modelled cost of guaranteed annuity options attached to certain unit-linked pension products in Brazil.

The following table illustrates the effects of selected interest rate, equity price and foreign exchange rate scenarios on our profit for the year and the total equity of our insurance manufacturing subsidiaries.

Where appropriate, we include the impact of the stress on the PVIF in the results of the sensitivity tests. The relationship between the profit and total equity and the risk factors is non-linear and, therefore, the results disclosed should not be extrapolated to measure sensitivities to different levels of stress. The sensitivities

are stated before allowance for management actions which may mitigate the effect of changes in market rates. The sensitivities presented allow for adverse changes in policyholder behaviour that may arise in response to changes in market rates.

The effects of +/-100 basis points parallel shifts in yield curves have increased from 2013 to 2014, driven mainly by falling yields and a flattening of the yield curve in France during 2014. In the low yield environment the projected cost of options and guarantees described above is particularly sensitive to yield curve movements. The market value of available-for-sale bonds is also sensitive to yield curve movements hence the larger opposite stresses on equity.

### *Sensitivity of HSBC's insurance manufacturing subsidiaries to market risk factors*

(Audited)

	2014		2013	
	Effect on profit after tax US\$m	Effect on total equity US\$m	Effect on profit after tax US\$m	Effect on total equity US\$m
+ 100 basis points parallel shift in yield curves	290	(345)	151	(199)
100 basis points parallel shift in yield curves <sup>53</sup>	(549)	214	(230)	139
10% increase in equity prices	180	180	149	149
10% decrease in equity prices	(153)	(153)	(129)	(129)
10% increase in US dollar exchange rate compared to all currencies	54	54	21	21
10% decrease in US dollar exchange rate compared to all currencies	(54)	(54)	(21)	(21)





**Table of Contents****Report of the Directors: Financial Review** (continued)**Credit risk***(Audited)*

Credit risk can give rise to losses through default and can lead to volatility in our income statement and balance sheet figures through movements in credit spreads, principally on the US\$53bn (2013: US\$51bn) bond portfolio supporting non-linked contracts and shareholders' funds.

The sensitivity of the profit after tax of our insurance subsidiaries to the effects on asset values of increases in credit spreads was a reduction of US\$7m (2013: US\$21m). The sensitivity of total equity was a reduction of US\$9m (2013: US\$46m). The sensitivities are relatively small because the vast majority of the debt securities held by our insurance subsidiaries are classified as either held to maturity or available for sale, and consequently any changes in the fair value of these financial investments, absent impairment, would have no effect

on the profit after tax (or to total equity in the case of the held-to-maturity securities). We calculate the sensitivity based on a one-day movement in credit spreads over a two-year period. A confidence level of 99%, consistent with our Group VaR, is applied.

**Credit quality***(Audited)*

The following table presents an analysis of treasury bills, other eligible bills and debt securities within our insurance business by measures of credit quality.

Only assets supporting liabilities under non-linked insurance and investment contracts and shareholders' funds are included in the table as financial risk on assets supporting unit-linked liabilities is predominantly borne by the policyholder. 84.8% (2013: 83.4%) of the assets included in the table are invested in investments rated as strong.

*For a definition of the five credit quality classifications, see page 207.*

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

Neither past due nor impaired				Total US\$m
Strong US\$m	Good US\$m	Satisfactory US\$m	Sub-standard US\$m	

**Supporting liabilities under non-linked insurance and investment contracts**

Trading assets debt securities	3				3
Financial assets designated at fair value	2,550	530	214	255	3,549
treasury and other eligible bills	5			35	40
debt securities	2,545	530	214	220	3,509
Financial investments debt securities	38,515	4,312	1,662	200	44,689
	41,068	4,842	1,876	455	48,241

**Supporting shareholders funds<sup>4</sup>**

Financial assets designated at fair value	214	322	30	69	635
treasury and other eligible bills				16	16
debt securities	214	322	30	53	619
Financial investments debt securities	3,378	196	154	54	3,782
	3,592	518	184	123	4,417

**Total<sup>45</sup>**

Trading assets debt securities	3				3
Financial assets designated at fair value	2,764	852	244	324	4,184
treasury and other eligible bills	5			51	56
debt securities	2,759	852	244	273	4,128
Financial investments debt securities	41,893	4,508	1,816	254	48,471
<b>At 31 December 2014</b>	<b>44,660</b>	<b>5,360</b>	<b>2,060</b>	<b>578</b>	<b>52,658</b>

**Supporting liabilities under non-linked insurance and investment contracts**

Trading assets debt securities	3				3
Financial assets designated at fair value	2,780	691	224	215	3,910
debt securities	2,780	691	224	215	3,910
Financial investments debt securities	36,113	4,596	1,699	231	42,639
	38,896	5,287	1,923	446	46,552

**Supporting shareholders funds<sup>4</sup>**

Financial assets designated at fair value	191	298	73	34	596
treasury and other eligible bills	50				50
debt securities	141	298	73	34	546
Financial investments debt securities	3,356	176	139	65	3,736
	3,547	474	212	99	4,332

**Total<sup>45</sup>**

Trading assets debt securities	3				3
Financial assets designated at fair value	2,971	989	297	249	4,506
treasury and other eligible bills	50				50
debt securities	2,921	989	297	249	4,456
Financial investments debt securities	39,469	4,772	1,838	296	46,375
At 31 December 2013	42,443	5,761	2,135	545	50,884

For footnotes, see page 202.



**Table of Contents****Report of the Directors: Financial Review** (continued)

Credit risk also arises when assumed insurance risk is ceded to reinsurers. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries, analysed by credit quality, is shown below. Our exposure

to third parties under the reinsurance agreements described in the Appendix to Risk on page 235 is included in this table.

*Reinsurers' share of liabilities under insurance contracts*<sup>45</sup>*(Audited)*

	Neither past due nor impaired				Past due but	Total US\$m
	Strong US\$m	Good US\$m	Satisfactory US\$m	Sub-standard US\$m	not impaired US\$m	
Unit-linked insurance	75	185				260
Non-linked insurance <sup>55</sup>	751	11	10			772
<b>At 31 December 2014</b>	<b>826</b>	<b>196</b>	<b>10</b>			<b>1,032</b>
Reinsurance debtors	11	6			21	38
Unit-linked insurance	72	218				290
Non-linked insurance <sup>55</sup>	1,103	8	7			1,118
At 31 December 2013	1,175	226	7			1,408
Reinsurance debtors	17	1			10	28

*For footnotes, see page 202.***Liquidity risk***(Audited)*

The following tables show the expected undiscounted cash flows for insurance contract liabilities and the remaining contractual maturity of investment contract liabilities at 31 December 2014.

The liquidity risk exposure is borne in conjunction with policyholders for the majority of our business, and wholly borne by the policyholder in the case of unit-linked business.

The profile of the expected maturity of the insurance contracts at 31 December 2014 remained comparable with 2013.

*Expected maturity of insurance contract liabilities*<sup>45</sup>*(Audited)*

	Expected cash flows (undiscounted)				Total US\$m
	Within 1 year US\$m	1-5 years US\$m	5-15 years US\$m	Over 15 years US\$m	
Unit-linked insurance	709	3,280	9,243	14,544	27,776
Non-linked insurance <sup>55</sup>	3,504	12,718	29,905	33,108	79,235
<b>At 31 December 2014</b>	<b>4,213</b>	<b>15,998</b>	<b>39,148</b>	<b>47,652</b>	<b>107,011</b>
Unit-linked insurance	1,106	3,609	9,757	13,725	28,197
Non-linked insurance <sup>55</sup>	3,977	11,731	26,848	31,306	73,862
At 31 December 2013	5,083	15,340	36,605	45,031	102,059

*For footnotes, see page 202.**Remaining contractual maturity of investment contract liabilities**(Audited)*

	Liabilities under investment contracts issued by insurance manufacturing subsidiaries <sup>46</sup>			Total US\$m
	Unit-linked investment contracts US\$m	Investment contracts with DPF US\$m	Other investment contracts US\$m	
Remaining contractual maturity:				
due within 1 year	151		389	540
due over 1 year to 5 years	133			133
due over 5 years to 10 years	194			194
due after 10 years	766			766
undated <sup>56</sup>	1,298	25,068	3,765	30,131
<b>At 31 December 2014</b>	<b>2,542</b>	<b>25,068</b>	<b>4,154</b>	<b>31,764</b>
Remaining contractual maturity:				
due within 1 year	232		454	686
due over 1 year to 5 years	778			778
due over 5 years to 10 years	852			852
due after 10 years	2,254			2,254

undated	5,614	26,427	3,755	35,796
At 31 December 2013	9,730	26,427	4,209	40,366

*For footnotes, see page 202.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)**Insurance risk**

Insurance risk is principally measured in terms of liabilities under the contracts in force.

A principal risk we face is that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income. The cost of claims and benefits can be influenced by many factors, including

mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities. The following table analyses our life insurance risk exposures by geographical region and by type of business. The insurance risk profile and related exposures remain largely consistent with those observed at 31 December 2013.

*Analysis of insurance risk liabilities under insurance contracts*<sup>46</sup>

(Audited)

	Europe US\$m	Asia US\$m	Latin America US\$m	Total US\$m
Non-linked insurance <sup>55</sup>	829	34,261	1,883	36,973
Insurance contracts with DPF <sup>57</sup>	367	29,112		29,479
Credit life	56	87		143
Annuities	71	127	1,275	1,473
Other	335	4,935	608	5,878
Unit-linked insurance	1,415	5,729	4,676	11,820
Investment contracts with DPF <sup>41,57</sup>	25,068			25,068
<b>Liabilities under insurance contracts at 31 December 2014</b>	<b>27,312</b>	<b>39,990</b>	<b>6,559</b>	<b>73,861</b>
Non-linked insurance <sup>55</sup>	1,383	30,554	2,013	33,950
Insurance contracts with DPF <sup>57</sup>	380	26,540		26,920
Credit life	130	74		204
Annuities	622	129	1,407	2,158
Other	251	3,811	606	4,668
Unit-linked insurance	3,976	5,065	4,763	13,804
Investment contracts with DPF <sup>41,57</sup>	26,427			26,427

Liabilities under insurance contracts at 31 December 2013	31,786	35,619	6,776	74,181
--	--------	--------	-------	--------

*For footnotes, see page 202.*

Our most significant life insurance products are insurance contracts with DPF issued in Hong Kong, investment contracts with DPF issued in France and unit-linked contracts issued in Latin America, Hong Kong and the UK.

### **Sensitivities to non-economic assumptions**

*(Audited)*

Policyholder liabilities and PVIF for life manufacturers are determined by reference to non-economic assumptions including mortality and/or morbidity, lapse rates and expense rates. The table below shows the sensitivity of profit and total equity to reasonably possible changes in these non-economic assumptions at that date across all our insurance manufacturing subsidiaries.

Mortality and morbidity risk is typically associated with life insurance contracts. The effect on profit of an increase in mortality or morbidity depends on the type of business being written. Our largest exposures to mortality and morbidity risk exist in Brazil, France and Hong Kong.

Sensitivity to lapse rates depends on the type of contracts being written. For insurance contracts, claims are funded by premiums received and income earned on the investment portfolio supporting the liabilities. For a portfolio of term assurance, an increase

in lapse rates typically has a negative effect on profit due to the loss of future premium income on the lapsed policies. However, some contract lapses have a positive effect on profit due to the existence of policy surrender charges. Brazil, France, Hong Kong and the UK are where we are most sensitive to a change in lapse rates.

Expense rate risk is the exposure to a change in the cost of administering insurance contracts. To the extent that increased expenses cannot be passed on to policyholders, an increase in expense rates will have a negative effect on our profits.

### **Sensitivity analysis**

*(Audited)*

	<b>2014</b>	2013
	<b>US\$m</b>	US\$m
<b>Effect on profit after tax and total equity at 31 December</b>		
10% increase in mortality and/or morbidity rates	<b>(65)</b>	(76)
10% decrease in mortality and/or morbidity rates	<b>72</b>	79
10% increase in lapse rates <sup>57</sup>	<b>(108)</b>	(119)
10% decrease in lapse rates <sup>57</sup>	<b>122</b>	133
10% increase in expense rates	<b>(106)</b>	(101)
10% decrease in expense rates	<b>106</b>	100

*For footnote, see page 202.*





**Table of Contents****Report of the Directors: Financial Review** (continued)**Other material risks**

	Page	App <sup>1</sup>	Tables	Page
	199			
- <b><u>Reputational risk</u></b>		235		
- <b><u>Fiduciary risk</u></b>	200			
- <b><u>Pension risk</u></b>	200	236		
- <u>The principal plan</u>	200		<i>The principal plan target asset allocation</i>	200
-			<i>Benefit payments (US\$m)</i>	201
- <u>Future developments</u>	201			
- <u>Defined contribution plans</u>	201			
- <b><u>Sustainability risk</u></b>	201	237		
- 1 Appendix to Risk risk policies and practices.				

**Reputational risk***(Unaudited)*

Reputational risk is the failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC itself, our employees or those with whom we are associated, that might cause stakeholders to form a negative view of HSBC.

Reputational risk relates to perceptions, whether based on fact or otherwise. Stakeholders' expectations are constantly changing and thus reputational risk is dynamic and varies between geographies, groups and individuals. As a global bank, HSBC shows unwavering commitment to operating, and to be seen to be operating, to the high standards we have set for ourselves in every jurisdiction. Reputational risk might result in financial or non-financial impacts, loss of confidence, adverse effects on our ability to keep and attract customers, or other consequences. Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk.

A number of measures to address the requirements of the US DPA and otherwise to enhance our AML, sanctions and other regulatory compliance frameworks have been taken and/or are ongoing. These measures, which should also serve over time to enhance our reputational risk management, include the following:

simplifying our business through the progressive implementation of our Group strategy, including the adoption of a global financial crime risk filter, which should help to standardise our approach to doing business in higher risk countries;

an increase in reputational risk resources in each region in which we operate and the introduction of a central case management and tracking process for reputational risk and client relationship matters;

the creation of combined reputational risk and client selection committees within the global businesses with a clear process to escalate and address matters at the appropriate level;

the continued roll-out of training and communication about the HSBC Values Programme that defines the way everyone in the Group should act and seeks to ensure that the Values are embedded into our operations; and

the continuous development and implementation of the Global Standards around financial crime compliance, which underpin our businesses. This includes ensuring globally consistent application of policies that govern AML and sanctions compliance programmes.

In July 2014, the new reputational risk and customer selection policies were issued which define a consistent and structured approach to managing these risks:

*Reputational risk (new policy):* defines reputational risk and sets out HSBC's approach to managing it;

*Customer selection and business acceptance (new policy):* outlines the risk factors to be considered when a new customer relationship is identified;

*Customer selection and exit management:* establishes the globally sustainable approach to customer selection and exit management for all accounts and relationships in all business lines. This details the criteria under which escalation or approval is required; and

*Sixth filter:* customers operating in high risk jurisdictions carry particular financial crime risks and may require specific approvals, or be considered for an exit, if the relationship exceeds HSBC's global risk appetite. HSBC has zero tolerance for knowingly engaging in any business, activity or association where foreseeable reputational damage has not been considered and mitigated. There must be no barriers to open discussion and the escalation of issues that could affect the Group negatively. While there is a level of risk in every aspect of business activity, appropriate consideration of potential harm to HSBC's good name must be a part of all business decisions.

Detecting and preventing illicit actors' access to the global financial system calls for constant vigilance and we will continue to cooperate closely with all governments to achieve success. This is integral to the execution of our strategy, to HSBC Values and to preserving and enhancing our reputation.

HSBC HOLDINGS PLC

199

## **Table of Contents**

### **Report of the Directors: Financial Review** (continued)

#### **Fiduciary risk**

*(Unaudited)*

**Fiduciary risk is the risk to the Group of breaching our fiduciary duties when we act in a fiduciary capacity as trustee or investment manager or as mandated by law or regulation.**

A fiduciary duty is one where HSBC holds, manages, oversees or has responsibility for assets for a third party that involves a legal and/or regulatory duty to act with a high standard of care and with good faith. A fiduciary must make decisions and act in the interests of the third party and must place the wants and needs of the client first, above the needs of the Group.

We may be held liable for damages or other penalties caused by failure to act in accordance with these duties. Fiduciary duties may also arise in other circumstances, such as when we act as an agent for a principal, unless the fiduciary duties are specifically excluded (e.g. under the agency appointment contract).

Our principal fiduciary businesses (the designated businesses ) have developed fiduciary risk appetite statements for their various fiduciary roles and have put in place key indicators to monitor their related risks.

#### **Pension risk**

*(Audited)*

**We operate a number of defined benefit and defined contribution pension plans throughout the world. The majority of pension risk arises from the Group's defined benefit plans of which the largest is the HSBC Bank (UK) Pension Scheme ( the principal plan ).**

During 2014, a new global pension risk framework was established, with accompanying new global policies on the management of risks related to defined benefit and defined contribution plans. In addition, a new Global Pensions Oversight Committee was established to oversee the running of all pension plans sponsored by HSBC around the world.

At 31 December 2014, the Group's aggregate defined benefit pension plan obligation was US\$42bn and the net asset was US\$2.7bn (2013: US\$40bn and US\$0.1bn, respectively). The increase in the net asset was mainly due to the increase in the principal plan's assets exceeding the increase in its benefit obligation. Of the Group total amounts, the principal plan contributed US\$30bn to the defined benefit obligation and US\$4.8bn to the net asset. The principal plan is the largest contributor to pension risk in the Group.

#### **The principal plan**

*(Audited)*

The principal plan is overseen by a corporate trustee who has fiduciary responsibility for the operation of the pension scheme. The principal plan comprises a defined benefit section and a defined contribution section. Unless stated otherwise, this narrative relates to the defined benefit section.

The investment strategy of the principal plan is to hold the majority of assets in bonds, with the remainder in a more diverse range of investments, and includes a portfolio of interest rate and inflation swaps in order to reduce interest rate risk and inflation risk (see Note 41 in the Financial Statements). The target asset allocation of the principal plan at the year-end is shown below. HSBC and the trustee have developed a general framework which, over time, will see the plan's asset strategy evolve to be less risky: this is described in further detail below.

*The principal plan's target asset allocation*

	<b>2014</b>	2013
	%	%
Equities <sup>58</sup>	<b>19.4</b>	19.4
Bonds	<b>64.5</b>	64.5
Alternative assets <sup>59</sup>	<b>10.6</b>	10.6
Property	<b>5.5</b>	5.5
Cash <sup>60</sup>		
<b>At 31 December</b>	<b>100.0</b>	100.0

*For footnotes, see page 202.*

The latest actuarial valuation of the principal plan was made as at 31 December 2011 by C G Singer, Fellow of the Institute and Faculty of Actuaries, of Towers Watson Limited. At that date, the market value of the plan's assets was £18bn (US\$28bn) (including assets relating to both the defined benefit and defined contribution plans, and additional voluntary contributions). The market value of the plan assets represented 100% of the amount expected to be required, on the basis of the assumptions adopted, to provide the benefits accrued to members after allowing for expected future increases in earnings under the projected unit method. There was therefore no resulting surplus/deficit and hence no recovery plan was required.

The expected cash flows from the principal plan were projected by reference to the Retail Price Index ( RPI ) swap break-even curve at 31 December 2011. Salary increases were assumed to be 0.5% per annum above RPI and inflationary pension increases, subject to a minimum of 0% and a maximum of 5% (maximum of 3% per annum in respect of service accrued since 1 July 2009), were assumed to be in line with RPI. The projected cash flows were discounted at the Libor swap curve at 31 December 2011 plus a margin for the expected return on the investment strategy of 160bps per annum. The mortality experience of the principal plan's pensioners over the six-year period (2006-2011) was analysed and, on the basis of this analysis, the mortality assumptions were set, based on the SAPS S1 series of tables adjusted to reflect the pensioner experience. Allowance was made for future improvements to mortality rates in line with the Continuous Mortality Investigation core projections with a long-run improvement rate set at 2% for males and 1.5% for females. The benefits expected to be payable from the defined benefit plan from 2015 are shown in the chart below.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)*Future benefit payments (US\$m)*

As part of the 31 December 2011 valuation, calculations were also made of the amount of assets that might be needed to meet the liabilities if the principal plan was discontinued and the members' benefits bought out with an insurance company (although in practice this may not be possible for a plan of this size) or the Trustee continued to run the plan without the support of HSBC. The amount required under this approach was estimated to be £26bn (US\$41bn) as at 31 December 2011. In arriving at this estimation, a more prudent assumption about future mortality was made than for the assessment of the ongoing position and it was assumed that the Trustee would alter the investment strategy to be an appropriately matched portfolio of UK government bonds. An explicit allowance for expenses was also included.

HSBC and the trustee have developed a general framework which, over time, will see the principal plan's asset strategy evolve to be less risky and further aligned to the expected future cash-flows, referred to as the Target Matching Portfolio (TMP). The TMP would therefore contain sufficient assets, the majority of which will be bond-like in nature, which are more closely aligned to the liability profile. Progress towards the TMP can be achieved by asset returns in excess of that assumed and/or additional funding. In 2013, HSBC agreed to make general framework contributions of £64m (US\$100m) in each of the calendar years 2013, 2014 and 2015 as well as £128m (US\$200m) in 2016. Further contributions have been agreed to be made in future years, which are linked to the continued implementation of the general framework.

HSBC Bank is also making contributions to the principal plan in respect of the accrual of benefits

of defined benefit section members. Since April 2013, HSBC has paid contributions at the rate of 43% of pensionable salaries (less member contributions). Contribution levels will be reviewed as part of the next actuarial valuation, which has an effective date of 31 December 2014. The results of this valuation are expected to be included in the Annual Report and Accounts 2015.

*Future developments*

*(Unaudited)*

Future service accrual for active members of the defined benefit section will cease with effect from 30 June 2015. All active members of the defined benefit section will become members of the defined contribution section from 1 July 2015, and their accrued defined benefit pensions based on service to 30 June 2015 will continue to be linked to final salary on retirement (underpinned by increases in CPI). The defined benefit service cost will therefore reduce to zero from 1 July 2015 and the defined contribution service cost will increase.

**Defined contribution plans**

Our global strategy is to move from defined benefit pension provisions to defined contribution, dependent on local legislative requirements and emerging practice. In defined contribution pension plans, the sponsor contributions are known, while the ultimate benefit will vary, typically with investment returns achieved by employee investment choices. While the market risk of defined contribution plans is significantly less than that of defined benefit plans, the Bank is still exposed to operational and reputational risk.

### **Sustainability risk**

*(Unaudited)*

Assessing the environmental and social impacts of providing finance to our customers is integral to our overall risk management processes.

In 2014, we issued new policies on forestry, agricultural commodities, World Heritage Sites and Ramsar Wetlands, following an extensive internal and external review of our previous forestry policy. The results of two independent reviews into the content and implementation of our previous policy were published on [www.hsbc.com](http://www.hsbc.com).

*A summary of our current policies and practices regarding reputational risk, pension risk and sustainability risk is provided in the Appendix to Risk on page 235.*

HSBC HOLDINGS PLC

201



**Table of Contents****Report of the Directors: Financial Review** (continued)**Footnotes to Risk****Credit risk**

- 1 *From 1 January 2014, non-trading reverse repos and repos are presented as separate lines in the balance sheet. Previously, non-trading reverse repos were included within Loans and advances to banks and Loans and advances to customers and non-trading repos were included within Deposits by banks and Customer accounts. Comparative data have been re-presented accordingly.*
- 2 *At 31 December 2014, the credit quality of financial guarantees and similar contracts was: US\$17bn strong, US\$16bn good, US\$12bn satisfactory, and US\$2bn sub-standard.*
- 3 *The amount of the loan commitments reflects, where relevant, the expected level of take-up of pre-approved loan offers made by mailshots to personal customers. In addition to those amounts, there is a further maximum possible exposure to credit risk of US\$71bn (2013: US\$34bn), reflecting the full take-up of loan commitments. The take-up of such offers is generally at modest levels. At 31 December 2014, the credit quality of loan and other credit-related commitments was: US\$322bn strong, US\$191bn good, US\$127bn satisfactory, US\$10bn sub-standard and US\$0.8bn impaired.*
- 4 *From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (see Note 23 on the Financial Statements for further details). Comparative data have been re-presented to reflect this change.*
- 5 *Financial includes loans and advances to banks.*
- 6 *First lien residential mortgages include Hong Kong Government Home Ownership Scheme loans of US\$3.4bn at 31 December 2014 (2013: US\$3.2bn). Where disclosed, earlier comparatives were 2012: US\$3.2bn; 2011: US\$3.3bn; 2010: US\$3.5bn.*
- 7 *Other personal lending includes second lien mortgages and other property-related lending.*
- 8 *Other commercial loans and advances include advances in respect of agriculture, transport, energy and utilities.*
- 9 *Impairment allowances are not reported for financial instruments, for which the carrying amount is reduced directly for impairment and not through the use of an allowance account.*
- 10 *Impairment is not measured for assets held in trading portfolios or designated at fair value as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly to the income statement. Consequently, we report all such balances under Neither past due nor impaired.*
- 11 *Loans and advances to customers includes asset-backed securities that have been externally rated as strong (2014: US\$1.2bn; 2013: US\$1.7bn), good (2014: US\$256m; 2013: US\$255m), satisfactory (2014: US\$332m; 2013: US\$200m), sub-standard (2014: US\$94m; 2013: US\$283m) and impaired (2014: US\$128m; 2013: US\$252m).*
- 12 *Collectively assessed impairment allowances are allocated to geographical segments based on the location of the office booking the allowances or provisions.*
- 13 *Included within Exchange and other movements is US\$0.4bn of impairment allowances reclassified to held for sale (2013: US\$0.2bn).*
- 14 *Of the US\$2,724m (2013: US\$3,580m) of renegotiated loans, US\$608m (2013: US\$716m) were neither past due nor impaired, US\$1m (2013: US\$52m) was past due but not impaired and US\$2,115m (2013: US\$2,812m) were*

*impaired.*

- 15 *French Banking Federation Master Agreement Relating to Transactions on Forward Financial Instruments plus CSA equivalent.*
- 16 *The German Master Agreement for Financial Derivative Transactions.*
- 17 *HSBC Finance lending is shown on a management basis and includes loans transferred to HSBC USA Inc. which are managed by HSBC Finance.*
- 18 *Property acquired through foreclosure is initially recognised at the lower of the carrying amount of the loan or its fair value less estimated costs to sell ( initial foreclosed property carrying amount ). The average gain/loss on sale of foreclosed properties is calculated as cash proceeds less the initial foreclosed properties carrying amount divided by the unpaid loan principal balance prior to write-down (excluding any accrued finance income) plus certain other ancillary disbursements that, by law, are reimbursable from the cash proceeds (e.g. real estate tax advances) and were incurred prior to our taking title to the property. This ratio represents the portion of our total loss on foreclosed properties that occurred after we took title to the property.*
- 19 *The average total gain/loss on foreclosed properties includes both the gain/loss on sale of the foreclosed property as discussed in footnote 18 and the cumulative write-downs recognised on the loans up to the time we took title to the property.*
- 20 *Included in this category are loans of US\$1.5bn (2013: US\$1.9bn) that have been re-aged once and were less than 60 days past due at the point of re-age. These loans are not classified as impaired following re-age due to the overall expectation that these customers will perform on the original contractual terms of their borrowing in the future.*
- 21 *Currency translation is the effect of translating the results of subsidiaries and associates for the previous year at the average rates of exchange applicable in the current year.*
- 22 *Negative numbers are favourable: positive numbers are unfavourable.*
- 23 *Carrying amount of the net principal exposure.*
- 24 *Total includes holdings of ABSs issued by Freddie Mac and Fannie Mae.*

#### **Liquidity and funding**

- 25 *The most favourable metrics are smaller advances to core funding and larger stressed one-month and three-month coverage ratios.*
- 26 *The HSBC UK entity shown comprises four legal entities; HSBC Bank plc (including all overseas branches, and SPEs consolidated by HSBC Bank plc for Financial Statement purposes), Marks and Spencer Financial Services Limited, HSBC Private Bank (UK) Ltd and HSBC Trust Company (UK) Limited, managed as a single operating entity, in line with the application of UK liquidity regulation as agreed with the UK PRA.*
- 27 *The Hongkong and Shanghai Banking Corporation represents the Group in Hong Kong, including its overseas branches. Each branch is monitored and controlled for liquidity and funding risk purposes as a stand-alone operating entity.*
- 28 *The HSBC USA principal entity shown represents the HSBC USA Inc consolidated group; predominantly HSBC USA Inc and HSBC Bank USA, NA. The HSBC USA Inc consolidated group is managed as a single operating entity.*
- 29 *The total shown for other principal HSBC operating entities represents the combined position of all the other operating entities overseen directly by the Risk Management Meeting of the GMB.*
- 30 *Estimated liquidity value represents the expected realisable value of assets prior to management assumed haircuts.*
- 31 *The undrawn balance for the five largest committed liquidity facilities provided to customers other than facilities to conduits.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

32 *The undrawn balance for the total of all committed liquidity facilities provided to the largest market sector, other than facilities to conduits.*

33 *The residual contractual maturity profile of the balance sheet is set out on in Note 31 on the Financial Statements.*

**Market risk**

34 *Trading portfolios comprise positions arising from the market-making and warehousing of customer-derived positions.*

35 *Portfolio diversification is the market risk dispersion effect of holding a portfolio containing different risk types. It represents the reduction in unsystematic market risk that occurs when combining a number of different risk types, for example, interest rate, equity and foreign exchange, together in one portfolio. It is measured as the difference between the sum of the VaR by individual risk type and the combined total VaR. A negative number represents the benefit of portfolio diversification. As the maximum occurs on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for these measures. For presentation purposes, portfolio diversification within the trading portfolio includes VaR-based RNIV.*

36 *The total VaR is non-additive across risk types due to diversification effects.*

37 *Investments in private equity are primarily made through managed funds that are subject to limits on the amount of investment. Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio as a whole. Regular reviews are performed to substantiate the valuation of the investments within the portfolio.*

38 *Investments held to facilitate ongoing business include holdings in government-sponsored enterprises and local stock exchanges.*

39 *Instead of assuming that all interest rates move together, we group our interest rate exposures into currency blocs whose rates are considered likely to move together. See Cautionary statement regarding forward-looking statements .*

**Risk management of insurance operations**

40 *Other includes term assurance, credit life insurance, universal life insurance and remaining non-life insurance.*

41 *Although investment contracts with discretionary participation features ( DPF ) are financial investments, HSBC continues to account for them as insurance contracts as permitted by IFRS 4.*

42 *The Other assets column shows shareholder assets as well as assets and liabilities classified as held for sale. The majority of the assets for insurance businesses classified as held for sale are reported as Other assets and investment properties and totalled US\$6.8bn at 31 December 2014 (31 December 2013: nil). The majority of these assets were debt and equity securities. All liabilities for insurance businesses classified as held for sale are reported in Other liabilities and totalled US\$6.8bn at 31 December 2014 (31 December 2013: nil). The majority of these liabilities were liabilities under insurance contracts and liabilities under investment contracts.*

43 *Present value of in-force long-term insurance contracts and investment contracts with DPF.*

44 *Deferred tax includes the deferred tax liabilities arising on recognition of PVIF.*

45

*Does not include associated insurance company SABB Takaful Company or joint venture insurance company Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited.*

- 46 *HSBC has no insurance manufacturing subsidiaries in the Middle East and North Africa or North America.*
- 47 *Comprise unit-linked life insurance contracts and linked long-term investment contracts.*
- 48 *Comprise non-linked insurance contracts and non-linked long-term investment contracts.*
- 49 *Comprise mainly loans and advances to banks, cash and intercompany balances with other non-insurance legal entities.*
- 50 *The cost of guarantees figure presented comprises the modelled cost of guarantees under products manufactured by our insurance subsidiaries, including both the cost of guarantees reserved for through policyholder liabilities and the amount accounted for as a deduction to PVIF. This is considered to provide more relevant information than the total liabilities to policyholders established for guaranteed products manufactured by our insurance subsidiaries as disclosed in prior periods.*
- 51 *A block of contracts in France with guaranteed nominal annual returns in the range 1.25%-3.72% are reported entirely in the 2.1%-4.0% category in line with the average guaranteed return of 2.7% offered to policyholders by these contracts.*
- 52 *Real annual return guarantees provide the policyholder a guaranteed return in excess of the rate of inflation, and are supported by inflation-linked debt securities with yields that are also expressed in real terms.*
- 53 *Where a 100 basis point parallel shift in the yield curve would result in a negative interest rate, the effects on profit after tax and total equity have been calculated using a minimum rate of 0%.*
- 54 *Shareholders' funds comprise solvency and unencumbered assets.*
- 55 *Non-linked insurance includes remaining non-life business.*
- 56 *In most cases, policyholders have the option to terminate their contracts at any time and receive the surrender values of their policies. These may be significantly lower than the amounts shown.*
- 57 *Insurance contracts and investment contracts with DPF can give policyholders the contractual right to receive, as a supplement to their guaranteed benefits, additional benefits that may be a significant portion of the total contractual benefits, but whose amount and timing are determined by HSBC. These additional benefits are contractually based on the performance of a specified pool of contracts or assets, or the profit of the company issuing the contracts.*

**Pension risk**

- 58 *In 2014, option overlay strategies which are expected to improve the risk/return profile of the equity allocation were implemented.*
- 59 *Alternative assets includes ABSs, MBSs and infrastructure assets.*
- 60 *Whilst there is no target cash allocation, the amount of cash is expected to vary between 0-5% depending upon the liquidity requirements of the scheme, which will affect the actual allocation of bonds correspondingly.*

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Risk elements in the loan portfolio**

61 *In addition to the numbers presented there were US\$0.5bn of impaired loans (2013: US\$0.2bn); US\$1m unimpaired loans contractually more than 90 days past due as to principal or interest (2013: US\$40m); and US\$ nil of troubled debt restructurings (not included in the classifications above) (2013: US\$70m), all relating to assets held for sale at 31 December 2014.*

62 *Assets held for resale represent assets obtained by taking possession of collateral held as security for financial assets.*

63 *Ratio excludes trading loans classified as in default.*

**Country distribution of outstandings and cross-border exposures**

64 *These balances were between 0.75% and 1% of total assets. All other balances were above 1%.*

HSBC HOLDINGS PLC

203a

**Table of Contents****Report of the Directors: Financial Review** (continued)**Appendix to Risk****Risk policies and practices**

*This appendix describes the significant policies and practices employed by HSBC in managing our credit risk, liquidity and funding, market risk, operational risk (including compliance risk, legal risk and fiduciary risk), insurance risk, reputational risk, pension risk and sustainability risk.*

**Risk governance**

*(Unaudited)*

Our strong risk governance reflects the importance placed by the Board and the Group Risk Committee ( GRC ) on shaping the Group s risk strategy and managing risks effectively. It is supported by a clear policy framework of risk ownership, a risk appetite process through which the types and levels of risk that we are prepared to accept in executing our strategy are articulated and monitored, performance scorecards cascaded from the GMB that align business and risk objectives, and the accountability of all staff for identifying, assessing and managing risks within the scope of their assigned responsibilities. This personal accountability, reinforced by the governance structure, mandatory learning and our approach to remuneration, helps to foster a disciplined and constructive culture of risk management and control throughout HSBC.

The executive and non-executive risk governance structures and their interactions are set out in the following table. Each major operating subsidiary has established a board committee with non-executive responsibility for oversight of risk-related matters and an executive committee with responsibility for risk-related matters.

*Governance structure for the management of risk*

<b>Authority</b>	<b>Membership</b>	<b>Responsibilities include:</b>
Board	Executive and non-executive Directors	Approving risk appetite, strategy and performance targets for the Group

Approving appointment of chief risk officers of subsidiary companies

Encouraging a strong risk governance culture which shapes the Group's attitude to risk

GRC

Independent non-executive Directors

Advising the Board on:

risk appetite and alignment with strategy

alignment of remuneration with risk appetite (through advice to the Group Remuneration Committee)

risks associated with proposed strategic acquisitions and disposals

Overseeing high-level risk related matters

Reviewing the effectiveness of the Group's systems of risk management and internal controls (other than over financial reporting)

Overseeing the maintenance and development of a supportive culture in relation to the management of risk

Financial System Vulnerabilities Committee

Non-executive Directors, including the Chairman of the Group Remuneration Committee, and

Overseeing controls and procedures designed to identify areas of exposure to financial crime or system abuse

co-opted non-director members

Overseeing matters relating to anti-money laundering, sanctions, terrorist financing and proliferation financing

Reviewing policies and procedures to ensure continuing obligations to regulatory and law enforcement agencies are met

Conduct & Values Committee

Independent non-executive Directors

Ensuring that in the conduct of its business, HSBC treats all stakeholders fairly

Advising the Board on HSBC policies, procedures and standards to ensure that the Group conducts business responsibly and consistently adheres to the HSBC Values

HSBC HOLDINGS PLC



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

<b>Authority</b>	<b>Membership</b>	<b>Responsibilities include:</b>
Risk Management Meeting of the GMB	Group Chief Risk Officer Chief Legal Officer Group Chief Executive Group Finance Director All other Group Managing Directors	Formulating high-level global risk policy Exercising delegated risk management authority Overseeing implementation of risk appetite and controls Monitoring all categories of risk and determining appropriate mitigating action Promoting a supportive Group culture in relation to risk management and conduct Implementing Global Standards throughout the Group
Global Risk Management Board	Group Chief Risk Officer Chief Risk Officers of HSBC's global businesses and regions	Supporting the Risk Management Meeting and the Group Chief Risk Officer in providing strategic direction for the Global Risk function, setting priorities and overseeing their execution

	Heads of Global Risk sub-functions	Overseeing consistent approach to accountability for, and mitigation of, risk across the Global Risk function
Global Business Risk Management Committees	Global Business Chief Risk Officer	Forward looking assessment of changes in Global Business activities or the markets in which it operates, analysing the possible risk impact and taking appropriate action
	Global Business Chief Executive	
	Global Business Chief Financial Officer	Overseeing the implementation of Global Business risk appetite and controls
	Heads of Global Risk sub-functions, as appropriate	
		Monitoring all categories of risk and determining appropriate mitigating actions
		Promoting a strong risk culture
Regional Risk Management Committees	Regional Chief Risk Officer	Formulating regional specific risk policy
	Regional Chief Executive Officer	
	Regional Chief Financial Officer	Overseeing the implementation of regional risk appetite and controls
	Regional Global Business Chief	
	Heads of Global Risk sub-functions, as appropriate	Monitoring all categories of risk and determining appropriate mitigating actions
		Promoting a strong risk culture
Subsidiary board committees responsible for risk-related matters and global business risk committees	Independent non-executive directors and/or HSBC employees with no line or functional responsibility for the activities of the relevant	Providing reports to the GRC or intermediate risk committee on risk-related matters and internal controls (other than over financial reporting) of relevant subsidiaries or businesses, as requested

subsidiary or global business, as appropriate

The governance framework also defines the required structure of committees for Risk sub-functions, stress testing and other key areas at Group, global business, regional and country level.

## Risk appetite

*(Unaudited)*

Our risk appetite framework is underpinned by the following core characteristics. These are applied to define the risk appetite statements on Group-wide, global business and regional levels.

**Strong capital position:** defined by a strong CET1 ratio and overall capital structure, both from a regulatory and internal perspective, which is not overly leveraged;

**Conservative liquidity management:** defined by a diversified funding structure and a conservative discipline whereby subsidiaries plan their contingency liquidity requirements on the assumption that there is no lender of last resort, either in the form of local supervisory intervention or via support from HSBC Holdings;

**Strong balance sheet:** core to HSBC's philosophy, generating a resilient stream of earnings;

**Strong brand:** our brand as the world's leading international bank is of paramount importance as is the Group's reputation and the quality of its business ethics;

**Risk must be commensurate with returns:** returns should be generated in line with the risk taken and in alignments with strategic plans and risk management policies;

**Robust Group structure of separate legal entities:** the legal entity structure provides the potential for firewalls to mitigate liquidity and capital contagion in crisis situations;

**The global business mix should produce sustainable long-term earnings growth:** our global businesses should be suitably diversified to provide a stream of non-volatile, predictable earnings;

HSBC HOLDINGS PLC

---

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Risk diversification:** the globally diverse nature of our activities produces significant risk diversification benefits which must be closely assessed on an ongoing basis and reflected in our capital requirements; and

**Financial crime risk:** our overarching approach and appetite to financial crime risk is that the Group will not tolerate operating without systems and controls in place aimed at preventing and detecting financial crime and will not conduct business with individuals or entities we believe are engaged in illicit behaviour.

**Credit risk**

**Credit risk management**

*(Audited)*

The role of an independent credit control unit is fulfilled by the Global Risk function. Credit approval authorities are delegated by the Board to certain executive officers of HSBC Holdings. Similar credit approval authorities are delegated by the boards of subsidiary companies to executive officers of the relevant subsidiaries. In each major subsidiary, a Chief Risk Officer reports to the local Chief Executive Officer on credit-related issues, while maintaining a direct functional reporting line to the Group Chief Risk Officer in Global Risk. Details of the roles and responsibilities of the credit risk management function and the policies and procedures for managing credit risk are set out below. There were no significant changes in 2014.

**The high-level oversight and management of credit risk provided globally by the Credit Risk function in Global Risk**

to formulate Group credit policy. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with Group policies;

to guide operating companies on our appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;

to undertake an independent review and objective assessment of risk. Global Risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;

to monitor the performance and management of portfolios across the Group;

to control exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading;

to set Group policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to our capital base, and remain within internal and regulatory limits;

to control our cross-border exposures (see page 207);

to maintain and develop our risk rating framework and systems, the governance of which is under the general oversight of the Group Model Oversight Committee ( MOC ). The Group MOC meets bi-monthly and reports to the Risk Management Meeting. It is chaired by the risk function and its membership is drawn from Global Risk and relevant global functions or businesses;

to report to the Risk Management Meeting, the GRC and the Board on high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances, stress testing results and recommendations and retail portfolio performance; and

to act on behalf of HSBC Holdings as the primary interface, for credit-related issues, with the Bank of England, the PRA, local regulators, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

### **Principal objectives of our credit risk management**

to maintain across HSBC a strong culture of responsible lending and a robust risk policy and control framework;

to both partner and challenge our businesses in defining, implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and

to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

### Concentration of exposure

*(Audited)*

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics or such counterparties are engaged in similar activities or operate in the same geographical areas or industry sectors so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. We use a number of controls and measures to minimise undue concentration of exposure in our portfolios across industry, country and global business. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Wrong-way risk occurs when a counterparty's exposures are adversely correlated with its credit quality. There are two types of wrong-way risk:

general wrong-way risk occurs when the probability of counterparty default is positively correlated with general risk factors such as, for example, where the counterparty is resident and/or incorporated in a higher-risk country and seeks to sell a non-domestic currency in exchange for its home currency; and

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

specific wrong-way risk occurs when the exposure to a particular counterparty is positively correlated with the probability of counterparty default, such as a reverse repo on the counterparty's own bonds. It is HSBC policy that specific wrong-way transactions are approved on a case-by-case basis.

We use a range of tools to monitor and control wrong-way risk, including requiring the business to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines.

### **Cross-border exposures**

We assess the vulnerability of countries to foreign currency payment restrictions, including economic and political factors, when considering impairment allowances on cross-border exposures. Impairment allowances are assessed in respect of all qualifying exposures within vulnerable countries unless these exposures and the inherent risks are:

performing, trade-related and of less than one year's maturity;  
mitigated by acceptable security cover which is, other than in exceptional cases, held outside the country concerned; in the form of securities held for trading purposes for which a liquid and active market exists, and which are measured at fair value daily; and  
performing facilities with a principal (excluding security) of US\$1m or below and/or with maturity dates shorter than three months.

### **Credit quality of financial instruments**

*(Audited)*

Our credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts that are predominantly within our wholesale businesses, risk ratings are reviewed regularly and any amendments are implemented promptly. Within our retail businesses, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Our risk rating system facilitates the internal ratings-based approach under the Basel framework adopted by the Group to support calculation of our minimum credit regulatory capital requirement. Our credit quality classifications are defined below.

Special attention is paid to problem exposures in order to accelerate remedial action. When appropriate, our operating companies use specialist units to provide customers with support to help them avoid default wherever possible.

Group and regional Credit Review and Risk Identification teams regularly review exposures and processes in order to provide an independent, rigorous assessment of credit risk across the Group, reinforce secondary risk management controls and share best practice. Internal audit, as a tertiary control function, focuses on risks with a global perspective and on the design and effectiveness of primary and secondary controls, carrying out oversight audits via the sampling of global and regional control frameworks, themed audits of key or emerging risks and project audits to assess major

change initiatives.

The five credit quality classifications defined below each encompass a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities.

### Credit quality classification

(Unaudited)

	Debt securities		Wholesale lending		Retail lending	
	and other bills		and derivatives	12 month	Internal	Expected
Quality classification	External		Internal	probability of	credit rating <sup>1</sup>	loss %
	credit rating		credit rating	default %		
Strong	A and above		CRR <sup>2</sup> 1 to CRR2	0 0.169	EL <sup>3</sup> 1 to EL2	0 0.999
Good	BBB+ to BBB		CRR3	0.170 0.740	EL3	1.000 4.999
Satisfactory	BB+ to B and unrated		CRR4 to CRR5	0.741 4.914	EL4 to EL5	5.000 19.999
Sub-standard	B- to C		CRR6 to CRR8	4.915 99.999	EL6 to EL8	20.000 99.999
Impaired	Default		CRR9 to CRR10	100	EL9 to EL10	100+ or defaulted <sup>4</sup>

1 We observe the disclosure convention that, in addition to those classified as EL9 to EL10, retail accounts classified EL1 to EL8 that are delinquent by 90 days or more are considered impaired, unless individually they have been assessed as not impaired (see page 136, *Past due but not impaired gross financial instruments* ).

2 Customer risk rating.

3 Expected loss.

4 The EL percentage is derived through a combination of PD and LGD, and may exceed 100% in circumstances where the LGD is above 100% reflecting the cost of recoveries.

HSBC HOLDINGS PLC



---

**Table of Contents****Report of the Directors: Financial Review** (continued)**Quality classification definitions**

*Strong* exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

*Good* exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

*Satisfactory* exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.

*Sub-standard* exposures require varying degrees of special attention and default risk is of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

*Impaired* exposures have been assessed as impaired. These include wholesale exposures where the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse by the bank to the actions such as realising security if held, or the customer is past due more than 90 days on any material credit obligation; retail accounts include loans and advances classified as EL9 to EL10, and for those classified EL1 to EL8 they are greater than 90 days past due unless individually they have been assessed as not impaired; and renegotiated loans that have met the requirements to be disclosed as impaired and have not yet met the criteria to be returned to the unimpaired portfolio (see below).

The customer risk rating ( CRR ) 10-grade scale summarises a more granular underlying 23-grade scale of obligor probability of default ( PD ). All HSBC customers are rated using the 10 or 23-grade scale, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

Each CRR band is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time.

The expected loss ( EL ) 10-grade scale for retail business summarises a more granular underlying EL scale for this customer segment; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications based upon the mapping of related CRR to external credit grade. The most recent mapping review resulted in B being mapped to CRR5. Accordingly B ratings are now mapped to Satisfactory . This represents a change in disclosure mapping unrelated to changes in counterparty creditworthiness.

### Renegotiated loans and forbearance

*(Audited)*

A range of forbearance strategies is employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures and other forms of loan modifications and re-ageing.

Our policies and practices are based on criteria which enable local management to judge whether repayment is likely to continue. These typically provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has showed a willingness to repay their loan and is expected to be able to meet the revised obligations.

### Identifying renegotiated loans

The contractual terms of a loan may be modified for a number of reasons including changing market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer. When the contractual payment terms of a loan are modified because we have significant concerns about the borrower's ability to meet contractual payments when due, these loans are classified as renegotiated loans .

For retail lending our credit risk management policy sets out restrictions on the number and frequency of renegotiations, the minimum period an account must have been opened before any renegotiation can be considered and the number of qualifying payments that must be received. The application of this policy varies according to the nature of the market, the product and the management of customer relationships through the occurrence of exceptional events. When considering whether there is significant concern regarding a customer's ability to meet contractual loan repayments when due, we assess the customer's delinquency status, account behaviour, repayment history, current financial situation and continued ability to repay. If the customer is not meeting contractual repayments or it is evident that they will be unable to do so without the renegotiation, there will be a significant concern regarding their ability to meet contractual payments, and the loan will be disclosed as impaired, unless the concession granted is insignificant as discussed below.

**Table of Contents****Report of the Directors: Financial Review** (continued)

For loan restructurings in wholesale lending, indicators of significant concerns regarding a borrower's ability to pay include:

- the debtor is currently in default on any of its debt;
- the debtor has declared or is in the process of declaring bankruptcy or entering into a similar process;
- there is significant doubt as to whether the debtor will continue to be a going concern;
- currently, the debtor has securities that have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange as a result of trading or financial difficulties;
- based on estimates and projections that only encompass current business capabilities, the Group forecasts that the debtor's entity-specific cash flows will be insufficient to service the debt (both interest and principal) in accordance with the contractual terms of the existing agreement through maturity. In this instance, actual payment default may not yet have occurred; and
- absent the modification, the debtor cannot obtain funds from sources other than its existing creditors at an effective interest rate equal to the current market interest rate for similar debt for a non-distressed debtor.

Where the modification of a loan's contractual payment terms represents a concession for economic or legal reasons relating to the borrower's financial difficulty, and is a concession that we would not otherwise consider, then the renegotiated loan is disclosed as impaired in accordance with our impaired loan disclosure convention described in more detail on page 212, unless the concession is insignificant and there are no other indicators of impairment. Insignificant concessions are primarily restricted to our CML portfolio in HSBC Finance, where loans which are in the early stages of delinquency (less than 60 days delinquent) and typically have the equivalent of two payments deferred for the first time, are excluded from our impaired loan classification, as the contractual payment deferrals are deemed to be insignificant compared with payments due on the loan as a whole. For details of HSBC Finance's loan renegotiation programmes and portfolios, see pages 154 and 155.

**Credit quality classification of renegotiated loans**

*(Audited)*

Under IFRSs, an entity is required to assess whether there is objective evidence that financial assets are impaired at the end of each reporting period. A loan is impaired and an impairment allowance is recognised when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated. Granting a concession to a customer that we would not otherwise consider, as a result of their financial difficulty, is objective evidence of impairment and impairment losses are measured accordingly.

A renegotiated loan is presented as impaired when:

- there has been a change in contractual cash flows as a result of a concession which the lender would otherwise not consider, and

it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full.

This presentation applies unless the concession is insignificant and there are no other indicators of impairment.

The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that are assessed for impairment on a collective basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

For retail lending the minimum period of payment performance required depends on the nature of loans in the portfolio, but is typically not less than six months. Where portfolios have more significant levels of forbearance activity, such as that undertaken by HSBC Finance, the minimum repayment performance period required may be substantially more (for further details on HSBC Finance see page 153). Payment performance periods are monitored to ensure they remain appropriate to the levels of recidivism observed within the portfolio. These performance periods are in addition to a minimum of two payments which must be received within a 60-day period for the customer to initially qualify for the renegotiation (in the case of HSBC Finance, in certain circumstances, for example where debt has been restructured in bankruptcy proceedings, fewer or no qualifying payments may be required). The qualifying payments are required in order to demonstrate that the renegotiated terms are sustainable for the borrower. For corporate and commercial loans, which are individually assessed for impairment and where non-monthly payments are more commonly agreed, the history of payment performance will depend on the underlying structure of payments agreed as part of the restructuring.

Renegotiated loans are classified as unimpaired where the renegotiation has resulted from significant concern about a borrower's ability to meet their contractual payment terms but the renegotiated terms are based on current market rates and contractual cash flows are expected to be collected in full following the renegotiation. Unimpaired renegotiated loans also include previously impaired renegotiated loans that have demonstrated satisfactory performance over a period of time or have been assessed based on all available evidence as having no remaining indicators of impairment.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, such as in some debt consolidations, the new loan is disclosed as renegotiated.

When determining whether a loan that is restructured should be derecognised and a new loan recognised, we consider the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument. The following are examples of circumstances that, individually or in aggregate, are likely to result in this test being met and derecognition accounting being applied:

- an uncollateralised loan becomes fully collateralised;
- the addition or removal of cross-collateralisation provisions;
- removal or addition of conversion features attached to the loan agreement;
- a change in the currency in which the principal or interest is denominated;
- a change in the liquidation preference or ranking of the instrument; or
- the contract is altered in any other manner so that the terms under the new or modified contract are substantially different from those under the original contract.

The following are examples of factors that we consider may indicate that the revised loan is a substantially different financial instrument, but are unlikely to be conclusive in themselves:

- changes in guarantees or loan covenants provided;
- less significant changes to collateral arrangements; or
- the addition of repayment provisions or prepayment premium clauses.

**Renegotiated loans and recognition of impairment allowances**

*(Audited)*

For retail lending, renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment to reflect the higher rates of losses often encountered in these segments. When empirical evidence indicates an increased propensity to default and higher losses on such accounts, such as for re-aged loans in the US, the use of roll-rate methodology ensures these factors are taken into account when calculating impairment allowances by applying roll rates specifically calculated on the pool of loans subject to forbearance. When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, a basic formulaic approach based on historical loss rate experience is used. As a result of our roll-rate methodology, we recognise collective impairment allowances on homogeneous groups of loans, including renegotiated loans, where there is historical evidence that there is a likelihood that loans in these groups will progress through the various stages of delinquency, and ultimately prove irrecoverable as a result of events occurring before the balance sheet date. This treatment applies irrespective of whether or not those loans are presented as impaired in accordance with our impaired loans disclosure convention. When we consider that there are additional risk factors inherent in the portfolios that may

not be fully reflected in the statistical roll rates or historical experience, these risk factors are taken into account by adjusting the impairment allowances derived solely from statistical or historical experience. For further details of the risk factor adjustments see Note 1k on the Financial Statements.

In the corporate and commercial sectors, renegotiated loans are typically assessed individually. Credit risk ratings are intrinsic to the impairment assessment. A distressed restructuring is classified as an impaired loan. The individual impairment assessment takes into account the higher risk of the non-payment of future cash flows inherent in renegotiated loans.

### **Corporate and commercial forbearance**

*(Unaudited)*

In the corporate and commercial sectors, forbearance activity is undertaken selectively where it has been identified that repayment difficulties against the original terms have already materialised, or are very likely to materialise. These cases are treated as impaired loans where:

the customer is experiencing, or is very likely to experience, difficulty in meeting a payment obligation to the Group (i.e. due to current credit distress); and

the Group is offering to the customer revised payment arrangements which constitute a concession (i.e. it is offering terms it would not normally be prepared to offer).

These cases are described as distressed restructurings. The agreement of a restructuring which meets the criteria above requires all loans, advances and counterparty exposures to the customer to be treated as impaired. Against the background of this requirement, as a customer approaches the point at which it becomes clear that there is an increasing risk that a restructuring of this kind might be necessary, the exposures will typically be regarded as sub-standard to reflect the deteriorating credit risk profile and will be graded as impaired when the restructure is proposed for approval, or sooner if there is sufficient concern regarding the customer's likeliness to pay.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

For the purposes of determining whether changes to a customer's agreement should be treated as a distressed restructuring the following types of modification are regarded as concessionary:

transfers from the customer of receivables from third parties, real estate, or other assets to satisfy fully or partially a debt;  
issuance or other granting of an equity interest to satisfy fully or partially a debt unless the equity interest is granted pursuant to existing terms for converting the debt into an equity interest; and  
modification of the terms of a debt, such as one or more of the following:

reduction (absolute or contingent) of the stated interest rate for the remaining original life of the debt;  
extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk;  
reduction (absolute or contingent) of the face amount or maturity amount of the debt; and  
reduction (absolute or contingent) of accrued interest.

Modifications that are unrelated to payment arrangements, such as the restructuring of collateral or security arrangements or the waiver of rights under covenants within documentation, are not regarded by themselves to be evidence of credit distress affecting payment capacity. Typically, covenants are in place to give the Group rights of repricing or acceleration, but they are frequently set at levels where payment capacity has yet to be affected, providing rights of action at earlier stages of credit deterioration. Such concessions do not directly affect the customer's ability to service the original contractual debt and are not reported as renegotiated loans. However, where a customer requests a non-payment related covenant waiver, the significance of the underlying breach of covenant will be considered together with any other indicators of impairment, and where there is a degree of severity of credit distress indicating uncertainty of payment, all available evidence will be considered in determining whether a loss event has occurred. The waiver will not, however, trigger classification as a renegotiated loan as payment terms have not been modified.

When both payment-related and non-payment related modifications are made together as a result of significant concerns regarding the payment of contractual cash flows, the loan is treated as a distressed restructuring and disclosed as a renegotiated loan.

Within corporate and commercial business segments, modifications of several kinds are frequently agreed for a customer contemporaneously. Transfer to an interest-only arrangement is the most common type of modification granted in the UK, whether in isolation or in combination with other concessions. Throughout the rest of the world, term extensions occur more frequently with other types of concession such as interest rate changes occurring less often.

In assessing whether payment-related forbearance is a satisfactory and sustainable strategy, the customer's entire exposure and facilities will be reviewed and their ability to meet the terms of both the revised obligation and other credit facilities not amended in the renegotiation is assessed. Should this assessment identify that a renegotiation will not deal with a customer's payment capacity issues satisfactorily, other special management options may be applied.

This process may identify the need to provide assistance to a customer specifically to restructure their business operations and activities so as to restore satisfactory payment capacity.

When considering acceptable restructuring terms we consider the ability of the customer to be able to service the revised interest payments as a necessity. When principal payment modifications are considered, again we require the customer to be able to comply with the revised terms as a necessary pre-condition for the restructuring to proceed. When principal payments are modified resulting in permanent forgiveness, or when it is otherwise considered that there is no longer a realistic prospect of recovery of outstanding principal, the affected balances are written off. When principal repayments are postponed, it is expected that the customer will be capable of paying in line with the renegotiated terms, including instances when the postponed principal repayment is expected from refinancing. In all cases, a loan renegotiation is only granted when the customer is expected to be able to meet the revised terms.

Modifications may be made on a temporary basis when time is needed for the customer to make arrangements for payment, when deterioration in payment capacity is expected to be acute but short lived, or when more time is needed to accommodate discussions regarding a more permanent accommodation with other bankers, for example in syndicated facilities where multilateral negotiation commonly features.

If a restructuring proceeds and the customer demonstrates satisfactory performance over a period of time, the case may be returned to a non-impaired grade (CRR1-8) provided no other indicators of impairment remain. Such a case cannot be returned to a non-impaired grade when a specific impairment allowance remains against any of the customer's credit facilities. The period of performance will vary depending on the frequency of payments to be made by the customer under the amended agreement and the extent to which the customer's financial position is considered to have improved.

HSBC HOLDINGS PLC



## **Table of Contents**

### **Report of the Directors: Financial Review** (continued)

#### **Impairment assessment**

*(Audited)*

It is our policy that each operating company in HSBC creates impairment allowances for impaired loans promptly and appropriately, when there is objective evidence that impairment of a loan or portfolio of loans has occurred.

For details of our impairment policies on loans and advances and financial investments, see Note 1k on the Financial Statements.

#### **Impairment and credit risk mitigation**

The existence of collateral has an effect when calculating impairment on individually assessed impaired loans. When we no longer expect to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for an impairment allowance. No impairment allowance is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

Personal lending portfolios are generally assessed for impairment on a collective basis as the portfolios typically consist of large groups of homogeneous loans. Two methods are used to calculate allowances on a collective basis: a roll-rate methodology or a more basic formulaic approach based on historical losses. In 2014, we reviewed the impairment allowance methodology used for retail banking and small business portfolios across the Group to ensure that the assumptions used in our collective assessment models continued to appropriately reflect the period of time between a loss event occurring and the account proceeding to delinquency and eventual write-off.

The historical loss methodology is typically used to calculate collective impairment allowances for secured or low default portfolios such as mortgages until the point at which they are individually identified and assessed as impaired. For loans which are collectively assessed using historical loss methodology, the historical loss rate is derived from the average contractual write-off net of recoveries over a defined period. The net contractual write-off rate is the actual amount of loss experienced after the realisation of collateral and receipt of recoveries.

A roll-rate methodology is more commonly adopted for unsecured portfolios when there are sufficient volumes of empirical data to develop robust statistical models. In certain circumstances mortgage portfolios have a statistically significant number of defaults and losses available, enabling reliable roll rates to be generated. In these cases a roll-rate methodology is applied until the point at which the loans are individually identified and assessed as impaired, and the average loss rate for each delinquency bucket is adjusted to reflect the average loss expected following realisation of security and receipt of recoveries. The average loss expected is derived from average historical collateral realisation values.

The nature of the collective allowance assessment prevents individual collateral values or LTV ratios from being included within the calculation. However, the loss rates used in the collective assessment are adjusted for the collateral realisation experiences which will vary depending on the LTV composition of the portfolio. For example, mortgage portfolios under a historical loss rate methodology with lower LTV ratios will typically experience lower loss history and consequently a lower net contractual write-off rate.

For wholesale collectively assessed loans, historical loss methodologies are applied to measure loss event impairments which have been incurred but not reported. Loss rates are derived from the observed contractual write-off net of recoveries over a defined period, typically no less than 60 months. The net contractual write-off rate is the actual or expected amount of loss experienced after realisation of collateral and receipt of recoveries. These historical loss rates are adjusted by an economic factor which amends the historical averages to better represent current economic conditions affecting the portfolio. In order to reflect the likelihood of a loss event not being identified and assessed an emergence period assumption is applied which reflects the period between a loss occurring and its identification. The emergence period is estimated by management for each identified portfolio. The factors that may influence this estimation include economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. The emergence period is assessed empirically on a periodic basis and may vary over time as these factors change.

### **Write-off of loans and advances**

*(Audited)*

For details of our policy on the write-off of loans and advances, see Note 1k on the Financial Statements.

In HSBC Finance, the carrying amounts of residential mortgage and second lien loans in excess of net realisable value are written off at or before the time foreclosure is completed or settlement is reached with the borrower. If there is no reasonable expectation of recovery, and foreclosure is pursued, the loan is normally written off no later than the end of the month in which the loan becomes 180 days contractually past due. We regularly obtain new appraisals for these collateral dependent loans (every 180 days) and adjust carrying values to the most recent appraisal if they have improved or deteriorated as the best estimate of the cash flows that will be received on the disposal of the collateral.

HSBC HOLDINGS PLC

212

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due, the standard period being the end of the month in which the account becomes 180 days contractually delinquent. Write-off periods may be extended, generally to no more than 360 days past due but, in very exceptional circumstances, to longer than that figure in a few countries where local regulation or legislation constrain earlier write-off or where the realisation of collateral for secured real estate lending takes this time.

In retail lending, final write-off should occur within 60 months of the default at the latest.

In the event of bankruptcy or analogous proceedings, write-off may occur earlier than at the periods stated above. Collections procedures may continue after write-off.

### **Impairment methodologies**

*(Audited)*

To identify objective evidence of impairment for available-for-sale ABSs, an industry standard valuation model is normally applied which uses data with reference to the underlying asset pools and models their projected future cash flows. The estimated future cash flows of the securities are assessed at the specific financial asset level to determine whether any of them are unlikely to be recovered as a result of loss events occurring on or before the reporting date.

The principal assumptions and inputs to the models are typically the delinquency status of the underlying loans, the probability of delinquent loans progressing to default, the prepayment profiles of the underlying assets and the loss severity in the event of default. However, the models utilise other variables relevant to specific classes of collateral to forecast future defaults and recovery rates. Management uses externally available data and applies judgement when determining the appropriate assumptions in respect of these factors. We use a modelling approach which incorporates historically observed progression rates to default to determine if the decline in aggregate projected cash flows from the underlying collateral will lead to a shortfall in contractual cash flows. In such cases, the security is considered to be impaired.

In respect of CDOs, expected future cash flows for the underlying collateral are assessed to determine whether there is likely to be a shortfall in the contractual cash flows of the CDO.

When a security benefits from a contract provided by a monoline insurer that insures payments of principal and interest, the expected recovery on the contract is assessed in determining the total expected credit support available to the ABS.

### **Loan Management Unit**

*(Unaudited)*

The HSBC Loan Management Unit ( LMU ) is a front line customer contact department within Wholesale Credit and Market Risk that assumes responsibility for managing business customer relationships requiring intensive and close

control where the bank's lending is at risk. LMU operates on a regional basis across the Group and is independent of the originating business management units. It reports locally to the chief credit officer position. Customers are identified and transferred to LMU by business management or the Wholesale Credit and Market Risk approval teams.

Customers managed by LMU are normally operating outside the Group's risk appetite. They typically show symptoms of significant financial difficulty, the management team displays limited experience of managing a business in distress and the management and financial information provided to the bank is insufficient and unreliable.

The levels of customer exposure under management and the size of the LMU team varies between countries depending on the breadth of business undertaken locally but LMU will always manage highly distressed situations where individual customer exposure exceeds US\$1.5m.

The primary focus of LMU is to protect the bank's capital and minimise losses by working consensually with customers to promote and support viable recovery strategies wherever achievable, with the ultimate intention of returning the customer to front line relationship management. In some cases, rehabilitation is not possible and LMU will consider a range of options to protect the bank's exposure and solvency of the customer. On occasion, it is not possible to find a satisfactory solution and the customer may file for insolvency or local equivalent. In all outcomes, LMU seeks to treat customers fairly, sympathetically and positively, in a professional way with transparent processes and procedures.

Remediation and restructuring strategies available in the business and LMU include granting a customer various types of concessions while seeking to enhance the ability of the customer to ultimately repay the Group which could include enhancing the overall security available to the bank. Any decision to approve a concession will be a function of the region's specific country and sector appetite, the key metrics of the customer, the market environment, the loan structure and security. Internal reviews on customers managed directly by LMU are performed on a scheduled basis in accordance with relevant accounting guidelines, credit policies and national banking regulations. Under certain circumstances, concessions granted may result in the loan being classified as a renegotiated loan.

### **Collateral and other credit enhancements held**

*(Audited)*

### **Loans and advances held at amortised cost**

The Group's practice is to lend on the basis of customers' ability to meet their obligations out of cash flow resources rather than rely on the value of security offered. Depending on a customer's standing and the type of product, facilities may be provided without security. For other lending, a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the bank may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating our exposure to credit risk.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

Additionally, risk may be managed by employing other types of collateral and credit risk enhancements such as second charges, other liens and unsupported guarantees, but the valuation of such mitigants is less certain and their financial effect has not been quantified.

**Refinance risk**

*(Audited)*

Many types of lending require the repayment of a significant proportion of the principal at maturity. Typically, the mechanism of repayment for the customer is through the acquisition of a new loan to settle the existing debt. Refinance risk arises where a customer is unable to repay such term debt on maturity, or to refinance debt at commercial rates. When there is evidence that this risk may apply to a specific contract, HSBC may need to refinance the loan on concessionary terms that it would not otherwise have considered, in order to recoup the maximum possible cash flows from the contract and potentially avoid the customer defaulting on the repayment of principal. When there is sufficient evidence that borrowers, based on their current financial capabilities, may fail at maturity to repay or refinance their loans, these loans are disclosed as impaired with recognition of a corresponding impairment allowance where appropriate.

**Nature of HSBC's securitisation and other structured exposures**

*(Audited)*

Mortgage-backed securities (MBSs) are securities that represent interests in groups of mortgages and provide investors with the right to receive cash from future mortgage payments (interest and/or principal). An MBS which references mortgages with different risk profiles is classified according to the highest risk class.

Collateralised debt obligations (CDOs) are securities backed by a pool of bonds, loans or other assets such as asset-backed securities (ABSs). CDOs may include exposure to sub-prime or Alt-A mortgage assets where these are part of the underlying assets or reference assets. As there is often uncertainty surrounding the precise nature of the underlying collateral supporting CDOs, all CDOs supported by residential mortgage-related assets are classified as sub-prime. Our holdings of ABSs and CDOs and direct lending positions, and the categories of mortgage collateral and lending activity, are described overleaf.

Our exposure to non-residential mortgage-related ABSs includes securities with collateral relating to commercial property mortgages, leveraged finance loans, student loans, and other assets such as securities with other receivable-related collateral.

***Definitions and classifications of ABSs and CDOs***

Definition	Classification
------------	----------------

## Categories of ABSs and CDOs

Sub-prime	Loans to customers who have limited credit histories, modest incomes or high debt-to-income ratios or have experienced credit problems caused by occasional delinquencies, prior charge-offs, bankruptcy or other credit-related actions.	For US mortgages, a FICO score of 620 or less has primarily been used to determine whether a loan is sub-prime. For non-US mortgages, management judgement is used.
US Home Equity Lines of Credit ( HELoC s) (categorised within Sub-prime )	A form of revolving credit facility provided to customers, which is supported in the majority of circumstances by a second lien or lower ranking charge over residential property.	Holdings of HELoCs are classified as sub-prime.
US Alt-A	Lower risk loans than sub-prime, but they share higher risk characteristics than lending under fully conforming standard criteria.	US credit scores and the completeness of documentation held (such as proof of income), are considered when determining whether an Alt-A classification is appropriate. Non sub-prime mortgages in the US are classified as Alt-A if they are not eligible for sale to the major US Government mortgage agencies or sponsored entities.
US Government agency and sponsored enterprises mortgage-related assets	Securities that are guaranteed by US Government agencies such as the Government National Mortgage Association ( Ginnie Mae ), or by US Government sponsored entities including Fannie Mae and Freddie Mac.	Holdings of US Government agency and US Government sponsored enterprises mortgage-related assets are classified as prime exposures.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)**Categories of****ABSs and CDOs****Definition****Classification**

UK non-conforming mortgages (categorised within Sub-prime )

UK mortgages that do not meet normal lending criteria. Examples include mortgages where the expected level of documentation is not provided (such as income with self-certification), or where poor credit history increases risk and results in pricing at a higher than normal lending rate.

UK non-conforming mortgages are treated as sub-prime exposures.

Other residential mortgages

Residential mortgages, including prime mortgages, that do not meet any of the classifications described above.

Prime residential mortgage-related assets are included in this category.

**Liquidity and funding**

*(Audited)*

The management of liquidity and funding is primarily undertaken locally (by country) in our operating entities in compliance with the Group's liquidity and funding risk management framework (the LFRF), and with practices and limits set by the GMB through the Risk Management Meeting and approved by the Board. These limits vary according to the depth and the liquidity of the markets in which the entities operate. Our general policy is that each defined operating entity should be self-sufficient in funding its own activities. Where transactions exist between operating entities, they are reflected symmetrically in both entities.



As part of our Asset, Liability and Capital Management (ALCM) structure, we have established ALCOs at Group level, in the regions and in operating entities. The terms of reference of all ALCOs include the monitoring and control of liquidity and funding.

The primary responsibility for managing liquidity and funding within the Group's framework and risk appetite resides with the local operating entities' ALCOs. Our most significant operating entities are overseen by regional ALCOs, Group ALCO and the Risk Management Meeting. The remaining smaller operating entities are overseen by regional ALCOs, with appropriate escalation of significant issues to Group ALCO and the Risk Management Meeting.

Operating entities are predominately defined on a country basis to reflect our local management of liquidity and funding. Typically, an operating entity will be defined as a single legal entity. However, to take account of the situation where operations in a country are booked across multiple subsidiaries or branches:

an operating entity may be defined as a wider sub-consolidated group of legal entities if they are incorporated in the same country, liquidity and funding are freely fungible between the entities and permitted by local regulation, and the definition reflects how liquidity and funding are managed locally; or

an operating entity may be defined more narrowly as a principal office (branch) of a wider legal entity operating in multiple countries, reflecting the local country management of liquidity and funding.

The Risk Management Meeting reviews and agrees annually the list of entities it directly oversees and the composition of these entities.

### Primary sources of funding

*(Audited)*

Customer deposits in the form of current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon maintaining depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing.

We also access wholesale funding markets by issuing senior secured and unsecured debt securities (publically and privately) and borrowing from the secured repo markets against high quality collateral, in order to obtain funding for non-banking subsidiaries that do not accept deposits, to align asset and liability maturities and currencies and to maintain a presence in local wholesale markets.

### The management of liquidity and funding risk

*(Audited)*

#### **Inherent liquidity risk categorisation**

We place our operating entities into one of two categories (low and medium) to reflect our assessment of their inherent liquidity risk considering political, economic and regulatory factors within the host country and factors specific to the operating entities themselves, such as their local market, market share and balance sheet strength. The categorisation involves management judgement and is based on the perceived liquidity risk of an operating entity relative to other entities in the Group. The categorisation is intended to reflect the possible impact of a liquidity event, not the probability of an event, and forms part of our risk appetite. It is used to determine the prescribed stress scenario that we require our operating entities to be able to withstand and manage to.

HSBC HOLDINGS PLC

215

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**Core deposits**

A key element of our internal framework is the classification of customer deposits into core and non-core based on our expectation of their behaviour during periods of liquidity stress. This characterisation takes into account the inherent liquidity risk categorisation of the operating entity originating the deposit, the nature of the customer and the size and pricing of the deposit. No deposit is considered to be core in its entirety unless it is contractually collateralising a loan. The core deposit base in each operating entity is considered to be a long-term source of funding and therefore is assumed not to be withdrawn in the liquidity stress scenario that we use to calculate our principal liquidity risk metrics.

The three filters considered in assessing whether a deposit in any operating entity is core are:

*price*: any deposit priced significantly above market or benchmark rates is generally treated as entirely non-core;

*size*: depositors with total funds above certain monetary thresholds are excluded. Thresholds are established by considering the business line and inherent liquidity risk categorisation; and

*line of business*: the element of any deposit remaining after the application of the price and size filters is assessed on the basis of the line of business with which the deposit is associated. The proportion of any customer deposit that can be considered core under this filter is between 35% and 90%.

Repo transactions and bank deposits cannot be classified as core deposits.

**Advances to core funding ratio**

Core customer deposits are an important source of funding to finance lending to customers, and mitigate against reliance on short-term wholesale funding. Limits are placed on operating entities to restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long-term debt funding with a residual maturity beyond one year; this measure is referred to as the advances to core funding ratio.

Advances to core funding ratio limits are set by the Risk Management Meeting for the most significant operating entities, and by regional ALCOs for smaller operating entities, and are monitored by ALCM teams. The ratio describes loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. In general, customer loans are assumed to be renewed and are included in the numerator of the ratio, irrespective of the contractual maturity date. Reverse repo arrangements are excluded from the advances to core funding ratio.

**Stressed coverage ratios**

Stressed coverage ratios are derived from stressed cash flow scenario analyses and express stressed cash inflows as a percentage of stressed cash outflows over one-month and three-month time horizons.

The stressed cash inflows include:

inflows (net of assumed haircuts) expected to be generated from the realisation of liquid assets; and contractual cash inflows from maturing assets that are not already reflected as a utilisation of liquid assets. In line with the approach adopted for the advances to core funding ratio, customer loans are generally assumed not to generate any cash inflows under stress scenarios and are therefore excluded from the numerator of the stressed coverage ratio, irrespective of the contractual maturity date.

A stressed coverage ratio of 100% or higher reflects a positive cumulative cash flow under the stress scenario being monitored. Group operating entities are required to maintain a ratio of 100% or more out to three months under the combined market-wide and HSBC-specific stress scenario defined by the inherent liquidity risk categorisation of the operating entity concerned.

Compliance with operating entity limits is monitored by ALCM teams and reported monthly to the Risk Management Meeting for the main operating entities and to regional ALCOs for the smaller operating entities.

### **Stressed scenario analysis**

*(Unaudited)*

We use a number of standard Group stress scenarios designed to model:

combined market-wide and HSBC-specific liquidity crisis scenarios; and  
market-wide liquidity crisis scenario.

These scenarios are modelled by all operating entities. The appropriateness of the assumptions for each scenario is reviewed by ALCM regularly and formally approved by the Risk Management Meeting and the Board annually as part of the liquidity and funding risk appetite approval process.

Stressed cash outflows are determined by applying a standard set of prescribed stress assumptions to the Group's cash flow model. Our framework prescribes the use of two market-wide scenarios and two further combined market-wide and HSBC-specific stress scenarios of increasing severity. In addition to our standard stress scenarios, individual operating entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

The two combined market-wide and HSBC-specific scenarios model a more severe scenario than the market-wide scenario. The relevant combined market-wide and HSBC-specific stress scenario that an operating entity manages to is based upon its inherent liquidity risk categorisation. The key assumptions factored into the two combined market-wide and HSBC-specific stress scenarios are summarised as follows:

all non-core deposits are deemed to be withdrawn within three months (80% within one month), with the level of non-core deposits dependent on the operating entity's inherent liquidity risk categorisation;

the ability to access interbank funding and unsecured term debt markets ceases for the duration of the scenario;

the ability to generate funds from illiquid asset portfolios (securitisation and secured borrowing) is restricted to 25-75% of the lower of issues in the last six months or expected issues in the next six months. The restriction is based on current market conditions and is dependent on the operating entity's inherent liquidity risk categorisation;

the ability to access repo funding ceases for any asset not classified as liquid under our liquid asset policy for the duration of the scenario;

drawdowns on committed lending facilities must be consistent with the severity of the market stress being modelled and dependent on the inherent liquidity risk categorisation of the operating entity;

outflows are triggered by a defined downgrade in long-term ratings. We maintain an ongoing assessment of the appropriate number of notches to reflect;

customer loans are assumed to be renewed at contractual maturity;

interbank loans and reverse repos are assumed to run off contractually; and

assets defined as liquid assets are assumed to be realised in cash ahead of their contractual maturity, after applying a defined stressed haircut of up to 20%.

**Liquid assets of HSBC's principal operating entities**

*(Audited)*

Stressed scenario analysis and the numerator of the coverage ratio include the assumed cash inflows that would be generated from the realisation of liquid assets, after applying the appropriate stressed haircut. These assumptions are made on the basis of management's expectation of when an asset is deemed to be realisable.

Liquid assets are unencumbered assets that meet the Group's definition of liquid assets and are either held outright or as a consequence of a reverse repo transaction with a residual contractual maturity beyond the time horizon of the stressed coverage ratio being monitored. Any unencumbered asset held as a result of reverse repo transactions with a contractual maturity within the time horizon of the stressed coverage ratio being monitored is excluded from the stock of liquid assets and is instead reflected as a contractual cash inflow.

Our framework defines the asset classes that can be assessed locally as high quality and realisable within one month and between one month and three months. Each local ALCO has to be satisfied that any asset which may be treated as liquid in accordance with the Group's liquid asset policy will remain liquid under the stress scenario being managed to.

Inflows from the utilisation of liquid assets within one month can generally only be based on confirmed withdrawable central bank deposits or the sale or repo of government and quasi-government exposures generally restricted to those denominated in the sovereign's domestic currency. High quality ABSs (predominantly US MBSs) and covered bonds are also included but inflows assumed for these assets are capped.

Inflows after one month are also reflected for high quality non-financial and non-structured corporate bonds and equities within the most liquid indices.

Internal categorisation	Cash inflow recognised	Asset classes
Level 1	Within one month	<ul style="list-style-type: none"> <li>Central government</li> <li>Central bank (including confirmed withdrawable reserves)</li> <li>Supranationals</li> <li>Multilateral development banks</li> <li>Coins and banknotes</li> </ul>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Level 2	Within one month but capped	<p>Local and regional government</p> <p>Public sector entities</p> <p>Secured covered bonds and pass-through ABSs</p> <p>Gold</p>
Level 3	From one to three months	<p>Unsecured non-financial entity securities</p> <p>Equities listed on recognised exchanges and within liquid indices</p>

Any entity owned and controlled by central or local/regional government but not explicitly guaranteed is treated as a public sector entity.

Any exposure explicitly guaranteed is reflected as an exposure to the ultimate guarantor.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

In terms of the criteria used to ensure liquid assets are of a high quality, the Group's liquid asset policy sets out the following additional criteria:

1. Central bank and central government exposures denominated in the domestic currency of the related sovereign and held onshore in the domestic banking system qualify as level 1 liquid assets.
2. Central bank and central government exposures denominated in the domestic currency of the related sovereign and held offshore must be risk weighted 20% or lower under the Basel standardised risk weighting methodology to qualify as level 1 liquid assets.
3. Central bank and central government exposures denominated in a currency other than the currency of the related sovereign (i.e. foreign currency) must be risk weighted 20% or lower under the Basel standardised risk weighting methodology and issued in a limited number of major currencies to qualify as level 1 liquid assets.

The treatment of eurozone countries using the euro as their domestic currency depends on whether the exposures are held onshore in the domestic banking system or offshore. Central bank and central government exposures held onshore in the domestic banking system qualify as level 1 liquid assets under criteria 1, but central bank and central government exposures held offshore are considered to be denominated in a foreign currency under criteria 3.

4. Local/regional government exposures held onshore and considered by the local regulator to be the same risk as central government exposures can be considered central government exposures.
5. Supranationals and multilateral development banks must be 0% risk weighted under the Basel standardised risk-weighting methodology to qualify as level 1 liquid assets.
6. To qualify as a level 2 liquid asset, the exposure must be risk weighted 20% or lower under the Basel standardised risk-weighting methodology.
7. To qualify as a level 3 liquid asset, an unsecured non-financial corporate debt exposure must satisfy a minimum internal rating requirement.

On a case-by-case basis, operating entities are permitted to treat other assets as liquid if these assets are realistically assessed to be liquid under stress. These liquid assets are reported as 'Other', separately from level 1, level 2 and level 3



liquid assets.

### **Net cash flow arising from interbank and intragroup loans and deposits**

Under the LFRF, a net cash inflow within three months arising from interbank and intra-Group loans and deposits will give rise to a lower liquid asset requirement. Conversely, a net cash outflow within three months arising from interbank and intra-Group loans and deposits will give rise to a higher liquid assets requirement.

### **Net cash flow arising from reverse repo, repo, stock borrowing, stock lending and outright short positions (including intra-Group)**

A net cash inflow represents liquid resources in addition to liquid assets because any unencumbered asset held as a consequence of a reverse repo transaction with a residual contractual maturity within the stressed coverage ratio time period is not reflected as a liquid asset.

The impact of net cash outflow depends on whether the underlying collateral encumbered as a result will qualify as a liquid asset when released at the maturity of the repo. The majority of the Group's repo transactions are collateralised by liquid assets and, as such, any net cash outflow shown is offset by the return of liquid assets, which are excluded from the liquid asset table above.

### **Wholesale debt monitoring**

*(Unaudited)*

Where wholesale debt term markets are accessed to raise funding, ALCO is required to establish cumulative rolling three-month and 12-month debt maturity limits to ensure no concentration of maturities within these timeframes.

### **Liquidity behaviouralisation**

*(Unaudited)*

Liquidity behaviouralisation is applied to reflect our assessment of the expected period for which we are confident that we will have access to our liabilities, even under a severe liquidity stress scenario, and the expected period for which we must assume that we will need to fund our assets. Behaviouralisation is applied when the contractual terms do not reflect the expected behaviour. Liquidity behaviouralisation is reviewed and approved by local ALCO in compliance with policies set by the Risk Management Meeting. Our approach to liquidity risk management will often mean different approaches are applied to assets and liabilities. For example, management may assume a shorter life for liabilities and a longer-term funding requirement for assets. All core deposits are assumed under the Group's core/non-core and advances to core funding frameworks to have a liquidity behaviouralised life beyond one year and to represent a homogeneous source of core funding. The behaviouralisation of assets is far more granular and seeks to differentiate the period for which we must assume that we will need to fund the asset.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**Funds transfer pricing***(Unaudited)*

Our funds transfer pricing policies give rise to a two-stage funds transfer pricing approach, reflecting the fact that we separately manage interest rate risk and liquidity and funding risk under different assumptions. They have been developed to be consistent with our risk management frameworks. Each operating entity is required to apply the Group's transfer pricing policy framework to determine for each material currency the most appropriate interest rate risk transfer pricing curve, a liquidity premium curve (which is the spread over the interest rate risk transfer pricing curve) and a liquidity recharge assessment (which is the spread under or over the interest rate risk transfer pricing curve).

The interest rate risk transfer pricing policy seeks to ensure that all market interest rate risk arising structurally from non-trading (banking book) assets and liabilities which is capable of being neutralised externally in the market or neutralised internally by off-setting transfers, is transferred to BSM to be managed centrally as non-trading market risk. For each material currency each operating entity employs a single interest rate risk transfer pricing curve. The transfer price curve used for this purpose reflects how BSM in each operating entity is best able to neutralise the interest rate risk in the market at the point of transfer. Where basis risk can be identified between the re-pricing basis of an external asset or external liability and the re-pricing basis of the interest rate risk transfer pricing curve, this basis risk may be transferred to BSM provided it can neutralise the basis risk in the market.

Liquidity and funding risk is transfer priced independently from interest rate risk because the liquidity and funding risk of an operating entity is transferred to ALCO to be managed centrally. ALCO monitors and manages the advances to core funding ratio and delegates the management of the liquid asset portfolio and execution of the wholesale term debt funding plan to BSM. This assists ALCO in ensuring the Group's stressed coverage ratios remain above 100% out to three months.

The liquidity and funding risk transfer price consists of two components:

**Liquidity recharge:** the cost of holding the benchmark liquid asset (the yield under the transfer price) to meet stressed cash outflows. The benchmark liquid asset is decided by ALCO and based on the weighted average duration that can be achieved by investing in level 1 liquid assets, with a residual duration of up to one year.

**Liquidity premium:** the assessed cost/value of term funding (the yield over the transfer price) to pay for term debt and core deposits.

The assessed cost of holding liquid assets is allocated to the outflows modelled by the Group's internal stressed coverage ratio framework.

Liquidity premium is charged to any asset that affects our three-month stressed coverage ratios based on the assessed behaviouralised liquidity life of the asset, with any asset affecting the Group's advances to core funding metric required to have a minimum behaviouralised life of at least one year, and the prevailing liquidity premium curve rate set by ALCO and calibrated in line with Group's calibration principles. Core deposits therefore share equally in the liquidity premiums charged to the assets they support, after deducting the cost of any term funding.

### **Repos and stock lending**

GB&M provides collateralised security financing services to its clients, providing them with cash financing or specific securities. When cash is provided to clients against collateral in the form of securities, the cash provided is recognised on the balance sheet as a reverse repo. When securities are provided to clients against cash collateral the cash received is recognised on the balance sheet as a repo or, if the securities are equity securities, as stock lending.

Each operating entity manages its collateral through a central collateral pool, in line with the LFRF. When specific securities need to be delivered and the entity does not have them currently available within the central collateral pool, the securities are borrowed on a collateralised basis. When securities are borrowed against cash collateral the cash provided is recognised on the balance sheet as a reverse repo or, if the securities are equity securities, as stock borrowing.

Operating entities may also borrow cash against collateral in the form of securities, using the securities available in the central collateral pool. Repos and stock lending can be used in this way to fund the cash requirement arising from securities owned outright by Markets to facilitate client business, and the net cash requirement arising from financing client securities activity.

Reverse repos, stock borrowing, repos and stock lending are reported net when the IFRSs offsetting criteria are met. In some cases transactions to borrow or lend securities are collateralised using securities. These transactions are off-balance sheet.

Any security accepted as collateral for a reverse repo or stock borrowing transaction must be of very high quality and its value subject to an appropriate haircut. Securities borrowed under reverse repo or stock borrowing transactions can only be recognised as part of the liquidity asset buffer for the duration of the transactions and only if the security received is eligible under the liquid asset policy within the LFRF.

Credit controls are in place to ensure that the fair value of any collateral received remains appropriate to collateralise the cash or fair value of securities given.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**The effect of active collateral management**

Collateral is managed on an operating entity basis, consistent with the approach adopted in managing liquidity and funding. Available collateral held by each operating entity is managed as a single collateral pool. In deciding which collateral to pledge, each operating entity seeks to optimise the use of the available collateral pool within the confines of the LFRF, irrespective of whether the collateral pledged is recognised on-balance sheet or was received in respect of reverse repo, stock borrowing or derivative transactions.

Managing collateral in this manner affects the presentation of asset encumbrance in that we may encumber on-balance sheet holdings while maintaining available unencumbered off-balance sheet holdings, even though we are not seeking to directly finance the on-balance sheet holdings pledged.

In quantifying the level of encumbrance of negotiable securities, the encumbrance is analysed by individual security. When a particular security is encumbered and we hold the security both on-balance sheet and off-balance sheet with the right to repledge, we assume for the purpose of this disclosure that the off-balance sheet holding received from the third party is encumbered ahead of the on-balance sheet holding.

An on-balance sheet encumbered and off-balance sheet unencumbered asset will occur, for example, if we receive a specific security as a result of a reverse repo/stock borrowing transaction, but finance the cash lent by pledging a generic collateral basket, even if the security received is eligible for the collateral basket pledged. It will also occur if we receive a generic collateral basket as a result of a reverse repo transaction but finance the cash lent by pledging specific securities, even if the securities pledged are eligible for the collateral basket.

**Encumbered and unencumbered assets****Definitions of the categories included in the table Analysis of on-balance sheet encumbered and unencumbered assets :**

*Encumbered assets* are assets on our balance sheet which have been pledged as collateral against an existing liability, and as a result are assets which are unavailable to the bank to secure funding, satisfy collateral needs or be sold to reduce potential future funding requirements.

*Unencumbered readily realisable assets* are assets regarded by the bank to be readily realisable in the normal course of business to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements,

and are not subject to any restrictions on their use for these purposes.

*Unencumbered other realisable assets* are assets where there are no restrictions on their use to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements, but they are not readily realisable in the normal course of business in their current form.

*Unencumbered reverse repo/stock borrowing receivables and derivative assets* are assets related specifically to reverse repo, stock borrowing and derivative transactions. They are shown separately as these on-balance sheet assets cannot be pledged but often give rise to the receipt of non-cash assets which are not recognised on the balance sheet, and can additionally be used to raise secured funding, meet additional collateral requirements or be sold.

*Unencumbered cannot be pledged as collateral are assets* that have not been pledged and which we have assessed could not be pledged and therefore could not be used to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements. An example is assets held by the Group's insurance subsidiaries that back liabilities to policyholders and support the solvency of these entities.

Historically, the Group has not recognised any contingent liquidity value for assets other than those assets defined under the LFRF as being liquid assets, and any other negotiable instruments that under stress are assumed to be realisable after three months, even though they may currently be realisable. This approach has generally been driven by our risk appetite not to place any reliance on central banks. In a few cases, we have recognised the contingent value of discrete pools of assets, but the amounts involved are insignificant. As a result, we have reported the majority of our loans and advances to customers and banks in the category *Other realisable assets* as management would need to perform additional actions in order to make the assets transferable and readily realisable.

### **Additional information**

The amount of assets pledged to secure liabilities reported in Note 19 on the Financial Statements may be greater than the book value of assets reported as being encumbered in the table on page 172. Examples of where such differences occur are:

ABSs and covered bonds, where the amount of liabilities issued plus the required mandatory over-collateralisation is lower than the book value of assets pledged to the pool. Any difference is categorised in the table above as *Unencumbered readily realisable assets* ;

negotiable securities held by custodians or settlement agents, where a floating charge has been given over the entire holding to secure intra-day settlement liabilities, are only reported as encumbered to the extent that we have a liability to the custodian or settlement agent at the reporting date, with the balance reported as *Unencumbered readily realisable assets* ; and

assets pre-positioned with central banks or government agencies are only reported as encumbered to the extent that we have secured funding with the collateral. The unutilised pre-positioned collateral is reported as Unencumbered readily realisable assets .

HSBC HOLDINGS PLC

220

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

Securities reflected on the balance sheet that are pledged as collateral against an existing liability or lent are reflected as encumbered for the duration of the transaction. When securities are received as collateral or borrowed, and when we have the right to sell or re-pledge these securities, they are reflected as available and unencumbered for the duration of the transaction, unless re-pledged or sold. Further analysis regarding the encumbrance of securities resulting from repos and stock lending and available unencumbered assets arising from reverse repos and stock borrowing is provided under the heading *Encumbered and unencumbered assets* on page 171.

In the normal course of business we do not seek to utilise repo financing as a source of funding to finance customer assets, beyond the collateralised security financing activities within Markets described above.

The original contractual maturity of reverse repo, stock borrowing, repo and stock lending is short term with the vast majority of transactions being for less than 90 days.

**Management of cross-currency liquidity and funding risk**

*(Unaudited)*

Our liquidity and funding risk framework also considers the ability of each entity to continue to access foreign exchange markets under stress when a surplus in one currency is used to meet a deficit in another currency, for example, by the use of the foreign currency swap markets. Where appropriate, operating entities are required to monitor stressed coverage ratios and advances to core funding ratios for non-local currencies.

**HSBC Holdings**

*(Audited)*

HSBC Holdings' primary sources of cash are dividends received from subsidiaries, interest on and repayment of intra-group loans and interest earned on its own liquid funds. HSBC Holdings also raises ancillary funds in the debt capital markets through subordinated and senior debt issuance. Cash is primarily used for the provision of capital to subsidiaries, interest payments to debt holders and dividend payments to shareholders.

HSBC Holdings is also subject to contingent liquidity risk by virtue of loan and other credit-related commitments and guarantees and similar contracts issued. Such commitments and guarantees are only issued after due consideration of HSBC Holdings' ability to finance the commitments and guarantees and the likelihood of the need arising.

HSBC Holdings actively manages the cash flows from its subsidiaries to optimise the amount of cash held at the holding company level. The ability of subsidiaries to pay dividends or advance monies to HSBC Holdings depends on, among other things, their respective local regulatory capital and banking requirements, statutory reserves, and financial and operating performance. During 2014 and 2013, none of the Group's subsidiaries experienced significant restrictions on paying dividends or repaying loans and advances. Also, there are no foreseen restrictions envisaged by our subsidiaries on paying dividends or repaying loans and advances. None of the subsidiaries which are excluded from our regulatory consolidation has capital resources below its minimum regulatory requirement.

## **Market risk**

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

*Market risk exposures (including graphs and tables) are provided under Market Risk on page 175.*

### **Exposure to market risk**

*(Unaudited)*

Exposure to market risk is separated into two portfolios:

*Trading portfolios* comprise positions arising from market-making and the warehousing of customer-derived positions.

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

Where appropriate, we apply similar risk management policies and measurement techniques to both trading and non-trading portfolios. Our objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with our status as one of the world's largest banking and financial services organisations.

The nature of the hedging and risk mitigation strategies performed across the Group corresponds to the market risk management instruments available within each operating jurisdiction. These strategies range from the use of traditional market instruments, such as interest rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

HSBC HOLDINGS PLC



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Overview of market risk in global businesses**

*(Unaudited)*

The diagram below illustrates the main business areas where trading and non-trading market risks reside and market risk measures to monitor and limit exposures.

*The interest rate risk on the fixed-rate securities issued by HSBC Holdings is not included in the Group VaR. The management of this risk is described on page 181.*

**Market risk governance**

*(Audited)*

Market risk is managed and controlled through limits approved by the Risk Management Meeting of the GMB for HSBC Holdings and our various global businesses. These limits are allocated across business lines and to the Group's legal entities.

The management of market risk is principally undertaken in Global Markets, where 77% of the total value at risk of HSBC (excluding insurance) and almost all trading VaR resides, using risk limits approved by the GMB. VaR limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set.

Group Risk, an independent unit within Group Head Office, is responsible for our market risk management policies and measurement techniques. Each major operating entity has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance with the policies defined by Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis. The market risk limits are governed according to the framework illustrated to the left.

Each operating entity is required to assess the market risks arising on each product in its business and to transfer them to either its local Markets unit for management, or to separate books managed under the supervision of the local ALCO.

Our aim is to ensure that all market risks are consolidated within operations that have the necessary skills, tools, management and governance to manage them. In certain cases where the market risks cannot be fully transferred, we identify the impact of varying scenarios on valuations or on net interest income resulting from any residual risk positions. Further details on the control and management process for residual risks are provided on page 224.

Model risk is governed through Model Oversight Committees ( MOC s) at the regional and global Wholesale Credit and Market Risk levels. They have direct oversight and approval responsibility for all traded risk models utilised for risk measurement and management and stress testing. The MOCs prioritise the development of models, methodologies and practices used for traded risk management within the Group and ensure that they remain within our risk appetite and business plans. The Markets MOC reports into the Group MOC, which oversees all model risk types at Group level. Group MOC informs the Group Risk Management Meeting about material issues at least on a bi-annual basis. The Risk Management Meeting is the Group s Designated Committee according to regulatory rules and has delegated day-to-day governance of all traded risk models to the Markets MOC.

HSBC HOLDINGS PLC

222

## **Table of Contents**

### **Report of the Directors: Financial Review** (continued)

Our control of market risk in the trading and non-trading portfolios is based on a policy of restricting individual operations to trading within a list of permissible instruments authorised for each site by Group Risk, of enforcing new product approval procedures, and of restricting trading in the more complex derivative products only to offices with appropriate levels of product expertise and robust control systems.

#### **Market risk measures**

*(Audited)*

#### **Monitoring and limiting market risk exposures**

Our objective is to manage and control market risk exposures while maintaining a market profile consistent with our risk appetite.

We use a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk and stress testing.

#### **Sensitivity analysis**

*(Unaudited)*

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios, including interest rates, foreign exchange rates and equity prices, such as the effect of a one basis point change in yield. We use sensitivity measures to monitor the market risk positions within each risk type. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

#### **Value at risk**

*(Audited)*

Value at risk ( VaR ) is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VaR is integrated into market risk management and is calculated for all trading positions regardless of how we capitalise those exposures. Where there is not an approved internal model, we use the appropriate local rules to capitalise exposures.

In addition, we calculate VaR for non-trading portfolios in order to have a complete picture of risk. Our models are predominantly based on historical simulation. VaR is calculated at a 99% confidence level for a one-day holding period. Where we do not calculate VaR explicitly, we use alternative tools as summarised in the Market Risk Stress Testing table found in the Stress testing section below.

Our VaR models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models used incorporate the following features:

historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;

potential market movements utilised for VaR are calculated with reference to data from the past two years; and

VaR measures are calculated to a 99% confidence level and use a one-day holding period.

The nature of the VaR models means that an increase in observed market volatility will lead to an increase in VaR without any changes in the underlying positions.

We are committed to the ongoing development of our in-house risk models.

#### *VaR model limitations*

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations. For example:

the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;

the use of a holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;

the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;

VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and

VaR is unlikely to reflect loss potential on exposures that only arise under conditions of significant market movement.



---

**Table of Contents****Report of the Directors: Financial Review** (continued)*Risk not in VaR framework**(Unaudited)*

Our VaR model is designed to capture significant basis risks such as credit default swap versus bond, asset swap spreads and cross-currency basis. Other basis risks which are not completely covered in VaR, such as the Libor tenor basis, are complemented by our risk not in VaR ( RNIV ) calculations, and are integrated into our capital framework.

The RNIV framework therefore aims to capture and capitalise material market risks that are not adequately covered in the VaR model. An example of this is Libor-overnight index swap basis risk for minor currencies. In such instances the RNIV framework uses stress tests to quantify the capital requirement. On average in 2014, the capital requirement derived from these stress tests represented 2.6% of the total internal model-based market risk requirement.

Risks covered by RNIV represent 18% of market risk RWAs for models with regulatory approval and include those resulting from underlying risk factors which are not observable on a daily basis across asset classes and products, such as dividend risk and correlation risks.

Risk factors are reviewed on a regular basis and either incorporated directly in the VaR models, where possible, or quantified through the VaR-based RNIV approach or a stress test approach within the RNIV framework. The severity of the scenarios is calibrated to be in line with the capital adequacy requirements. The outcome of the VaR-based RNIV is included in the VaR calculation and back-testing; a stressed VaR RNIV is also computed for the risk factors considered in the VaR-based RNIV approach.

In 2014, we modified our RNIV model on a non-diversified basis across risk factors to comply with new PRA CRD IV implementation guidelines.

*Level 3 assets*

The fair values of Level 3 assets and liabilities in trading portfolios are disclosed on page 380, and represent only a small proportion of the overall trading portfolio. Market risk arising from Level 3 instruments is managed by various market risk techniques such as stress testing and notional limits. The table on page 384 shows the movement in Level 3 financial instruments.

*Back-testing*

We routinely validate the accuracy of our VaR models by back-testing them against both clean and hypothetical profit and loss against the corresponding VaR numbers. Hypothetical profit and loss excludes non-modelled items such as fees, commissions and revenues of intra-day transactions.

We would expect on average to see two or three profits and two or three losses in excess of VaR at the 99% confidence level over a one-year period. The actual number of profits or losses in excess of VaR over this period can therefore be used to gauge how well the models are performing. To ensure a conservative approach to calculating our

risk exposures, it is important to note that profits in excess of VaR are only considered when back-testing the accuracy of our models and are not used to calculate the VaR numbers used for risk management or capital purposes.

We back-test our Group VaR at various levels which reflect a full legal entity scope of HSBC, including entities that do not have local permission to use VaR for regulatory purposes.

### **Stress testing**

*(Unaudited)*

Stress testing is an important tool that is integrated into our market risk management tool to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VaR modelling.

Stress testing is implemented at legal entity, regional and overall Group levels. A standard set of scenarios is utilised consistently across all regions within the Group. Scenarios are tailored to capture the relevant events or market movements at each level. The risk appetite around potential stress losses for the Group is set and monitored against referral limits.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Market risk reverse stress tests are undertaken on the premise that there is a fixed loss. The stress test process identifies which scenarios lead to this loss. The rationale behind the reverse stress test is to understand scenarios which are beyond normal business settings that could have contagion and systemic implications.

Stressed VaR and stress testing, together with reverse stress testing and the management of gap risk, provide management with insights regarding the tail risk beyond VaR for which HSBC's appetite is limited.

**Trading portfolios**

*(Audited)*

**Gap risk**

Certain products are structured in such a way that they give rise to enhanced gap risk, being the risk that loss is incurred upon occurrence of a gap event. A gap event is a significant and sudden change in market price with no accompanying trading opportunity. Such movements may occur, for example, when, in reaction to an adverse event or unexpected news announcement, some parts of the market move far beyond their normal volatility range and become temporarily illiquid. In 2014 gap risk principally arose from non-recourse loan transactions, mostly for corporate clients, where the collateral against the loan is limited to the posted shares. Upon occurrence of a gap event, the value of the equity collateral could fall below the outstanding loan amount.

Given their characteristics, these transactions make little or no contribution to VaR nor to traditional market risk sensitivity measures. We capture their risks within our stress testing scenarios and monitor gap risk on an ongoing basis. We did not incur any notable gap loss in 2014.

**De-peg risk**

For certain currencies (pegged or managed) the spot exchange rate is pegged at a fixed rate (typically to USD or EUR), or managed within a predefined band around a pegged rate. De-peg risk is the risk of the peg or managed band changing or being abolished, and moving to a floating regime.

HSBC has a lot of experience in managing fixed and managed currency regimes. Using stressed scenarios on spot rates, we are able to analyse how de-peg events would impact the positions held by HSBC. We monitor such scenarios to pegged or managed currencies, such as the Hong Kong dollar, renminbi, Middle Eastern currencies and the Swiss franc with appreciation capped against the euro during 2014, and limit any potential losses that would occur. This complements traditional market risk metrics, such as historical VaR, which may not fully capture the risk involved in holding positions in pegged or managed currencies. Historical VaR relies on past events to determine the likelihood of potential profits or losses. However, pegged or managed currencies may not have experienced a de-peg event during the historical timeframe being considered.

**ABS/MBS exposures**



The ABS/MBS exposures within the trading portfolios are managed within sensitivity and VaR limits as described on page 176, and are included within the stress testing scenarios described above.

### Non-trading portfolios

*(Audited)*

Most of the Group's non-trading VaR relates to Balance Sheet Management ( BSM ) or local treasury management functions. Contributions to Group non-trading VaR are driven by interest rates and credit spread risks arising from all global businesses. There is no commodity market risk in the non-trading portfolios.

Non-trading VaR also includes the interest rate risk of non-trading financial instruments held by the global businesses and transferred into portfolios managed by BSM or local treasury functions. In measuring, monitoring and managing risk in our non-trading portfolios, VaR is just one of the tools used. The management of interest rate risk in the banking book is described further in Non-trading interest rate risk below, including the role of BSM.

Non-trading VaR excludes equity risk on available-for-sale securities, structural foreign exchange risk, and interest rate risk on fixed rate securities issued by HSBC Holdings, the scope and management of which are described in the relevant sections below.

Our control of market risk in the non-trading portfolios is based on transferring the assessed market risk of non-trading assets and liabilities created outside BSM or Markets, to the books managed by BSM, provided the market risk can be neutralised. The net exposure is typically managed by BSM through the use of fixed rate government bonds (liquid assets held in available-for-sale books) and interest rate swaps. The interest rate risk arising from fixed rate government bonds held within available-for-sale portfolios is reflected within the Group's non-traded VaR. Interest rate swaps used by BSM are typically classified as either a fair value hedge or a cash flow hedge and are included within the Group's non-traded VaR. Any market risk that cannot be neutralised in the market is managed by local ALCO in segregated ALCO books.

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

#### **Credit spread risk for available-for-sale debt instruments**

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VaR. The VaR shows the effect on income from a one-day movement in credit spreads over a two-year period, calculated to a 99% confidence interval.

#### **Equity securities classified as available for sale**

Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio. Regular reviews are performed to substantiate the valuation of the investments within the portfolio and investments held to facilitate ongoing business, such as holdings in government-sponsored enterprises and local stock exchanges.

#### **Structural foreign exchange exposures**

*(Unaudited)*

Structural foreign exchange exposures represent net investments in subsidiaries, branches and associates, the functional currencies of which are currencies other than the US dollar. An entity's functional currency is that of the primary economic environment in which the entity operates.

Exchange differences on structural exposures are recognised in *Other comprehensive income*. We use the US dollar as our presentation currency in our consolidated financial statements because the US dollar and currencies linked to it form the major currency bloc in which we transact and fund our business. Our consolidated balance sheet is, therefore, affected by exchange differences between the US dollar and all the non-US dollar functional currencies of underlying subsidiaries.

We hedge structural foreign exchange exposures only in limited circumstances. Our structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that our consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question.

We may also transact hedges where a currency in which we have structural exposures is considered likely to revalue adversely, and it is possible in practice to transact a hedge. Any hedging is undertaken using forward foreign exchange contracts which are accounted for under IFRSs as hedges of a net investment in a foreign operation, or by financing with borrowings in the same currencies as the functional currencies involved.

#### **Non-trading interest rate risk**

*(Unaudited)*

Non-trading interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts, and the re-pricing behaviour of managed rate products. These assumptions around behavioural features are captured in our interest rate risk behaviouralisation framework, which is described below.

We aim, through our management of market risk in non-trading portfolios, to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

Analysis of interest rate risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments.

Our funds transfer pricing policies give rise to a two stage funds transfer pricing approach. For details see page 219.

### **Interest rate risk behaviouralisation**

Unlike liquidity risk, which is assessed on the basis of a very severe stress scenario, non-trading interest rate risk is assessed and managed according to business-as-usual conditions. In many cases the contractual profile of non-trading assets/liabilities arising from assets/liabilities created outside Markets or BSM does not reflect the behaviour observed.

Behaviouralisation is therefore used to assess the market interest rate risk of non-trading assets/liabilities and this assessed market risk is transferred to BSM, in accordance with the rules governing the transfer of interest rate risk from the global businesses to BSM.

Behaviouralisation is applied in three key areas:

the assessed re-pricing frequency of managed rate balances;

the assessed duration of non-interest bearing balances, typically capital and current accounts; and

the base case expected prepayment behaviour or pipeline take-up rate for fixed rate balances with embedded optionality.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

Interest rate behaviouralisation policies have to be formulated in line with the Group's behaviouralisation policies and approved at least annually by local ALCO, regional ALCM and Group ALCM, in conjunction with local, regional and Group market risk monitoring teams.

The extent to which balances can be behaviouralised is driven by:

the amount of the current balance that can be assessed as stable under business-as-usual conditions; and

for managed rate balances, the historic market interest rate re-pricing behaviour observed; or

for non-interest bearing balances, the duration for which the balance is expected to remain under business-as-usual conditions. This assessment is often driven by the re-investment tenors available to BSM to neutralise the risk through the use of fixed rate government bonds or interest rate derivatives, and for derivatives the availability of cash flow hedging capacity.

**Balance Sheet Management**

Effective governance across BSM is supported by the dual reporting lines it has to the CEO of GB&M and to the Group Treasurer. In each operating entity, BSM is responsible for managing liquidity and funding under the supervision of the local ALCO (which usually meets on a monthly basis). It also manages the non-trading interest rate positions transferred to it within a Global Markets limit structure.

In executing the management of the liquidity risk on behalf of ALCO, and managing the non-trading interest rate positions transferred to it, BSM invests in highly-rated liquid assets in line with the Group's liquid asset policy. The majority of the liquidity is invested in central bank deposits and government, supranational and agency securities with most of the remainder held in short-term interbank and central bank loans.

Withdrawable central bank deposits are accounted for as cash balances. Interbank loans, statutory central bank reserves and loans to central banks are accounted for as loans and advances to banks. BSM's holdings of securities are accounted for as available-for-sale or, to a lesser extent, held-to-maturity assets.

Statutory central bank reserves are not recognised as liquid assets. The statutory reserves that would be released in line with the Group's stressed customer deposit outflow assumptions are reflected as stressed inflows.

BSM is permitted to use derivatives as part of its mandate to manage interest rate risk. Derivative activity is predominantly through the use of vanilla interest rate swaps which are part of cash flow hedging and fair value hedging relationships.

Credit risk in BSM is predominantly limited to short-term bank exposure created by interbank lending, exposure to central banks and high quality sovereigns, supranationals or agencies which constitute the majority of BSM's liquidity portfolio. BSM does not manage the structural credit risk of any Group entity balance sheets.

BSM is permitted to enter into single name and index credit derivatives activity, but it does so to manage credit risk on the exposure specific to its securities portfolio in limited circumstances only. The risk limits are extremely limited and closely monitored. At 31 December 2014 and 31 December 2013, BSM had no open credit derivative index risk.

VaR is calculated on both trading and non-trading positions held in BSM. It is calculated by applying the same methodology used for the Markets business and utilised as a tool for market risk control purposes.

BSM holds trading portfolio instruments in only very limited circumstances. Positions and the associated VaR were not significant during 2014 and 2013.

### Sensitivity of net interest income

*(Unaudited)*

A principal part of our management of market risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). This monitoring is undertaken at an entity level by local ALCOs.

Entities apply a combination of scenarios and assumptions relevant to their local businesses, and standard scenarios which are required throughout HSBC. The latter are consolidated to illustrate the combined pro forma effect on our consolidated net interest income.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the Group's current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by BSM or in the business units to mitigate the effect of interest rate risk. In reality, BSM seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The net interest income sensitivity calculations assume that interest rates of all maturities move by the same amount in the up-shock scenario. Rates are not assumed to become negative in the down-shock scenario which may, in certain currencies, effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the entity has discretion in terms of the timing and extent of rate changes.

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

#### **Defined benefit pension schemes**

*(Audited)*

Market risk arises within our defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. Pension scheme obligations fluctuate with changes in long-term interest rates, inflation, salary levels and the longevity of scheme members. Pension scheme assets include equities and debt securities, the cash flows of which change as equity prices and interest rates (and credit risk) vary. There is a risk that market movements in equity prices and interest rates could result in asset values which, taken together with regular ongoing contributions, are insufficient over time to cover the level of projected obligations and these, in turn, could increase with a rise in inflation and members living longer. Management and, in certain instances, trustees (who act on behalf of the pension schemes' beneficiaries) assess these risks using reports prepared by independent external consultants, take action and, where appropriate, adjust investment strategies and contribution levels accordingly.

#### **HSBC Holdings**

*(Audited)*

As a financial services holding company, HSBC Holdings has limited market risk activity. Its activities predominantly involve maintaining sufficient capital resources to support the Group's diverse activities; allocating these capital resources across our businesses; earning dividend and interest income on its investments in our businesses; providing dividend payments to HSBC Holdings' equity shareholders and interest payments to providers of debt capital; and maintaining a supply of short-term capital resources for deployment under extraordinary circumstances. It does not take proprietary trading positions.

The main market risks to which HSBC Holdings is exposed are non-trading interest rate risk and foreign currency risk. Exposure to these risks arises from short-term cash balances, funding positions held, loans to subsidiaries, investments in long-term financial assets and financial liabilities including debt capital issued. The objective of HSBC Holdings' market risk management strategy is to reduce exposure to these risks and minimise volatility in capital resources, cash flows and distributable reserves. Market risk for HSBC Holdings is monitored by HSBC Holdings ALCO in accordance with its risk appetite statement.

HSBC Holdings uses interest rate swaps and cross currency interest rate swaps to manage the interest rate risk and foreign currency risk arising from its long-term debt issues.

#### **Operational risk**

*(Unaudited)*

The objective of our operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with our risk appetite, as defined by the GMB.

Operational risk is organised as a specific risk discipline within Global Risk, and a formal governance structure provides oversight over its management. The Global Operational Risk function reports to the Group Chief Risk Officer and supports the Global Operational Risk Committee. It is responsible for establishing and maintaining the operational risk management framework ( ORMF ) and monitoring the level of operational losses and the effectiveness of the control environment. It is also responsible for operational risk reporting at Group level, including the preparation of reports for consideration by the Risk Management Meeting and Group Risk Committee. The Global Operational Risk Committee meets at least quarterly to discuss key risk issues and review the effective implementation of the ORMF.

The ORMF defines minimum standards and processes and the governance structure for the management of operational risk and internal control in our geographical regions, global businesses and global functions. The ORMF has been codified in a high level standards manual supplemented with detailed policies which describes our approach to identifying, assessing, monitoring and controlling operational risk and gives guidance on mitigating action to be taken when weaknesses are identified.

Business managers throughout the Group are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

A centralised database is used to record the results of the operational risk management process. Operational risk and control self-assessments are input and maintained by business units. Business and functional management and Business Risk and Control Managers monitor the progress of documented action plans to address shortcomings. To ensure that operational risk losses are consistently reported and monitored at Group level, all Group companies are required to report individual losses when the net loss is expected to exceed US\$10,000, and to aggregate all other operational risk losses under US\$10,000. Losses are entered into the Group Operational Risk database and are reported to the Risk Management Meeting on a monthly basis.

For further details, see the *Pillar 3 Disclosures 2014* report.

HSBC HOLDINGS PLC

228

## Table of Contents

### **Report of the Directors: Financial Review** (continued)

#### **Compliance risk**

*(Unaudited)*

Compliance risk falls within the definition of operational risk. All Group companies are required to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice. These rules, regulations, standards and Group policies include those relating to anti-money laundering, anti-bribery and corruption, counter-terrorist and proliferation financing, sanctions compliance, conduct of business, market conduct and other financial regulations.

The two Compliance sub-functions: Financial Crime Compliance ( FCC ) and Regulatory Compliance ( RC ), are appropriately supported by shared Compliance Chief Operating Officer, Assurance and Reputational Risk Management teams. The Global Head of Financial Crime Compliance and the Global Head of Regulatory Compliance both report to the Group Chief Risk Officer.

There are compliance teams in each of the countries where we operate and in all global businesses. These compliance teams are principally overseen by Heads of Financial Crime Compliance and Regulatory Compliance located in Europe, the US, Canada, Latin America, Asia and the Middle East and North Africa. The effectiveness of the regional and global business compliance teams are reviewed by the Assurance team.

Global policies and procedures require the prompt identification and escalation to Financial Crime Compliance or Regulatory Compliance of all actual or suspected breaches of any law, rule, regulation, policy or other relevant requirement. These escalation procedures are supplemented by a requirement for the submission of compliance certificates at the half-year and year-end by all Group companies and functions detailing any known breaches as above. The contents of these escalation and certification processes are reported to the Risk Management Meeting, the Group Risk Committee and the Board. They are disclosed in the *Annual Report and Accounts* and *Interim Report*, as appropriate.

Our focus on compliance and conduct issues is further reinforced by the Financial System Vulnerabilities Committee, which reports to the Board on matters relating to financial crime and financial system abuse and provides a forward-looking perspective on financial crime risk. In addition, the Conduct & Values Committee reports to the Board on matters relating to the responsible conduct of business and adherence to HSBC's Values.

In 2014, the new enhanced global AML and sanctions policies and a globally consistent approach to the management of conduct were approved by the Board as described in *Compliance risk* on page 189.

#### **Legal risk**



*(Unaudited)*

Each legal department is required to have processes and procedures in place to manage legal risk that conform to Group standards.

Legal risk falls within the definition of operational risk and includes:

contractual risk, which is the risk of a member of HSBC suffering financial loss, legal or regulatory action or reputational damage because its rights and/or obligations under a contract to which it is a party are technically defective;

dispute risk, which is the risk of a member of HSBC suffering financial loss or reputational damage due to an adverse dispute environment or a failure to take appropriate steps to defend, prosecute and/or resolve actual or threatened legal claims brought against or by a Group member;

legislative risk, which is the risk that an HSBC company fails to adhere to the laws of the jurisdictions in which it operates; and

non-contractual rights risk, which is the risk that a Group member's assets are not properly owned or protected or are infringed by others or the infringement by a Group member of another party's rights.

Our global legal function assists management in controlling legal risk. There are legal departments in 49 of the countries in which we operate. In addition to the Group Legal function, there are regional legal functions in each of Europe, North America, Latin America, the Middle East and North Africa and Asia headed by regional General Counsels, and a global General Counsel responsible for each of the global businesses.

### Global security and fraud risk

*(Unaudited)*

Security and fraud risk issues are managed at Group level by Global Security and Fraud Risk. This unit, which has responsibility for information, fraud, contingency, financial intelligence, physical and geopolitical risks is fully integrated within the central Group Risk function. This enables management to identify and mitigate the permutations of these and other non-financial risks to its business lines across the jurisdictions in which we operate.

The Information Security Risk function is responsible for defining the strategy and policy by which the organisation protects its information assets and services from compromise, corruption or loss, whether caused deliberately or inadvertently by internal or external parties. It provides independent advice, guidance and oversight to the business about the effectiveness of information security controls and practices in place or being proposed.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

The Fraud Risk function is responsible for ensuring that effective prevention, detection and investigation measures are in place against all forms of fraudulent activity, whether initiated internally or externally, and is available to support any part of the business. To achieve that and to attain the level of integration needed to face the threat, the management of all types of fraud (e.g. card fraud, non-card fraud and internal fraud, including investigations) is established within one management structure and is part of the Global Risk function.

We use technology extensively to prevent and detect fraud. For example, customers' credit and debit card spending is monitored continuously and suspicious transactions are highlighted for verification, internet banking sessions are reviewed and transactions monitored in a similar way and all new account applications are screened for fraud. We have a fraud systems strategy which is designed to provide minimum standards and allow easier sharing of best practices to detect fraud and minimise false alerts.

We have developed a holistic and effective anti-fraud strategy which, in addition to the use of advanced technology, includes fraud prevention policies and practices, the implementation of strong internal controls, investigations response teams and liaison with law enforcement where appropriate.

The Contingency Risk function is responsible for ensuring that the group's critical systems, processes and functions have the resilience to maintain continuity in the face of major disruptive events.

Within this wider risk, Business Continuity Management covers the pre-planning for recovery, seeking to minimise the adverse effects of major business disruption, either globally, regionally or within country, against a range of actual or emerging risks. The pre-planning concentrates on the protection of customer services, our staff, revenue generation, the integrity of data and documents and meeting regulatory requirements.

Each business has its own recovery plan, which is developed following the completion of a Business Impact Analysis. This determines how much time the business could sustain an outage before the level of losses becomes unacceptable, i.e. its criticality. These plans are reviewed and tested every year. The planning is undertaken against Group policy and standards and each business confirms in an annual compliance certificate that all have been met. Should there be exceptions, these are raised and their short-term resolution is overseen by Group and regional business continuity teams.

It is important that plans are dynamic and meet all risks, particularly those of an emerging nature such as possible pandemics and cyber-attacks. The ORMF is used to measure our resilience to these risks, and is confirmed to Group and regional risk committees.

Resilience is managed through various risk mitigation measures. These include agreeing with IT acceptable recovery times of systems, ensuring our critical buildings have the correct infrastructure to enable ongoing operations, requiring critical vendors to have their own recovery plans and arranging with Group Insurance appropriate cover for business interruption costs.

The Financial Intelligence Unit is jointly administered by Security and Fraud Risk and Financial Crime Compliance. It uses advanced analytics and subject matter expertise to detect indicators of financial crime in the Group's clients and

counter-parties.

The Physical Security function develops practical physical, electronic and operational counter-measures to ensure that the people, property and assets managed by the Group are protected from crime, theft, attack and groups hostile to HSBC's interests.

Geopolitical risk unit provides both regular and ad hoc reporting to business executives and senior Security and Fraud Risk management on geopolitical risk profiles and evolving threats in countries in which the Group operates. This both enhances strategic business planning and provides an early view into developing security risks. Security travel controls and guidance are also maintained.

### Systems risk

*(Unaudited)*

Systems risk is the risk of failure or other deficiency in the automated platforms that support the Group's daily execution (application systems) and the systems infrastructure on which they reside (data centres, networks and distributed computers).

The management of systems risk is overseen globally by the HSBC Technology and Services ( HTS ) organisation. Oversight is provided through monthly risk management committee meetings that provide a comprehensive overview of existing and emerging top risks.

HTS line management manages the control environment over systems risks using risk and control assessments and scenario analysis. Key risk indicators are used to assure a consistent basis of risk evaluation across geographical and line of business boundaries. Material risks are monitored through the periodic testing of associated key controls.

Business-critical services have been identified through a central, global oversight body. Quantitative scorecards, called risk appetite statements, are used for monitoring performance, and have been established for each of these services.

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

Service Resilience and Systems Continuity Planning functions are in place to ensure systems meet agreed target service levels and, in the event of major disruptive events, can be recovered within recovery time objectives agreed with the business.

**Vendor risk management**

*(Unaudited)*

Our vendor risk management ( VRM ) programme is a global framework for managing risk with third party vendors, especially where we are reliant on outsourced agreements to provide critical services to our customers. VRM contains a rigorous process to identify material contracts and their key risks and ensure controls are in place to manage and mitigate these risks. Global and regional governance structures have been implemented to oversee vendor third party service providers.

**Risk management of insurance operations**

**Overview of insurance products**

*(Audited)*

HSBC manufactures the following main classes of contract:

life insurance contracts with discretionary participation features ( DPF );

credit life insurance business;

annuities;

term assurance and critical illness policies;

linked life insurance;

investment contracts with DPF;

unit-linked investment contracts; and

other investment contracts (including pension contracts written in Hong Kong).

We additionally write a small amount of non-life insurance business primarily covering personal and commercial property.

### Nature and extent of risks

*(Audited)*

The majority of the risks in our Insurance business derive from manufacturing activities and can be categorised between financial risks and insurance risk; financial risks include market risk, credit risk and liquidity risk. Operational and sustainability risks are also present and are covered by the Group's respective overall risk management processes.

The following sections describe how financial risks and insurance risk are managed. The assets of insurance manufacturing subsidiaries are included within the consolidated risk disclosures on pages 111 to 203, although separate disclosures in respect of insurance manufacturing subsidiaries are provided in the Risk management of insurance operations section on pages 190 to 198.

Insurance manufacturers establish control procedures complying with the guidelines and requirements issued by Group Insurance and local regulatory requirements. Country level oversight is exercised by local risk management committees. Country Chief Risk Officers have direct reporting lines into local Insurance Chief Executive Officers and functional reporting lines into the Group Insurance Chief Risk Officer, who has overall accountability for risk management in insurance operations globally. The Group Insurance Executive Committee oversees the control framework globally and is accountable to the RBWM Risk Management Committee on risk matters.

In addition, local ALCOs monitor and review the duration and cash flow matching of insurance assets and liabilities.

All insurance products, whether manufactured internally or by a third party, are subjected to a product approval process prior to introduction.

### Financial risks

*(Audited)*

Our insurance businesses are exposed to a range of financial risks, including market risk, credit risk and liquidity risk. Market risk includes interest rate, equity and foreign exchange risks. The nature and management of these risks is described below.

Manufacturing subsidiaries are exposed to financial risks when, for example, the proceeds from financial assets are not sufficient to fund the obligations arising from insurance and investment contracts. In many jurisdictions, local

regulatory requirements prescribe the type, quality and concentration of assets that these subsidiaries must maintain to meet insurance liabilities. These requirements complement Group-wide policies.

HSBC HOLDINGS PLC

231

**Table of Contents****Report of the Directors: Financial Review** (continued)**Market risk***(Audited)***Description of market risk**

The main features of products manufactured by our insurance manufacturing subsidiaries which generate market risk, and the market risk to which these features expose the subsidiaries, are discussed below.

Interest rate risk arises to the extent that yields on the assets are lower than the investment returns implied by the guarantees payable to policyholders by insurance manufacturing subsidiaries. When the asset yields are below guaranteed yields, products may be closed to new business, repriced or restructured. A list of the different types of guarantees within our insurance contracts is outlined below.

**Categories of guaranteed benefits**

annuities in payment;

deferred/immediate annuities: these consist of two phases – the savings and investing phase and the retirement income phase;

annual return: the annual return is guaranteed to be no lower than a specified rate. This may be the return credited to the policyholder every year, or the average annual return credited to the policyholder over the life of the policy, which may occur on the maturity date or the surrender date of the contract; and

capital: policyholders are guaranteed to receive no less than the premiums paid plus declared bonuses less expenses.

The proceeds from insurance and investment products with DPF are primarily invested in bonds with a proportion allocated to other asset classes in order to provide customers with the potential for enhanced returns. Subsidiaries

with portfolios of such products are exposed to the risk of falls in market prices which cannot be fully reflected in the discretionary bonuses. An increase in market volatility could also result in an increase in the value of the guarantee to the policyholder.

Long-term insurance and investment products typically permit the policyholder to surrender the policy or let it lapse at any time. When the surrender value is not linked to the value realised from the sale of the associated supporting assets, the subsidiary is exposed to market risk. In particular, when customers seek to surrender their policies when asset values are falling, assets may have to be sold at a loss to fund redemptions.

A subsidiary holding a portfolio of long-term insurance and investment products, especially with DPF, may attempt to reduce exposure to its local market by investing in assets in countries other than that in which it is based. These assets may be denominated in currencies other than the subsidiary's local currency. Where the foreign exchange exposure associated with these assets is not hedged, for example because it is not cost effective to do so, this exposes the subsidiary to the risk of its local currency strengthening against the currency of the related assets.

For unit-linked contracts, market risk is substantially borne by the policyholder, but market risk exposure typically remains as fees earned for management are related to the market value of the linked assets.

### **Asset and liability matching**

It is not always possible to match asset and liability durations, partly because there is uncertainty over policyholder behaviour which introduces uncertainty over the receipt of all future premiums and the timing of claims, and partly because the forecast payment dates of liabilities may exceed the duration of the longest dated investments available.

We use models to assess the effect of a range of future scenarios on the values of financial assets and associated liabilities, and ALCOs employ the outcomes in determining how to best structure asset holdings to support liabilities. The scenarios include stresses applied to factors which affect insurance risk such as mortality and lapse rates. Of particular importance is assessing the expected pattern of cash inflows against the benefits payable on the underlying contracts, which can extend for many years.

Our current portfolio of assets includes debt securities issued at a time when yields were higher than those observed in the current market. As a result, yields on extant holdings of debt securities exceed those available on current issues. We reduced short-term bonus rates paid to policyholders on certain participating contracts to manage the immediate strain on the business. Should interest rates and yield curves remain low further reductions may be necessary.

### **How market risk is managed**

All our insurance manufacturing subsidiaries have market risk mandates which specify the investment instruments in which they are permitted to invest and the maximum quantum of market risk which they may retain. They manage market risk by using some or all of the techniques listed below, depending on the nature of the contracts they write.

#### **Techniques for managing market risk**

for products with DPF, adjusting bonus rates to manage the liabilities to policyholders. The effect is that a significant portion of the market risk is borne by the policyholder;



structuring asset portfolios to support projected liability cash flows;

using derivatives, to a limited extent, to protect against adverse market movements or better match liability cash flows;

HSBC HOLDINGS PLC

232

---

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

for new products with investment guarantees, considering the cost when determining the level of premiums or the price structure;

periodically reviewing products identified as higher risk, which contain investment guarantees and embedded optionality features linked to savings and investment products;

including features designed to mitigate market risk in new products, such as charging surrender penalties to recoup losses incurred when policyholders surrender their policies;

exiting, to the extent possible, investment portfolios whose risk is considered unacceptable; and

repricing of premiums charged to policyholders.

In the product approval process, the risks embedded in new products are identified and assessed. When, for example, options and guarantees are embedded in new products, the due diligence process ensures that complete and appropriate risk management procedures are in place. For all but the simplest of guaranteed benefits the assessment is undertaken by Group Insurance. Management reviews certain exposures more frequently when markets are more volatile to ensure that any matters arising are dealt with in a timely fashion.

**How the exposure to market risk is measured**

Our insurance manufacturing subsidiaries monitor exposures against mandated limits regularly and report them to Group Insurance. Exposures are aggregated and reported on a quarterly basis to senior risk management forums in Group Insurance.

In addition, large insurance manufacturing subsidiaries perform a high-level monthly assessment of market risk exposure against risk appetite. This is submitted to Group Insurance and a global assessment presented to the RBWM Risk Management Committee.

### Standard measures for quantifying market risks

for interest rate risk, the sensitivities of the net present values of asset and expected liability cash flows, in total and by currency, to a one basis point parallel shift in the discount curves used to calculate the net present values;

for equity price risk, the total market value of equity holdings and the market value of equity holdings by region and country; and

for foreign exchange risk, the total net short foreign exchange position and the net foreign exchange positions by currency.

The standard measures are relatively straightforward to calculate and aggregate, but they have limitations. The most significant one is that a parallel shift in yield curves of one basis point does not capture the non-linear relationships between the values of certain assets and liabilities and interest rates. Non-linearity arises, for example, from investment guarantees and product features which enable policyholders to surrender their policies. We bear the shortfall if the yields on investments held to support contracts with guaranteed benefits are less than the investment returns implied by the guaranteed benefits.

We recognise these limitations and augment our standard measures with stress tests which examine the effect of a range of market rate scenarios on the aggregate annual profits and total equity of our insurance manufacturing subsidiaries, after taking into consideration tax and accounting treatments where material and relevant. The results of these tests are reported to Group Insurance and risk committees every quarter.

The table, Sensitivity of HSBC's insurance manufacturing subsidiaries to market risk factors on page 195, indicates the sensitivity of insurance manufacturers profit and total equity to market risk factors.

### Credit risk

*(Audited)*

#### Description of credit risk

Credit risk arises in two main areas for our insurance manufacturers:

(i) risk of default by debt security counterparties after investing premiums to generate a return for policyholders and shareholders; and

(ii) risk of default by reinsurance counterparties and non-reimbursement for claims made after ceding insurance risk.

#### How credit risk is managed

Our insurance manufacturing subsidiaries are responsible for the credit risk, quality and performance of their investment portfolios. Our assessment of the creditworthiness of issuers and counterparties is based primarily upon internationally recognised credit ratings and other publicly available information.

Investment credit exposures are monitored against limits by our local insurance manufacturing subsidiaries, and are aggregated and reported to Group Insurance Credit Risk and Group Credit Risk. Stress testing is performed by Group Insurance on the investment credit exposures using credit spread sensitivities and default probabilities.

HSBC HOLDINGS PLC

233

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

We use a number of tools to manage and monitor credit risk. These include a Credit Watch Report which contains a watch-list of investments with current credit concerns and is circulated fortnightly to senior management in Group Insurance and the individual Country Chief Risk Officers to identify investments which may be at risk of future impairment.

**Liquidity risk**

*(Audited)*

**Description of liquidity risk**

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

There are three aspects to liquidity risk. The first arises in normal market conditions and is referred to as funding liquidity risk; specifically, the capacity to raise sufficient cash when needed to meet payment obligations. Secondly, market liquidity risk arises when the size of a particular holding may be so large that a sale cannot be completed around the market price. Finally, standby liquidity risk refers to the capacity to meet payment terms in abnormal conditions.

**How liquidity risk is managed**

Our insurance manufacturing subsidiaries primarily fund cash outflows arising from claim liabilities from the following sources of cash inflows:

premiums from new business, policy renewals and recurring premium products;

interest and dividends on investments and principal repayments of maturing debt investments;

cash resources; and

the sale of investments.

They manage liquidity risk by utilising some or all of the following techniques:

matching cash inflows with expected cash outflows using specific cash flow projections or more general asset and liability matching techniques such as duration matching;

maintaining sufficient cash resources;

investing in good credit-quality investments with deep and liquid markets to the degree to which they exist;

monitoring investment concentrations and restricting them where appropriate, for example, by debt issues or issuers; and

establishing committed contingency borrowing facilities.

Each of these techniques contributes to mitigating the three types of liquidity risk described above.

Every quarter, our insurance manufacturing subsidiaries are required to complete and submit liquidity risk reports to Group Insurance for collation and review. Liquidity risk is assessed in these reports by measuring changes in expected cumulative net cash flows under a series of stress scenarios designed to determine the effect of reducing expected available liquidity and accelerating cash outflows. This is achieved, for example, by assuming new business or renewals are lower, and surrenders or lapses are greater, than expected.

### Insurance risk

*(Audited)*

Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (HSBC). The principal risk we face in manufacturing insurance contracts is that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income.

The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.

Insurance risks are controlled by high-level policies and procedures set both centrally and locally, taking into account where appropriate local market conditions and regulatory requirements. Formal underwriting, reinsurance and claims-handling procedures designed to ensure compliance with regulations are applied, supplemented with stress testing.

As well as exercising underwriting controls, we use reinsurance as a means of mitigating exposure to insurance risk. Where we manage our exposure to insurance risk through the use of third-party reinsurers, the associated revenue and manufacturing profit is ceded to the reinsurers. Although reinsurance provides a means of managing insurance risk, such contracts expose us to credit risk, the risk of default by the reinsurer.

The principal drivers of our insurance risk are described below. The liabilities for long-term contracts are set by reference to a range of assumptions around these drivers. These typically reflect the issuers' own experiences. The type and quantum of insurance risk arising from life insurance depends on the type of business, and varies considerably.



**Table of Contents****Report of the Directors: Financial Review** (continued)

*mortality and morbidity*: the main contracts which generate exposure to these risks are term assurance, whole life products, critical illness and income protection contracts and annuities. The risks are monitored on a regular basis, and are primarily mitigated by underwriting controls and reinsurance and by retaining the ability in certain cases to amend premiums in the light of experience;

*lapses and surrenders*: the risks associated with this are generally mitigated by product design, the application of surrender charges and management actions, for example, managing the level of bonus payments to policyholders. A detailed persistency analysis at a product level is carried out at least on an annual basis; and

*expense risk* is mitigated by pricing, for example, retaining the ability in certain cases to amend premiums and/or policyholder charges based on experience, and cost management discipline.

Liabilities are affected by changes in assumptions (see Sensitivity analysis on page 198).

**Reputational risk**

*(Unaudited)*

We regularly review our policies and procedures for safeguarding against reputational risk. This is an evolutionary process which takes account of relevant developments, industry guidance, best practice and societal expectations.

We have always aspired to the highest standards of conduct and, as a matter of routine, take account of reputational risks to our business. Reputational risks can arise from a wide variety of causes. As a banking group, our good reputation depends not only upon the way in which we conduct our business, but also by the way in which clients to whom we provide financial services, and our vendors, conduct themselves.

The Global Head of Financial Crime Compliance and the Global Head of Regulatory Compliance are the risk stewards for reputational risk. The development of policies, and an effective control environment for the identification, assessment, management and mitigation of reputational risk, is co-ordinated through the Group Reputational Risk Policy Committee ( GRRPC ), which is chaired by the Group Chairman. The primary role of the GRRPC is to consider areas and activities presenting significant reputational risk and, where appropriate, to make recommendations to the Group Risk Management Meeting for policy or procedural changes to mitigate such risk. Each of the Group's geographical regions is required to ensure that reputational risks are also considered at a regional level, either through a special section of their respective Regional Risk Management Committee meetings, or a Regional Reputational Risk Policy Committee. A summary of the minutes from the regional meetings is tabled at GRRPC. Significant issues posing reputational risk are reported to Group Risk Committee and the Holdings Board and, where appropriate, to the Conduct & Values Committee.



In July 2014, the new Reputational Risk and Customer Selection policies were issued which define a consistent and structured approach to managing these risks. For further details, see *Reputational risk* on page 199. Each of the global businesses and functions is required to have a procedure to assess and address reputational risks potentially arising from proposed business transactions and client activity. These are supported by a central team which ensures that issues are directed to the appropriate forum, that decisions taken are implemented and that management information is collated and actions reported to senior management. In 2014, the combined Reputational Risk and Client Selection committees were created within the global businesses with a clear process to escalate and address matters at the appropriate level. The global functions manage and escalate reputational risks within established operational risk frameworks.

Standards on all major aspects of business are set for HSBC and for individual subsidiaries, businesses and functions. Reputational risks, including environmental, social and governance matters, are considered and assessed by the Board, the GMB, the Risk Management Meeting, the Global Standards Steering Meeting, subsidiary company boards, Board committees and senior management during the formulation of policy and the establishment of our standards. These policies, which form an integral part of the internal control system (see page 288), are communicated through manuals and statements of policy and are promulgated through internal communications and training. The policies set out our risk appetite and operational procedures in all areas of reputational risk, including money laundering deterrence, counter-terrorist financing, environmental impact, anti-bribery and corruption measures and employee relations. The policy manuals address risk issues in detail and co-operation between Group departments and businesses is required to ensure a strong adherence to our risk management system and our sustainability practices.

## **Fiduciary risk**

*(Unaudited)*

Business activities in which fiduciary risk is inherent are only permitted within designated lines of business. Fiduciary risk is managed within the designated businesses via a comprehensive policy framework and monitoring of key indicators. The Group's principal fiduciary businesses and activities ( designated businesses and activities ) are:

HSBC Securities Services, which is exposed to fiduciary risk via its Funds Services and Corporate Trust and loan agency activities;

HSBC Global Asset Management, which is exposed to fiduciary risks via its investment management activities on behalf of clients;

HSBC Global Private Banking, which is exposed to fiduciary risks via its private trust division and discretionary investment management;

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

HSBC Insurance, which is exposed to fiduciary risks via the investment management activities it undertakes when providing insurance products and services;

RBWM Trust Investment Wrappers, required by regulation for the provision of normal RBWM Wealth Management products and services; and

HSBC Employee Pension Scheme activities, where fiduciary duties may arise as part of carrying out a function of discretion or control over an HSBC employee pension scheme's operations.

The Group's requirements for the management of fiduciary risk are laid down in the fiduciary section of the Global Risk Functional Instruction Manual, which is owned by Global Operational Risk. No business other than the designated businesses may undertake fiduciary activities without notifying Global Operational Risk and receiving specific dispensations from the relevant fiduciary policy requirements.

Other policies around the provision of advice, including investment advice and corporate advisory, and the management of potential conflicts of interest, also mitigate our fiduciary risks.

**Pension risk**

*(Audited)*

We operate a number of pension plans throughout the world, as described in the Pension risk section on page 200 and below.

In order to fund the benefits associated with defined benefit plans, sponsoring Group companies (and, in some instances, employees) make regular contributions in accordance with advice from actuaries and in consultation with the scheme's trustees (where relevant). The defined benefit plans invest these contributions in a range of investments designed to meet their long-term liabilities.

The level of these contributions has a direct impact on HSBC's cash flow and would normally be set to ensure that there are sufficient funds to meet the cost of the accruing benefits for the future service of active members. However, higher contributions will be required when plan assets are considered insufficient to cover the existing pension liabilities. Contribution rates are typically revised annually or triennially, depending on the plan. The agreed contributions to the principal plan are revised triennially.

**A deficit in a defined benefit plan may arise from a number of factors, including:**

investments delivering a return below that required to provide the projected plan benefits. This could arise, for example, when there is a fall in the market value of equities, or when increases in long-term interest rates cause a fall in the value of fixed income securities held;

the prevailing economic environment leading to corporate failures, thus triggering write-downs in asset values (both equity and debt);

a change in either interest rates or inflation which causes an increase in the value of the scheme liabilities; and

scheme members living longer than expected (known as longevity risk).

A plan's investment strategy is determined after taking into consideration the market risk inherent in the investments and its consequential impact on potential future contributions. The long-term investment objectives of both HSBC and, where relevant and appropriate, the trustees are:

to limit the risk of the assets failing to meet the liabilities of the plans over the long-term; and  
to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of the defined benefit plans.

In pursuit of these long-term objectives, a benchmark is established for the allocation of the defined benefit plan assets between asset classes. In addition, each permitted asset class has its own benchmarks, such as stock market or property valuation indices and, where relevant, desired levels of out-performance. The benchmarks are reviewed at least triennially within 18 months of the date at which an actuarial valuation is made, or more frequently if required by local legislation or circumstances. The process generally involves an extensive asset and liability review.

Ultimate responsibility for investment strategy rests with either the trustees or, in certain circumstances, a management committee. The degree of independence of the trustees from HSBC varies in different jurisdictions.

Defined contribution plans result in far less exposure to market risk for the bank, but remain exposed to operational and reputational risks as they place the responsibility and flexibility more directly with employees. To manage these risks, the performance of defined contribution investment funds are monitored and local engagement with employees is actively promoted to ensure they are provided with sufficient information about the options available to them.

**Pension plans in the UK**

The HSBC Bank (UK) Pension Scheme (the principal plan) has both defined benefit and defined contribution sections. The defined benefit section accounts for approximately 72% of our total defined benefit obligations around

the world. The defined benefit section was closed to new entrants in 1996 and from 1 July 2015 it will be closed to further accrual for

HSBC HOLDINGS PLC

236

**Table of Contents****Report of the Directors: Financial Review** (continued)

current employees who are in that section, who will join the defined contribution section for future pensions. All new employees have joined the defined contribution section since 1996. The principal plan is overseen by an independent corporate trustee who has a fiduciary responsibility for the operation of the pension plan. The trustee is responsible for monitoring and managing the investment strategy and administration of scheme benefits. The principal plan holds a diversified portfolio of investments to meet future cash flow liabilities arising from accrued benefits as they fall due to be paid. The trustee of the principal plan is required to produce a written Statement of Investment Principles which governs decision-making about how investments are made and the need for adequate diversification is taken into account in the choice of asset allocation and manager structure in the defined benefit section. Longevity risk in the principal plan is assessed as part of the measurement of the pension liability and managed through the funding process of the plan.

**Sustainability risk**

*(Unaudited)*

Sustainability risks arise from the provision of financial services to companies or projects which run counter to the needs of sustainable development; in effect, this risk arises when the environmental and social effects outweigh economic benefits. Within Group Head Office, a separate function, Global Corporate Sustainability, is mandated to manage these risks globally working through local offices as appropriate. Sustainability Risk Managers have regional or national responsibilities for advising on and managing environmental and social risks. Global Corporate Sustainability's risk management responsibilities include:

formulating sustainability risk policies. This includes overseeing our sustainability risk standards, our application of the Equator Principles and our sustainability policies (covering agricultural commodities, chemicals, defence, energy, forestry, freshwater infrastructure, mining and metals, and World Heritage Sites and Ramsar Wetlands); undertaking an independent review of transactions where sustainability risks are assessed to be high; and supporting our operating companies to assess similar risks of a lower magnitude;

building and implementing systems-based processes to ensure consistent application of policies, reduce the costs of sustainability risk reviews and capture management information to measure and report on the effect of our lending and investment activities on sustainable development; and

providing training and capacity building within our operating companies to ensure sustainability risks are identified and mitigated consistently to either our own standards, international standards or local regulations, whichever is

higher.

HSBC HOLDINGS PLC

237

**Table of Contents****Report of the Directors: Financial Review (continued)**

<b>Capital</b>	<b>Page</b>	<b>App<sup>1</sup></b>	<b>Tables</b>	<b>Page</b>
<b><u>Capital overview</u></b>	<b>239</b>		<i><u>Capital ratios</u></i>	<b>239</b>
<u>Capital management</u>		257	<i><u>Total regulatory capital and risk-weighted assets</u></i>	<b>239</b>
<u>Approach and policy</u>		257		
<u>Stress testing</u>		257		
<u>Risks to capital</u>		257		
<u>Risk-weighted asset targets</u>		257		
<u>Capital generation</u>		258		
<u>Capital measurement and allocation</u>		258		
<u>Regulatory capital</u>		258		
<u>Pillar 1 capital requirements</u>		258		
<u>Pillar 2 capital requirements</u>		259		
<u>Pillar 3 disclosure requirements</u>		260		
<b><u>Risk-weighted assets</u></b>	<b>239</b>		<i><u>RWAs by risk type</u></i>	<b>240</b>
			<i><u>RWAs by global businesses</u></i>	<b>240</b>
			<i><u>RWAs by geographical regions</u></i>	<b>240</b>
<u>Credit risk RWAs</u>	<b>240</b>		<i><u>Credit risk exposure RWAs by geographical region</u></i>	<b>240</b>
			<i><u>Credit risk exposure RWAs by global businesses</u></i>	<b>240</b>
			<i><u>RWA movement by geographical regions by key driver credit risk IRB only</u></i>	<b>242</b>
			<i><u>RWA movement by global businesses by key driver credit risk IRB only</u></i>	<b>242</b>
<u>Counterparty credit risk and market risk RWAs</u>	<b>243</b>		<i><u>Counterparty credit risk RWAs</u></i>	<b>243</b>
			<i><u>RWA movement by key driver counterparty credit risk advanced approach</u></i>	<b>243</b>
			<i><u>Market risk RWAs</u></i>	<b>244</b>
			<i><u>RWA movement by key driver market</u></i>	<b>244</b>

		<i>risk internal model based</i>	
		<i>Capital and RWA movements by major driver CRD IV end point basis</i>	245
<u>Operational risk RWAs</u>	244		
<u>RWA movement by key driver basis of preparation and supporting notes</u>			260
<u>Credit risk drivers definitions and quantifications</u>			260
<u>Counterparty risk drivers definitions and quantifications</u>			261
<u>Market risk drivers definitions and quantifications</u>			261
<b><u>Capital structure</u></b>	245	<i>Source and application of total regulatory capital</i>	245
		<i>Composition of regulatory capital</i>	246
		<i>Reconciliation of regulatory capital from transitional basis to an estimated CRD IV end point basis</i>	247
<b><u>Regulatory balance sheet</u></b>	248	<i>Reconciliation of balance sheets financial accounting to regulatory scope of consolidation</i>	249
<u>Regulatory and accounting consolidations</u>	248		
<b><u>Leverage ratio</u></b>	251	<i>Estimated leverage ratio</i>	251
<u>Leverage ratio: basis of preparation</u>			261
<b><u>Regulatory developments</u></b>	252		
<u>Regulatory capital buffers</u>	252	<i>Capital requirements framework</i>	254
<u>Regulatory stress testing</u>	254		
<u>RWA developments</u>	254		
<u>Leverage ratio proposals</u>	255		
<u>Banking structural reform and recovery and resolution planning</u>	255		
<u>Other regulatory updates</u>	256		

1 Appendix to Capital.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)

**Our objective in the management of Group capital is to maintain appropriate levels of capital to support our business strategy and meet our regulatory and stress testing related requirements.**

**Capital highlights**

The transitional CET1 ratio of 10.9% was up from 10.8% at the end of 2013 as a result of continued capital generation and management initiatives offset by RWA growth, foreign exchange movements and regulatory changes.

The end point CET1 ratio of 11.1% was up from 10.9% at the end of 2013 as a result of similar drivers.

**Capital overview**

*(Unaudited)*

***Capital ratios***

*(Unaudited)*

	At 31 December	
	2014	2013
	%	%
<b>CRD IV transitional</b>		
Common equity tier 1 ratio	10.9	10.8
Tier 1 ratio	12.5	12.0
Total capital ratio	15.6	14.9
<b>CRD IV end point</b>		
Common equity tier 1 ratio	11.1	10.9
<b>Basel 2.5</b>		
Core tier 1 ratio	n/a	13.6
Tier 1 ratio	n/a	14.5
Total capital ratio	n/a	17.8

***Total regulatory capital and risk-weighted assets***

*(Unaudited)*

	<b>CRD IV transitional at 31 Dec 2014 US\$m</b>	CRD IV transitional estimated at 31 Dec 2013 US\$m	Basel 2.5 at 31 Dec 2013 US\$m
Common equity tier 1 capital	<b>133,200</b>	131,233	
Core tier 1 capital			149,051
Additional tier 1 capital	<b>19,539</b>	14,408	9,104
Tier 2 capital	<b>37,991</b>	35,538	35,854
Total regulatory capital	<b>190,730</b>	181,179	194,009
Risk-weighted assets	<b>1,219,765</b>	1,214,939	1,092,653

On 1 January 2014, CRD IV came into force and capital and RWAs at 31 December 2014 are calculated and presented on the Group's interpretation of final CRD IV legislation and final rules issued by the PRA. Prior to 1 January 2014, RWAs and capital were calculated and presented in accordance with the previous regime under CRD III, also referred to as Basel 2.5. As a result, unless otherwise stated, comparatives for capital and RWAs at 31 December 2013 are on a Basel 2.5 basis.

The capital and RWAs on a CRD IV basis incorporate the effect of the PRA's final rules as set out in the PRA Rulebook. This transposed various areas of national discretion within the final CRD IV legislation into UK law. In its final rules, the PRA did not adopt most of the CRD IV transitional provisions available, instead opting for an acceleration of the CRD IV end point definition of common equity tier 1 ( CET1 ) capital. However, CRD IV

transitional provisions for unrealised gains were applied, such that unrealised gains on investment property and available-for-sale securities are not recognised for capital until 1 January 2015. As a result, our transitional capital ratio in 2014 is slightly lower than the comparable end point capital ratio.

In April 2014, the PRA published its rules and supervisory statements implementing some of the CRD IV provisions relating to capital buffers, further details of which are provided in the Regulatory capital buffers section on page 252.

In June 2014, the PRA published its revised expectations in relation to capital ratios for major UK banks and building societies, namely that from 1 July 2014 we are expected to meet a 7% CET1 ratio using the CRD IV end point definition. This applies alongside CRD IV requirements.

Despite the rules published to date, there remains continued uncertainty around the amount of capital that UK banks will be required to hold. This relates specifically to the quantification and interaction of capital buffers and Pillar 2. The PRA is currently consulting on their revised approach to Pillar 2, the PRA buffer and its interaction with the CRD IV buffers. Furthermore, there are a significant number of draft and unpublished EBA technical and implementation standards due in 2015.

Our approach to managing Group capital is designed to ensure that we exceed current regulatory requirements and that we respect the payment priority of our capital providers. Throughout 2014, we complied with the PRA's regulatory capital adequacy requirements, including those relating to stress testing. We are also well placed to meet our expected future capital requirements.

During 2014, we managed our capital position to meet an internal target CET1 ratio on an end point basis of greater than 10%. This has since been reviewed, and in 2015 we expect to manage Group capital to meet a medium-term

target for return on equity of more than 10%. This is modelled on a CET1 ratio on an end point basis in the range of 12% to 13%.

*A summary of our policies and practices regarding capital management, measurement and allocation is provided in the Appendix to Capital on page 257.*

### **Risk-weighted assets**

*(Unaudited)*

CRD IV contributed to an increased capital requirement. The key changes introduced were:

securitisation positions which were previously deducted 50% from core tier 1 and 50% from total capital, are now included in RWAs at 1,250%;

an additional capital charge to cover the risk of mark-to-market losses on expected counterparty risk referred to as credit valuation adjustment ( CVA ) risk;

deferred tax assets and significant investments, subject to thresholds, are now risk weighted at 250%;

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

increased risk weights on exposures to financial institutions, referred to as asset value correlation ( *AVC* ); and

new requirements for exposures to central counterparties ( *CCP* ). There are enhanced incentives for clearing OTC derivative transactions through *CCP*.

*RWAs by risk type*

(Unaudited)

	CRD IV transitional and end point		Basel 2.5
	2014	2013	basis
	US\$bn	US\$bn	2013 US\$bn
Credit risk	<b>955.3</b>	936.5	864.3
Standardised approach	<b>356.9</b>	358.6	329.5
IRB foundation approach	<b>16.8</b>	13.5	13.6
IRB advanced approach	<b>581.6</b>	564.4	521.2
Counterparty credit risk	<b>90.7</b>	95.8	45.8
Standardised approach	<b>25.2</b>	36.6	3.6
Advanced approach	<b>65.5</b>	59.2	42.2
Market risk	<b>56.0</b>	63.4	63.4
Operational risk	<b>117.8</b>	119.2	119.2
<b>At 31 December</b>	<b>1,219.8</b>	1,214.9	1,092.7
Of which:			
US run-off portfolios	<b>99.2</b>	142.3	104.9
Legacy credit in GB&M	<b>44.1</b>	63.7	26.4
US CML and Other	<b>55.1</b>	78.6	78.5
Card and Retail Services <sup>1</sup>		1.1	1.1

*For footnotes, see page 256.*

*RWAs by global businesses*

(Unaudited)

—	<b>CRD IV</b>	Basel 2.5
---	---------------	-----------

	<b>transitional and end point 2014 US\$bn</b>	basis 2013 US\$bn
Retail Banking and Wealth Management	205.1	233.5
Commercial Banking	432.4	391.7
Global Banking and Markets	516.1	422.3
Global Private Banking	20.8	21.7
Other	45.4	23.5
<b>At 31 December</b>	<b>1,219.8</b>	<b>1,092.7</b>

*RWAs by geographical regions<sup>2</sup>*

*(Unaudited)*

	<b>CRD IV transitional and end point 2014 US\$bn</b>	Basel 2.5 basis 2013 US\$bn
Europe	375.4	300.1
Asia	499.8	430.7
Middle East and North Africa	63.0	62.5
North America	221.4	223.8
Latin America	88.8	89.5
<b>At 31 December</b>	<b>1,219.8</b>	<b>1,092.7</b>

*For footnote, see page 256.*

**Credit risk RWAs**

*(Unaudited)*

*Credit risk exposure RWAs by geographical region*

	<b>Europe US\$bn</b>	<b>Asia<sup>3</sup> US\$bn</b>	<b>MENA US\$bn</b>	<b>North America US\$bn</b>	<b>Latin America US\$bn</b>	<b>Total US\$bn</b>
<b>CRD IV basis</b>						
IRB approach	216.1	213.1	15.6	142.0	11.6	598.4

IRB advanced approach	203.3	213.1	11.6	142.0	11.6	581.6
IRB foundation approach	12.8		4.0			16.8
Standardised approach	47.1	186.0	39.0	29.6	55.2	356.9
<b>RWAs at 31 December 2014</b>	<b>263.2</b>	<b>399.1</b>	<b>54.6</b>	<b>171.6</b>	<b>66.8</b>	<b>955.3</b>

**Basel 2.5 basis**

IRB advanced approach	157.1	182.9	11.2	161.5	8.5	521.2
IRB foundation approach	9.8		3.8			13.6
Standardised approach	44.5	165.9	40.0	22.7	56.4	329.5
RWAs at 31 December 2013	211.4	348.8	55.0	184.2	64.9	864.3

*For footnote, see page 256.*

*Credit risk exposure RWAs by global businesses*

	Principal (US run-off portfolio)		RBWM					Total US\$bn
	RBWM US\$bn	US\$bn	Total RBWM US\$bn	CMB US\$bn	GB&M US\$bn	GPB US\$bn	Other US\$bn	
<b>CRD IV basis</b>								
IRB approach	55.9	47.3	103.2	217.4	255.6	10.2	12.0	598.4
IRB advanced approach	55.9	47.3	103.2	209.4	248.1	10.0	10.9	581.6
IRB foundation approach				8.0	7.5	0.2	1.1	16.8
Standardised approach	60.4	4.8	65.2	181.8	70.1	6.6	33.2	356.9
<b>RWAs at 31 December 2014</b>	<b>116.3</b>	<b>52.1</b>	<b>168.4</b>	<b>399.2</b>	<b>325.7</b>	<b>16.8</b>	<b>45.2</b>	<b>955.3</b>
<b>Basel 2.5 basis</b>								
IRB advanced approach	58.4	72.6	131.0	183.2	192.8	10.4	3.8	521.2
IRB foundation approach				6.3	5.8	0.1	1.4	13.6
Standardised approach	60.6	3.1	63.7	169.3	71.6	6.9	18.0	329.5
RWAs at 31 December 2013	119.0	75.7	194.7	358.8	270.2	17.4	23.2	864.3

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Credit risk RWAs are calculated using three approaches, as permitted by the PRA. For consolidated Group reporting, we have adopted the advanced internal ratings-based ( IRB ) approach for the majority of our business, with a small proportion being on the foundation IRB approach and the remaining portfolios on the standardised approach.

**Standardised approach**

For portfolios treated under the standardised approach, credit risk RWAs increased by US\$27.4bn, which reflected a reduction of US\$13.6bn due to foreign exchange movements.

Corporate growth in Asia, Europe, North America and Latin America, including term and trade-related lending, increased RWAs by US\$25.0bn, of which growth in our associate, BoCom, accounted for US\$6.4bn.

The move to a CRD IV basis increased RWAs on 1 January 2014 by US\$ 7.1bn. This movement mainly comprised material holdings and deferred tax asset amounts in aggregate below the capital threshold risk-weighted at 250% US\$28.3bn, partially offset by the reclassification of non-credit obligation assets to the IRB approach for reporting purposes US\$16.3bn and the netting of collective impairments against exposure at default under the standardised approach US\$3.5bn.

During the year, several individually immaterial portfolios moved from the IRB approach to the standardised approach, increasing standardised RWAs by US\$6.0bn and reducing IRB RWAs by US\$4.8bn.

The disposal of our operations in Jordan, Pakistan, Colombia and Kazakhstan reduced RWAs by US\$1.0bn.

In Asia, movement in the fair value of our material holdings, mainly in Industrial Bank, resulted in an increase in RWAs of US\$5.9bn. This was partially offset by the reclassification of Vietnam Technological and Commercial Joint Stock Bank from an associate to an investment, which reduced RWAs by US\$1.1bn.

**Internal ratings-based approach**

Credit risk RWA movements by key driver for portfolios treated under the IRB approach are set out in the tables on page 242 and 243. For basis of preparation on Credit risk, Counterparty credit risk and Market risk RWA flow, see Annual Reports and Accounts Appendix to Capital on page 257. For portfolios treated under the IRB approach, credit risk RWAs increased by US\$63.6bn which reflected a reduction of US\$20.1bn due to foreign exchange movements driven by the strengthening of the US dollar against other currencies.

**Acquisitions and disposals**

In GB&M, the sale of ABSs in North America reduced RWAs by US\$4.2bn. Additionally, GB&M continued to manage down the securitisation positions held through the sale of certain structured investment conduit positions, lowering RWAs by US\$3.0bn in Europe. The disposal of our businesses in Kazakhstan, Colombia, Pakistan and Jordan resulted in a reduction in RWAs of

US\$1.2bn in Europe, Latin America, the Middle East and North Africa.

### **Book size**

Book size movement reflected higher corporate lending, including term and trade-related lending, increasing RWAs by US\$40.3bn in Asia, Europe and North America for CMB and GB&M. Sovereign book growth in GB&M increased RWAs by US\$3.3bn, mainly in Asia, Latin America, the Middle East and North Africa.

In North America, in RBWM, continued run-off of the US CML retail mortgage portfolios resulted in a RWA reduction of US\$6.9bn.

### **Book quality**

RWAs reduced by US\$8.5bn in the US run-off portfolio, primarily due to continued run-off which resulted in an improvement in the book quality of the residual portfolio.

Book quality improvements in the Principal RBWM business of US\$5.9bn related to model recalibrations reflecting improving property prices in the US and favourable changes in portfolio mix reducing RWAs in Europe.

A ratings upgrade for securitisation portfolio resulted in a decrease in RWAs of US\$3.2bn.

This was partially offset by adverse movements in average customer credit quality in corporate, sovereign and institutional portfolios in Europe, North America, Middle East, North Africa, Asia and Latin America increased RWAs by US\$7.6bn.

### **Model updates**

In Europe, a loss given default ( LGD ) floor applied to UK corporate portfolios resulted in an increase in RWAs of US\$19.0bn in CMB and GB&M.

This was partially offset by model updates in North America, primarily the implementation of new risk models for the US mortgage run-off portfolio, resulting in a decrease in RWAs of US\$6.2bn.

### **Methodology and policy changes**

Methodology and policy updates increased RWAs by US\$52.2bn.

#### *CRD IV impact*

The rise related to the implementation of CRD IV rules at 1 January 2014, which increased RWAs by US\$48.2bn. The main CRD IV movements arose from securitisation positions that were previously deducted from capital and are now included as a part of credit risk RWAs and risk-weighted at 1,250%, resulting in a US\$40.2bn increase in GB&M, primarily Europe. CRD IV also introduced an asset valuation correlation multiplier for financial counterparties, producing a US\$9.2bn increase in RWAs primarily in GB&M in Asia and Europe.



**Table of Contents****Report of the Directors: Financial Review** (continued)*Internal updates*

A decrease in RWAs of US\$9.2bn arose from the set-off of negative AFS reserves against EAD for GB&M legacy credit portfolios.

In Asia, internal methodology changes associated with trade finance products accounted for a reduction in RWAs of US\$4.9bn.

Additionally, the transfer of individually immaterial portfolios moving to the standardised approach reduced IRB RWAs by US\$4.8bn in Principal RBWM and CMB in most regions and increased RWAs in the standardised approach by US\$6.0bn.

The reclassification of part of the mortgage portfolio led to a decrease in RWAs of US\$4.5bn in North America, of which US\$4.1bn was in the run-off portfolio.

*External updates*

Selected portfolios with a low default history, mainly in Europe, Asia and North America, were subjected to external updates with the introduction of LGD floors applied to corporates and institutions, increasing RWAs by US\$9.8bn. A further RWA floor was introduced on retail mortgages in Asia, resulting in an increase of US\$1.7bn.

*Non-credit obligation assets*

The reclassification of non-credit obligation assets from the standardised to the IRB approach for reporting purposes increased RWAs under the latter approach by US\$16.3bn and reduced the STD RWAs by the same amount.

*RWA movement by geographical regions by key driver – credit risk – IRB only**(Unaudited)*

	<b>Europe US\$bn</b>	<b>Asia US\$bn</b>	<b>MENA US\$bn</b>	<b>North America US\$bn</b>	<b>Latin America US\$bn</b>	<b>Total US\$bn</b>
RWAs at 1 January 2014 on Basel 2.5 basis	<b>166.9</b>	<b>182.9</b>	<b>15.0</b>	<b>161.5</b>	<b>8.5</b>	<b>534.8</b>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Foreign exchange movement	(11.6)	(4.0)	(0.2)	(2.4)	(1.9)	(20.1)
Acquisitions and disposals	(3.5)		(0.7)	(4.2)	(0.1)	(8.5)
Book size	11.4	19.5	1.8	2.9	2.0	37.6
Book quality	(1.5)		(0.8)	(10.3)	1.4	(11.2)
Model updates	19.4	0.3		(6.1)		13.6
New/updated models	19.4	0.3		(6.1)		13.6
Methodology and policy	35.0	14.4	0.5	0.6	1.7	52.2
Internal updates	(11.7)	(5.2)	(0.2)	(6.4)	(0.1)	(23.6)
External updates	2.2	8.5	(0.2)	0.7	0.1	11.3
CRD IV impact	37.0	5.7	0.4	4.9	0.2	48.2
NCOA moving from STD to IRB	7.5	5.4	0.5	1.4	1.5	16.3
Total RWA movement	49.2	30.2	0.6	(19.5)	3.1	63.6
RWAs at 31 December 2014 on CRD IV basis	216.1	213.1	15.6	142.0	11.6	598.4
RWAs at 1 January 2013 on Basel 2.5 basis	150.7	162.3	12.6	187.1	11.2	523.9
Foreign exchange movement	3.3	(4.5)	(0.5)	(1.9)	(1.0)	(4.6)
Acquisitions and disposals	(1.5)			(8.6)	(1.7)	(11.8)
Book size	2.1	21.2	1.4	(10.6)	0.2	14.3
Book quality	(1.5)	5.3	1.3	(10.8)	(0.3)	(6.0)
Model updates	11.6		0.1	(0.2)		11.5
Portfolios moving onto IRB approach	13.4					13.4
New/updated models	(1.8)		0.1	(0.2)		(1.9)
Methodology and policy	2.2	(1.4)	0.1	6.5	0.1	7.5
Internal updates	(0.2)	(7.8)	0.1	(0.6)	0.1	(8.4)
External updates	2.4	6.4		7.1		15.9
Total RWA movement	16.2	20.6	2.4	(25.6)	(2.7)	10.9
RWAs at 31 December 2013 on Basel 2.5 basis	166.9	182.9	15.0	161.5	8.5	534.8

For footnote, see page 256.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*RWA movement by global businesses by key driver credit risk IRB only**(Unaudited)*

	<b>Principal</b>	<b>RBWM</b>	<b>Total</b>					
	<b>RBWMUS</b>	<b>run-off)</b>	<b>RBWM</b>	<b>CMB</b>	<b>GB&amp;M</b>	<b>GPB</b>	<b>Other</b>	<b>Total</b>
	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>
RWAs at 1 January 2014 on Basel 2.5 basis	<b>58.4</b>	<b>72.6</b>	<b>131.0</b>	<b>189.5</b>	<b>198.5</b>	<b>10.6</b>	<b>5.2</b>	<b>534.8</b>
Foreign exchange movement	<b>(2.6)</b>		<b>(2.6)</b>	<b>(8.7)</b>	<b>(8.1)</b>	<b>(0.2)</b>	<b>(0.5)</b>	<b>(20.1)</b>
Acquisitions and disposals					<b>(8.2)</b>		<b>(0.3)</b>	<b>(8.5)</b>
Book size	<b>1.8</b>	<b>(6.9)</b>	<b>(5.1)</b>	<b>23.2</b>	<b>21.1</b>	<b>(0.5)</b>	<b>(1.1)</b>	<b>37.6</b>
Book quality	<b>(5.7)</b>	<b>(8.6)</b>	<b>(14.3)</b>	<b>2.8</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>0.8</b>	<b>(11.2)</b>
Model updates	<b>0.6</b>	<b>(6.2)</b>	<b>(5.6)</b>	<b>12.2</b>	<b>7.0</b>			<b>13.6</b>
New/updated models	<b>0.6</b>	<b>(6.2)</b>	<b>(5.6)</b>	<b>12.2</b>	<b>7.0</b>			<b>13.6</b>
Methodology and policy	<b>3.4</b>	<b>(3.6)</b>	<b>(0.2)</b>	<b>(1.6)</b>	<b>45.5</b>	<b>0.6</b>	<b>7.9</b>	<b>52.2</b>
Internal updates	<b>(3.0)</b>	<b>(3.9)</b>	<b>(6.9)</b>	<b>(5.0)</b>	<b>(11.2)</b>	<b>(0.5)</b>		<b>(23.6)</b>
External updates	<b>1.8</b>		<b>1.8</b>	<b>2.5</b>	<b>6.3</b>	<b>0.5</b>	<b>0.2</b>	<b>11.3</b>
CRD IV impact				<b>(0.7)</b>	<b>48.6</b>	<b>0.2</b>	<b>0.1</b>	<b>48.2</b>
NCOA moving from STD to IRB	<b>4.6</b>	<b>0.3</b>	<b>4.9</b>	<b>1.6</b>	<b>1.8</b>	<b>0.4</b>	<b>7.6</b>	<b>16.3</b>
Total RWA movement	<b>(2.5)</b>	<b>(25.3)</b>	<b>(27.8)</b>	<b>27.9</b>	<b>57.1</b>	<b>(0.4)</b>	<b>6.8</b>	<b>63.6</b>
RWAs at 31 December 2014 on CRD IV basis	<b>55.9</b>	<b>47.3</b>	<b>103.2</b>	<b>217.4</b>	<b>255.6</b>	<b>10.2</b>	<b>12.0</b>	<b>598.4</b>

	<b>RBWM</b>	<b>CMB</b>	<b>GB&amp;M</b>	<b>GPB</b>	<b>Other</b>	<b>Total</b>
	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>	<b>US\$bn</b>
RWAs at 1 January 2013 on Basel 2.5 basis	163.1	169.0	177.7	9.6	4.5	523.9
Foreign exchange movement	(0.4)	(1.5)	(2.7)	0.1	(0.1)	(4.6)
Acquisitions and disposals	(10.1)	(0.1)	(1.6)			(11.8)
Book size	(12.7)	14.5	13.5	(0.7)	(0.3)	14.3
Book quality	(6.4)	3.5	(3.4)	0.3		(6.0)
Model updates	(0.2)	10.1	(1.0)	2.6		11.5

Portfolios moving onto IRB approach		10.0	0.8	2.6		13.4
New/updated models	(0.2)	0.1	(1.8)			(1.9)
Methodology and policy	(2.3)	(6.0)	16.0	(1.3)	1.1	7.5
Internal updates	(2.3)	(3.4)	(0.6)	(2.1)		(8.4)
External updates		(2.6)	16.6	0.8	1.1	15.9
<b>Total RWA movement</b>	<b>(32.1)</b>	<b>20.5</b>	<b>20.8</b>	<b>1.0</b>	<b>0.7</b>	<b>10.9</b>
RWAs at 31 December 2013 on Basel 2.5 basis	131.0	189.5	198.5	10.6	5.2	534.8

### Counterparty credit risk and market risk RWAs

(Unaudited)

#### Counterparty credit risk RWAs

(Unaudited)

	CRD IV basis 2014 US\$bn	Basel 2.5 basis 2013 US\$bn
Advanced approach	65.5	42.2
CCR IRB approach	62.0	42.2
CVA	3.5	
Standardised approach	25.2	3.5
CCR standardised approach	4.4	3.5
CVA	18.0	
CCP	2.8	
<b>RWAs at 31 December</b>	<b>90.7</b>	<b>45.7</b>

*RWA movement by key driver counterparty credit risk advanced approach*

(Unaudited)

	CRD IV basis 2014 US\$bn	Basel 2.5 basis 2013 US\$bn
RWAs at 1 January	42.2	45.7
Book size	1.6	(0.9)
Book quality	(0.6)	(2.7)
Model updates	0.1	

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Methodology and policy	22.2	0.1
Internal updates	(3.8)	0.1
External regulatory updates	9.0	
CRD IV impact	17.0	
Total RWA movement	23.3	(3.5)
<b>RWAs at 31 December</b>	<b>65.5</b>	<b>42.2</b>

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)*Market risk RWAs**(Unaudited)*

	<b>CRD IV basis 2014 US\$bn</b>	Basel 2.5 basis 2013 US\$bn
Internal model based		
VaR	<b>7.3</b>	4.9
Stressed VaR	<b>10.4</b>	9.4
Incremental risk charge	<b>20.1</b>	23.1
Comprehensive risk measure		2.6
Other VaR and stressed VaR	<b>6.8</b>	12.2
Internal model based	<b>44.6</b>	52.2
Standardised approach	<b>11.4</b>	11.2
<b>At 31 December</b>	<b>56.0</b>	63.4
<i>RWA movement by key driver – market risk internal model based</i>		

*(Unaudited)*

	<b>CRD IV basis 2014 US\$bn</b>	Basel 2.5 basis 2013 US\$bn
RWAs at 1 January	<b>52.2</b>	44.5
Acquisitions and disposals	<b>(2.2)</b>	
Movement in risk levels	<b>(4.2)</b>	(14.5)
Model updates		17.6
Methodology and policy	<b>(1.2)</b>	4.6
Internal updates	<b>(3.8)</b>	4.6
External updates	<b>2.6</b>	
Total RWA movement	<b>(7.6)</b>	7.7
<b>RWAs at 31 December</b>	<b>44.6</b>	52.2
<i>Counterparty credit risk RWAs</i>		

Counterparty credit risk RWAs increased by US\$45.0bn, in 2014. The RWA increase of US\$21.7bn for the standardised approach mainly relates to the implementation of CRD IV on 1 January 2014, which introduced CVA and CCP RWAs.

### **Advanced approach**

#### *Book size*

The increase in book size was mainly driven by business movements and the impact of the strengthening of the US dollar against other currencies on the mark to market of derivatives contracts.

#### *Model updates*

In Europe, an LGD floor applied to UK corporate portfolios resulted in an increase in RWAs of US\$2.2bn. This was offset by a decrease in RWAs of US\$2.0bn due to model updates to the Internal Model Method ( IMM ) used for selected portfolios in London.

#### *Methodology and policy changes*

The CVA and AVC multiplier for financial counterparties introduced by the implementation of CRD IV increased RWAs by US\$6.8bn and US\$10.2bn, respectively, on 1 January 2014.

Within external regulatory and policy updates, selected portfolios were subject to PRA LGD floors, which increased RWAs by US\$7.5bn, mainly in Europe and Asia. Additionally, guidance received in the fourth quarter of 2014 led to the application of a potential future

exposure charge on sold options, contributing to a US\$1.5bn increase in RWAs.

Decreases in RWAs from internal methodology updates were mainly driven by additional CVA exemptions following internal due diligence and review alongside a more efficient allocation of collateral in Europe, which decreased RWAs by US\$3.8bn.

### **Market risk RWAs**

Total market risk RWAs decreased by US\$7.4bn in 2014.

### **Standardised approach**

The market risk RWA movements for portfolios not within the scope of modelled approaches resulted in an increase of US\$0.2bn. The increase in RWAs of US\$2.6bn related to CRD IV treatment of trading book securitisation positions that were previously deducted from capital. This was offset by reductions in RWAs of US\$2.5bn for interest rate position risk, primarily in Latin America due to the introduction of the scenario matrix method for options and a general reduction in positions in Latin America and the US.

### **Internal model based**

#### *Acquisitions and disposals*

The sale of our correlation trading portfolio, reduced comprehensive risk measure RWAs by US\$2.0bn. The disposal of our business in Kazakhstan resulted in a reduction of US\$0.2bn in RWAs.

*Movement in risk levels*

Movement in risk levels reflected a decrease mainly in VaR and Stressed VaR as a result of reduced FX and Equity trading positions.

*Methodology and policy changes*

The increase in RWAs from external updates related mainly to the introduction, for collateralised transactions, of the basis between the currency of trade and the currency of collateral into the VaR calculation and the removal of the diversification benefit from Risks not in VaR ( RNIV ) calculations, driving an increase of US\$6.7bn.

This was partially offset by decreases in RWAs of US\$4.3bn from Internal updates, mainly due to refinements in the RNIV calculation for the Equities and Rates desks.

Further decreases in RWAs following regulatory approval for a change in the basis of consolidation for modelled market risk charges delivered a reduction in RWAs of US\$4.1bn.

**Operational risk RWAs**

The reduction in operational risk RWAs of US\$1.4bn was due to the full amortisation of operational risk RWAs for the US CRS portfolio disposed of in May 2012, combined with a lower three-year average operating income.

HSBC HOLDINGS PLC



**Table of Contents****Report of the Directors: Financial Review** (continued)*Capital and RWA movements by major driver CRD IV end point basis**(Unaudited)*

	<b>CET1 capital US\$bn</b>	<b>RWAs US\$bn</b>
CRD IV end point basis at 1 January 2014 <sup>4</sup>	132.5	1,214.9
Accounting profit for the period	13.7	
Regulatory adjustments to accounting profit	(1.0)	
Dividends net of scrip <sup>5</sup>	(7.5)	
Regulatory change: LGD floors		38.6
Corporate lending growth		64.8
Management initiatives:	2.2	(66.3)
legacy reduction and run-off	2.2	(43.0)
portfolio and entity disposals		(5.2)
RWA initiatives		(18.1)
Exchange differences	(8.4)	(33.6)
Other movements	4.5	1.4
<b>CRD IV end point basis at 31 December 2014</b>	<b>136.0</b>	<b>1,219.8</b>

RWAs increased in the year, primarily from corporate lending growth and regulatory change. These have been largely offset by management initiatives and foreign exchange movements. Management initiatives include legacy reduction and run-off, portfolio and entity disposals and a number of other initiatives including a better alignment of VaR scope to management's view of risk, improved collateral allocation, increased use of IMM and a review of product mappings to regulatory categories.

**Capital structure***Source and application of total regulatory capital**(Audited)*

**CRD IV  
transitional**

Basel 2.5

	Year to 31 Dec 2014	Year to 31 Dec 2013
	US\$m	US\$m
<b>Movement in total regulatory capital</b>		
Opening common equity/core tier 1 capital <sup>4</sup>	131,233	138,789
Contribution to common equity/core tier 1 capital from profit for the period	12,678	17,124
Consolidated profits attributable to shareholders of the parent company	13,688	16,204
Removal of own credit spread net of tax	(328)	920
Debit valuation adjustment	254	
Deconsolidation of insurance entities and SPE entities	(936)	
Net dividends including foreseeable net dividends <sup>5</sup>	(7,541)	(6,987)
Dividends net of scrip recognised under Basel 2.5		(6,987)
Update for fourth interim dividend scrip take-up in excess of plan	1,108	
First interim dividend net of scrip	(1,766)	
Second interim dividend net of scrip	(1,686)	
Third interim dividend net of scrip	(1,835)	
Fourth foreseeable interim dividend	(4,131)	
Add back: planned scrip take-up	769	
Decrease in goodwill and intangible assets deducted	2,424	535
Ordinary shares issued	267	297
Foreign currency translation differences	(8,356)	(1,294)
Other, including regulatory adjustments	2,495	587
<b>Closing common equity/core tier 1 capital</b>	<b>133,200</b>	<b>149,051</b>
Opening additional/other tier 1 capital <sup>4</sup>	14,408	12,259
Issued hybrid capital securities net of redemptions	4,961	(1,151)
Unconsolidated investments	17	(2,004)
Other, including regulatory adjustments	153	
<b>Closing tier 1 capital</b>	<b>152,739</b>	<b>158,155</b>
Opening other tier 2 capital <sup>4</sup>	35,538	29,758
Issued tier 2 capital securities net of redemptions	2,414	1,609
Unconsolidated investments	26	6,447
Other, including regulatory adjustments	13	(1,960)
<b>Closing total regulatory capital</b>	<b>190,730</b>	<b>194,009</b>

*For footnotes, see page 256.*

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

Internal capital generation contributed US\$5.1bn to common equity tier 1 capital, being profits attributable to shareholders of the parent company after regulatory adjustment for own

credit spread, debit valuation adjustment, deconsolidation of insurance entities and net of dividends. The 2014 fourth interim dividend is net of planned scrip.

*Composition of regulatory capital*

		CRD IV transitional	Basel 2.5
		At	At
		Estimated at	
	<b>31 Dec 2014</b>	31 Dec 2013	31 Dec 2013
	<i>(Audited)</i>	<i>(Unaudited)</i>	<i>(Audited)</i>
<i>Ref</i>	US\$m	US\$m	US\$m
<b>Tier 1 capital</b>			
Shareholders' equity	<b>166,617</b>	164,057	173,449
Shareholders' equity per balance sheet	<i>a</i> <b>190,447</b>	181,871	181,871
Foreseeable interim dividend <sup>5</sup>	<b>(3,362)</b>	(3,005)	
Preference share premium	<i>b</i> <b>(1,405)</b>	(1,405)	(1,405)
Other equity instruments	<i>c</i> <b>(11,532)</b>	(5,851)	(5,851)
Deconsolidation of special purpose entities <sup>7</sup>	<i>a</i> <b>(323)</b>	(1,166)	(1,166)
Deconsolidation of insurance entities	<i>a</i> <b>(7,208)</b>	(6,387)	
Non-controlling interests	<b>4,640</b>	3,644	4,955
Non-controlling interests per balance sheet	<i>d</i> <b>9,531</b>	8,588	8,588
Preference share non-controlling interests	<i>e</i> <b>(2,127)</b>	(2,388)	(2,388)
Non-controlling interests transferred to tier 2 capital	<i>f</i> <b>(473)</b>	(488)	(488)
Non-controlling interests in deconsolidated subsidiaries	<i>d</i> <b>(851)</b>	(757)	(757)
Surplus non-controlling interests disallowed in CET1	<b>(1,440)</b>	(1,311)	
Regulatory adjustments to the accounting basis	<b>(6,309)</b>	(2,230)	480
Unrealised (gains)/losses in available-for-sale debt and equities <sup>8</sup>	<b>(1,378)</b>		1,121
Own credit spread <sup>9</sup>	<b>767</b>	1,112	1,037

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Debit valuation adjustment		(197)	(451)	
Defined benefit pension fund adjustment <sup>10</sup>	<i>g</i>	(4,069)	(1,731)	(518)
Reserves arising from revaluation of property		(1,375)	(1,281)	(1,281)
Cash flow hedging reserve		(57)	121	121
Deductions		(31,748)	(34,238)	(29,833)
Goodwill and intangible assets	<i>h</i>	(22,475)	(24,899)	(25,198)
Deferred tax assets that rely on future profitability (excludes those arising from temporary differences)	<i>n</i>	(1,036)	(680)	
Additional valuation adjustment (referred to as PVA)		(1,341)	(2,006)	
Investments in own shares through the holding of composite products of which HSBC is a component (exchange traded funds, derivatives and index stock)		(1,083)	(677)	
50% of securitisation positions				(1,684)
50% of tax credit adjustment for expected losses				151
Negative amounts resulting from the calculation of expected loss amounts	<i>i</i>	(5,813)	(5,976)	(3,102)
<b>Common equity/core tier 1 capital</b>		<b>133,200</b>	131,233	149,051
<b>Additional tier 1 capital</b>				
Other tier 1 capital before deductions		19,687	14,573	16,110
Preference share premium	<i>b</i>	1,160	1,160	1,405
Preference share non-controlling interests	<i>e</i>	1,955	1,955	2,388
Allowable non-controlling interest in AT1	<i>d</i>	884	731	
Hybrid capital securities	<i>j</i>	15,688	10,727	12,317
Deductions		(148)	(165)	(7,006)
Unconsolidated investments <sup>11</sup>		(148)	(165)	(7,157)
50% of tax credit adjustment for expected losses				151
<b>Tier 1 capital</b>		<b>152,739</b>	145,641	158,155

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

	CRD IV transitional At 31 Dec 2014 (Audited) US\$m	Estimated at 31 Dec 2013 (Unaudited) US\$m	Basel 2.5 At 31 Dec 2013 (Audited) US\$m
Ref			
<b>Tier 2 capital</b>			
Total qualifying tier 2 capital before deductions	38,213	35,786	47,812
Reserves arising from revaluation of property and unrealised gains in available-for-sale equities			2,755
Collective impairment allowances			2,616
Allowable non-controlling interest in tier 2	99	86	
Perpetual subordinated debt	2,218	2,218	2,777
Term subordinated debt	35,656	33,242	39,364
Non-controlling interests in tier 2 capital	240	240	300
Total deductions other than from tier 1 capital	(222)	(248)	(11,958)
Unconsolidated investments <sup>11</sup>	(222)	(248)	(7,157)
50% of securitisation positions			(1,684)
50% negative amounts resulting from the calculation of expected loss amounts			(3,102)
Other deductions			(15)
<b>Total regulatory capital</b>	<b>190,730</b>	181,179	194,009

For footnotes, see page 256.

The references (a) – (n) identify balance sheet components on page 249 which are used in the calculation of regulatory capital.

*Reconciliation of regulatory capital from transitional basis to an estimated CRD IV end point basis*

(Unaudited)

At 31 Dec 2014 US\$m	Estimated at 31 Dec 2013 US\$m
----------------------------	--------------------------------------

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Common equity tier 1 capital on a transitional basis	<b>133,200</b>	131,233
Unrealised gains arising from revaluation of property	<b>1,375</b>	1,281
Unrealised gains in available for sale reserves	<b>1,378</b>	
<b>Common equity tier 1 capital end point basis</b>	<b>135,953</b>	132,514
Additional tier 1 capital on a transitional basis	<b>19,539</b>	14,408
Grandfathered instruments:		
Preference share premium	<b>(1,160)</b>	(1,160)
Preference share non-controlling interests	<b>(1,955)</b>	(1,955)
Hybrid capital securities	<b>(10,007)</b>	(10,727)
Transitional provisions:		
Allowable non-controlling interest in AT1	<b>(487)</b>	(366)
Unconsolidated investments	<b>148</b>	165
Additional tier 1 capital end point basis	<b>6,078</b>	365
<b>Tier 1 capital end point basis</b>	<b>142,031</b>	132,879
Tier 2 capital on a transitional basis	<b>37,991</b>	35,538
Grandfathered instruments:		
Perpetual subordinated debt	<b>(2,218)</b>	(2,218)
Term subordinated debt	<b>(21,513)</b>	(21,513)
Transitional provisions:		
Non-controlling interest in tier 2 capital	<b>(240)</b>	(240)
Allowable non-controlling interest in tier 2	<b>396</b>	345
Unconsolidated investments	<b>(148)</b>	(165)
<b>Tier 2 capital end point basis</b>	<b>14,268</b>	11,747
<b>Total regulatory capital end point basis</b>	<b>156,299</b>	144,626

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

The capital position presented on a CRD IV transitional basis follows the CRD IV legislation as implemented in the UK via the PRA's final rules in the Policy Statement ( PS 7/13 ) issued in December 2013, and as incorporated in the PRA Rulebook.

The effects of draft EBA technical standards are not generally captured in our numbers. These could have additional effects on our capital position and RWAs.

Whilst CRD IV allows for the majority of regulatory adjustments and deductions from CET1 to be implemented on a gradual basis from 1 January 2014 to 1 January 2018, the PRA has largely decided not to make use of these transitional provisions. Due to the exclusion of unrealised gains on investment property and available-for-sale securities which are only capable of being recognised in CET1 capital from 1 January 2015, and PRA acceleration of unrealised losses on these items, our CET1 capital and ratio is lower on a transitional basis than it is on an end point basis.

For additional tier 1 and tier 2 capital, the PRA followed the transitional provisions timing as set out in CRD IV to apply the necessary regulatory adjustments and deductions. The effect of these adjustments is being phased in at 20% per annum from 1 January 2014 to 1 January 2018.

Furthermore, non-CRD IV compliant additional tier 1 and tier 2 instruments benefit from a grandfathering period. This progressively reduces the eligible amount by 10% annually, following an initial reduction of 20% on 1 January 2014, until they are fully phased out by 1 January 2022.

Under CRD IV, as implemented in the UK, banks are required to meet a minimum CET1 ratio of 4.0% of RWAs (increasing to 4.5% from 1 January 2015), a minimum tier 1 ratio of 5.5% of RWAs (increasing to 6% from 1 January 2015) and a total capital ratio of 8% of RWAs. Alongside CRD IV requirements, from 1 July 2014, the PRA expects major UK banks and building societies to meet a 7% CET1 ratio using the CRD IV end point definition. Going forward, as the grandfathering provisions fall away, we intend to meet these regulatory minima in an economically efficient manner by issuing non-common equity capital as necessary. At 31 December 2014, the Group had US\$19.8bn of CRD IV compliant non-common equity capital instruments, of which US\$3.5bn of tier 2 and US\$5.7bn of additional tier 1 were issued during the year (for details on the additional tier 1 instruments issued during the year see Note 35 on the Financial Statements). At 31 December 2014, the Group also had US\$37.1bn of non-common equity capital instruments qualifying as eligible capital under CRD IV by virtue of the application of the grandfathering provisions, after applying the 20% reduction outlined above.

**Regulatory balance sheet****Regulatory and accounting consolidations**

*(Unaudited)*

The basis of consolidation for the purpose of financial accounting under IFRS, described in Note 1 on the Financial Statements, differs from that used for regulatory purposes as described in Structure of the regulatory group on page 13

of the *Pillar 3 Disclosures 2014* report. The table below provides a reconciliation of the financial accounting balance sheet to the regulatory scope of consolidation.

Interests in banking associates are equity accounted in the financial accounting consolidation, whereas their exposures are proportionally consolidated for regulatory purposes in accordance with PRA's application of EU legislation.

Subsidiaries engaged in insurance activities are excluded from the regulatory consolidation, leaving the investment to be recorded at cost. In prior years, the investment of these insurance subsidiaries was recorded at the net asset value. This change in treatment from 1 January 2014 has been aligned to the capital treatment under CRD IV where we have excluded post-acquisition reserves from our CET1 capital and the investment to be deducted from CET1 (subject to thresholds) valued at cost.

The regulatory consolidation does not include special purpose entities ( SPEs ) where significant risk has been transferred to third parties. Exposures to these SPEs are risk-weighted as securitisation positions for regulatory purposes.

Entities in respect of which the basis of consolidation for financial accounting purposes differs from that used for regulatory purposes can be found in table 5 of the *Pillar 3 Disclosures 2014* report.

HSBC HOLDINGS PLC

248



**Table of Contents****Report of the Directors: Financial Review** (continued)*Reconciliation of balance sheets – financial accounting to regulatory scope of consolidation**(Unaudited)*

	At 31 December 2014			
	Accounting balance sheet US\$m	Deconsolidation of insurance/ other entities US\$m	Consolidation of banking associates US\$m	Regulatory balance sheet US\$m
<b>Assets</b>				
Cash and balances at central banks	129,957		30,731	160,688
Items in the course of collection from other banks	4,927		80	5,007
Hong Kong Government certificates of indebtedness	27,674			27,674
Trading assets	304,193	(720)	2,357	305,830
Financial assets designated at fair value	29,037	(28,791)	3,312	3,558
Derivatives	345,008	(94)	353	345,267
Loans and advances to banks	112,149	(2,727)	7,992	117,414
Loans and advances to customers	974,660	(10,809)	116,484	1,080,335
of which:				
impairment allowances on IRB portfolios	(6,942)			(6,942)
impairment allowances on standardised portfolios	(5,395)		(2,744)	(8,139)
Reverse repurchase agreements – non-trading	161,713	(30)	7,510	169,193
Financial investments	415,467	(50,420)	33,123	398,170
Capital invested in insurance and other entities		2,542		2,542
Current tax assets	1,309	(16)		1,293
Prepayments, accrued income and other assets	75,176	(5,295)	8,501	78,382
of which:				
goodwill and intangible assets of disposal groups held for sale	8			8
retirement benefit assets	(5,028)			(5,028)
impairment allowances on assets held for sale	(16)			(16)
of which:				
IRB portfolios	(16)			(16)
standardised portfolios				
Interests in associates and joint ventures	18,181		(17,479)	702

of which:

positive goodwill on acquisition	<i>h</i>	621		(606)	15
Goodwill and intangible assets	<i>h</i>	27,577	(5,593)	571	22,555
Deferred tax assets	<i>n</i>	7,111	163	474	7,748
Total assets		2,634,139	(101,790)	194,009	2,726,358

**Liabilities and equity**

Hong Kong currency notes in circulation		27,674			27,674
Deposits by banks		77,426	(21)	40,530	117,935
Customer accounts		1,350,642	(535)	141,858	1,491,965
Repurchase agreements non-trading		107,432			107,432
Items in course of transmission to other banks		5,990	(3)		5,987
Trading liabilities		190,572	(42)	50	190,580
Financial liabilities designated at fair value		76,153	(6,317)		69,836

of which:

term subordinated debt included in tier 2 capital	<i>m</i>	21,822			21,822
hybrid capital securities included in tier 1 capital	<i>j</i>	1,495			1,495
Derivatives		340,669	37	331	341,037
Debt securities in issue		95,947	(7,797)	3,720	91,870
Current tax liabilities		1,213	(138)	317	1,392
Liabilities under insurance contracts		73,861	(73,861)		
Accruals, deferred income and other liabilities		53,396	(3,659)	5,145	54,882

of which:

retirement benefit liabilities		3,208	(2)	56	3,262
contingent liabilities and contractual commitments		234			234

of which:

credit-related provisions on IRB portfolios	<i>i</i>	132			132
credit-related provisions on standardised portfolios		102			102
Provisions		4,998	(63)		4,935
Deferred tax liabilities		1,524	(1,009)	2	517
Subordinated liabilities		26,664		2,056	28,720

of which:

hybrid capital securities included in tier 1 capital	<i>j</i>	2,761			2,761
perpetual subordinated debt included in tier 2 capital	<i>l</i>	2,773			2,773
term subordinated debt included in tier 2 capital	<i>m</i>	21,130			21,130

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

<b>At 31 December 2014</b>				
	<b>Accounting</b>	<b>Deconsolidation</b>	<b>Consolidation</b>	<b>Regulatory</b>
	<b>balance</b>	<b>of insurance/</b>	<b>of banking</b>	<b>balance</b>
	<b>sheet</b>	<b>other</b>	<b>associates</b>	<b>sheet</b>
<i>Ref</i>	<b>US\$m</b>	<b>entities</b>	<b>US\$m</b>	<b>US\$m</b>
		<b>US\$m</b>		
Total shareholders' equity	<b>190,447</b>	<b>(7,531)</b>		<b>182,916</b>
of which:				
other equity instruments included in tier 1 capital	<b>11,532</b>			<b>11,532</b>
preference share premium included in tier 1 capital	<b>1,405</b>			<b>1,405</b>
Non-controlling interests	<b>9,531</b>	<b>(851)</b>		<b>8,680</b>
of which:				
non-cumulative preference shares issued by subsidiaries included in tier 1 capital	<b>2,127</b>			<b>2,127</b>
non-controlling interests included in tier 2 capital, cumulative preferred stock	<b>300</b>			<b>300</b>
non-controlling interests attributable to holders of ordinary shares in subsidiaries included in tier 2 capital	<b>173</b>			<b>173</b>
<b>Total liabilities and equity at 31 December 2014</b>	<b>2,634,139</b>	<b>(101,790)</b>	<b>194,009</b>	<b>2,726,358</b>

<b>At 31 December 2013</b>				
	<b>Accounting</b>	<b>Deconsolidation</b>	<b>Consolidation</b>	<b>Regulatory</b>
	<b>balance</b>	<b>of insurance/</b>	<b>of banking</b>	<b>balance</b>
	<b>sheet</b>	<b>other entities</b>	<b>associates</b>	<b>sheet</b>
<i>Ref</i>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>	<b>US\$m</b>

Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Assets					
Trading assets		303,192	32	1,686	304,910
Loans and advances to customers		1,080,304	(13,182)	110,168	1,177,290
of which:					
impairment allowances on IRB portfolios	<i>i</i>	(9,476)			(9,476)
impairment allowances on standardised portfolios	<i>k</i>	(5,667)		(2,465)	(8,132)
Financial investments		425,925	(52,680)	31,430	404,675
Capital invested in insurance and other entities			9,135		9,135
Interests in associates and joint ventures		16,640		(15,982)	658
of which:					
positive goodwill on acquisition	<i>h</i>	608		(593)	15
Goodwill and intangible assets	<i>h</i>	29,918	(5,369)	631	25,180
Other assets		815,339	(37,634)	57,477	835,182
of which:					
goodwill and intangible assets of disposal groups held for sale	<i>h</i>	3			3
retirement benefit assets	<i>g</i>	2,140			2,140
impairment allowances on assets held for sale		(111)			(111)
of which:					
IRB portfolios	<i>i</i>				
standardised portfolios	<i>k</i>	(111)			(111)
Total assets at 31 December 2013		2,671,318	(99,698)	185,410	2,757,030
Liabilities and equity					
Deposits by banks		129,212	(193)	33,296	162,315
Customer accounts		1,482,812	(711)	142,924	1,625,025
Trading liabilities		207,025	(129)	161	207,057
Financial liabilities designated at fair value		89,084	(13,471)		75,613
of which:					
term subordinated debt included in tier 2 capital	<i>m</i>	18,230			18,230
hybrid capital securities included in tier 1 capital	<i>j</i>	3,685			3,685
Debt securities in issue		104,080	(9,692)	1,021	95,409
Retirement benefit liabilities	<i>g</i>	2,931	(11)	56	2,976
Subordinated liabilities		28,976	2	2,961	31,939
of which:					
hybrid capital securities included in tier 1 capital	<i>j</i>	2,873			2,873
perpetual subordinated debt included in tier 2 capital	<i>l</i>	2,777			2,777
term subordinated debt included in tier 2 capital	<i>m</i>	23,326			23,326
Other liabilities		436,739	(73,570)	4,991	368,160
of which:					

contingent liabilities and contractual commitments		177	177
of which:			
credit-related provisions on IRB portfolios	<i>i</i>	155	155
credit-related provisions on standardised portfolios	<i>k</i>	22	22

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

At 31 December 2013				
Deconsolidation				
	Accounting	of	Consolidation	Regulatory
	balance	insurance/	of banking	balance
	sheet	other	associates	sheet
<i>Ref</i>	US\$m	entities	US\$m	US\$m
		US\$m	US\$m	
Total shareholders equity	181,871	(1,166)		180,705
of which:				
other equity instruments included in tier 1 capital	5,851			5,851
preference share premium included in tier 1 capital	1,405			1,405
Non-controlling interests	8,588	(757)		7,831
of which:				
non-cumulative preference shares issued by subsidiaries included in tier 1 capital	2,388			2,388
non-controlling interests included in tier 2 capital, cumulative preferred stock	300			300
non-controlling interests attributable to holders of ordinary shares in subsidiaries included in tier 2 capital	188			188
Total liabilities and equity at 31 December 2013	2,671,318	(99,698)	185,410	2,757,030

*The references (a) – (n) identify balance sheet components which are used in the calculation of regulatory capital on page 246.*

**Leverage ratio**

*(Unaudited)*

*For a detailed basis of preparation of the leverage ratio, see the Appendix to Capital, page 261.*

**Estimated leverage ratio**

*(Unaudited)*

	<b>EU Delegated Act basis at 31 Dec 2014 US\$bn</b>	Basel III 2010 basis at 31 Dec 2013 US\$bn
Total assets per accounting balance sheet	2,634	2,671
Deconsolidation of insurance/other entities	(104)	
Capital invested in insurance entities	2	
Consolidation of banking associates	194	
Total assets per regulatory/accounting balance sheet	2,726	2,671
Adjustment to reverse netting of loans and deposits allowable under IFRS	38	93
Reversal of accounting values:		
Derivatives	(345)	(282)
Repurchase agreement and securities finance	(180)	(200)
Replaced with values after applying regulatory rules:		
Derivatives:	166	239
Mark-to-market value	81	69
Deductions of receivables assets for cash variation margin	(82)	
Add-on amounts for potential future exposure	148	170
Exposure amount resulting from the additional treatment for written credit derivatives	19	
Repurchase agreement and securities finance:	188	147
Gross securities financing transactions assets	269	
Netted amounts of cash payables and cash receivables of gross securities financing transactions assets	(89)	
Securities financing transactions assets netted under Basel III 2010 framework		147
Measurement of counterparty risk	8	
Addition of off balance sheet commitments and guarantees:	396	388
Guarantees and contingent liabilities	67	85
Commitments	321	295
Other	8	8
Exclusion of items already deducted from the capital measure	(36)	(28)
<b>Exposure measure after regulatory adjustments</b>	<b>2,953</b>	<b>3,028</b>
Tier 1 capital under CRD IV (end point)	142	133
<b>Estimated leverage ratio (end point)</b>	<b>4.8%</b>	<b>4.4%</b>

In January 2014, the Basel Committee published its finalised leverage ratio framework, along with public disclosure requirements applicable from 1 January 2015, updating its 2010 recommendations.

In June 2014, the PRA published its revised expectations in relation to the leverage ratio for major UK banks and building societies, namely that from 1 July 2014, we are expected to meet a 3% end point tier 1 leverage ratio,

HSBC HOLDINGS PLC

251



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

calculated using the CRD IV definition of capital for the numerator and the Basel 2014 exposure measure for the denominator.

In October 2014, the European Commission adopted a delegated act to establish a common definition of the leverage ratio for EU banks (based on the Basel revised definition). This was published in the EU's Official Journal in January 2015.

Under CRD IV, the legislative proposals and final calibration of the leverage ratio are expected to be determined following a review of the revised Basel proposals and the basis of the EBA's assessment of the impact and effectiveness of the leverage ratio during a monitoring period between 1 January 2014 and 30 June 2016.

In January 2015, the PRA issued a letter setting out the approach to be taken for calculating the leverage ratio for 2014 year end disclosures. While the numerator continues to be calculated using the final CRD IV end point tier 1 capital definition, the exposure measure is now calculated based on the EU delegated act (rather than the Basel 2014 definition used in the *Interim Report 2014*). Reporting on the basis of the EU Delegated Act (rather than the Basel 2014 definition) results in an immaterial 2bps positive difference.

Our leverage ratio for 2013 as disclosed above and in our *Annual Report and Accounts 2013* was based on the Basel 2010 text at the direction of the PRA. The change to reporting on the EU Delegated Act from the Basel 2010 text contributes a US\$115bn increase in the exposure measure. Key changes include:

A change to the regulatory scope of consolidation increases the exposure measure by US\$132bn.

The netting of securities financing transactions (SFTs) is based on the accounting criteria and an additional add-on for counterparty risk increases the exposure measure by US\$66bn.

The inclusion of written credit derivatives at a notional amount increases the exposure measure by US\$23bn.

Revision to permit the offsetting of cash variation margin against derivative assets and liabilities results in a decrease in the exposure measure of US\$65bn.

A change to the Credit Conversion Factors (CCFs) applied to off-balance sheet exposures decreases the exposure measure by US\$41bn.

*For further details on the basis of preparation, see page 261.*

It should be noted that the UK specific leverage ratio proposals published in October 2014 by the Financial Policy Committee ( FPC ) are conceptually different to the Basel and CRD IV leverage frameworks and are not yet in place. Further details of the UK proposals can be found under Leverage ratio proposals on page 255.

## Regulatory developments

*(Unaudited)*

### Regulatory capital buffers

CRD IV establishes a number of capital buffers, to be met with CET1 capital, broadly aligned with the Basel III framework. CRD IV contemplates that these will be phased in from 1 January 2016, subject to national discretion.

Automatic restrictions on capital distributions apply if a bank's CET1 capital falls below the level of its CRD IV combined buffer. This is defined as the total of the capital conservation buffer ( CCB ), the countercyclical capital buffer ( CCyB ), the global systemically important institutions ( G-SII s) buffer and the systemic risk buffer ( SRB ) as these become applicable. The PRA have proposed that the use of the PRA buffer will not result in automatic restrictions on capital distributions.

In April 2014, HM Treasury published the statutory instrument Capital Requirements (Capital Buffers and Macro-Prudential Measures) Regulations 2014 transposing into UK legislation the main provisions in CRD IV related to capital buffers, with the exception of the SRB. In January 2015, HM Treasury published amendments to this statutory instrument in order to transpose the SRB.

The PRA is the designated authority for the G-SIIs buffer, the other systemically important institutions ( O-SII s) buffer and the CCB. In April 2014, they published rules and supervisory statements implementing the main CRD IV provisions in relation to these buffers. The Bank of England is the designated authority for the CCyB and other macro prudential measures. Whilst the PRA is the designated authority for applying and determining the SRB, the FPC is responsible for creating the SRB framework for calibration.

### G-SII buffer

The G-SII buffer (which is the EU implementation of the Basel G-SIB buffer) is to be met with CET1 capital and will be phased in from 1 January 2016. In October 2014, finalised technical standards on the methodology for identification of G-SIIs were published in the EU's Official Journal and came into effect from 1 January 2015.

In November 2014, the FSB and the Basel Committee updated the list of G-SIBs, using end-2013 data. The add-on of 2.5% previously assigned to HSBC was left unchanged.

Following direction from the PRA to UK banks in its Supervisory Statement issued in April 2014, and in accordance with the EBA final draft Implementing Technical Standards ( ITS ) and guidelines published in June 2014, we published the EBA template in July 2014. This disclosed the information used for the identification and scoring process which underpins our G-SIB designation. The final ITS for disclosure requirements were published in September 2014, and will form the basis of our future 2015 disclosure of G-SII indicators.

---

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Capital conservation buffer**

The CCB was designed to ensure banks build up capital outside periods of stress that can be drawn down when losses are incurred and is set at 2.5% of RWAs. The PRA will phase-in this buffer from 1 January 2016 to 1 January 2019.

**Countercyclical and other macro-prudential buffers**

CRD IV contemplates a countercyclical buffer in line with Basel III, in the form of an institution-specific CCyB and the application of increased requirements to address macro-prudential or systemic risk.

In January 2014, the FPC issued a policy statement on its powers to supplement capital requirements, through the use of the CCyB and the Sectoral Capital Requirements ( SCR ) tools. The CCyB is expected to be set in the range of 0-2.5% of relevant credit exposures RWAs, although it is uncapped. Under UK legislation, the FPC is required to determine whether to recognise any CCyB rates set by other EEA countries before 2016.

In June 2014, the FPC set the CCyB rate for UK exposures at 0%. At its September 2014 meeting, the FPC left the CCyB rate for UK exposures unchanged at 0% and recognised the 1% CCyB rates introduced by Norway and Sweden to become effective from 3 October 2015. In January 2015, the HKMA announced the application of a CCyB rate of 0.625% to Hong Kong exposures, to apply from 1 January 2016. In accordance with UK legislation and PRA supervisory statement PS 3/14, this rate will directly apply to the calculation of our institution-specific CCyB rate from 1 January 2016.

The institution-specific CCyB rate for the Group will be based on the weighted average of the CCyB rates that apply in the jurisdictions where relevant credit exposures are located. Currently the Group's institution specific CCyB is zero. The SCR tool is not currently deployed in the UK.

**Systemic risk buffer**

In addition to the measures above, CRD IV sets out an SRB for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigating structural macro-prudential risk.

In January 2015, the legislative changes necessary to transpose the SRB were implemented. The SRB is to be applied to ring fenced banks and building societies (over a certain threshold), which are together defined as SRB institutions. The SRB can be applied on an individual, sub-consolidated or consolidated basis and is applicable from 1 January 2019. By 31 May 2016, the FPC is required to create a framework for identifying the extent to which the failure or distress of SRB institutions will pose certain long-term non-cyclical systemic or macro-prudential risks. The PRA will apply this framework to determine whether specific SRB institutions would be subject to an SRB rate, and the level at which the buffer would be applied, and is able to exercise supervisory

judgement to determine what the rate should be. Where applicable, the buffer rate must be set in the range of 1% to 3%. The buffer rate would apply to all the SRB institution's exposures unless the PRA has recognised a buffer rate set

in another member state. If the SRB is applied on a consolidated basis it is expected that the higher of the G-SII or SRB would apply, in accordance with CRD IV.

### Pillar 2 and the PRA buffer

Under the Pillar 2 framework, banks are already required to hold capital in respect of the internal capital adequacy assessment and supervisory review which leads to a final determination by the PRA of individual capital guidance under Pillar 2A and Pillar 2B. Pillar 2A was previously met by total capital, but since 1 January 2015, in accordance with the PRA supervisory statement SS 5/13, is met with at least 56% CET1.

Pillar 2A guidance is a point in time assessment of the amount of capital the PRA considers that a bank should hold to meet the overall financial adequacy rule. It is therefore subject to change pending annual assessment and the supervisory review process. During 2014, the Group Pillar 2A guidance amounted to 1.5% of RWAs, of which 0.9% was to be met by CET1. In February 2015, this was revised to 2.0% of RWAs, of which 1.1% is to be met by CET1 and is effective immediately.

In January 2015, the PRA published a consultation on the Pillar 2 Framework. This set out the methodologies that the PRA proposed to use to inform its setting of firms Pillar 2 capital requirements, including proposing new approaches for determining Pillar 2 requirements for credit risk, operational risk, credit concentration risk and pension obligation risk.

As part of CRD IV implementation, the PRA proposed to introduce a PRA buffer, to replace the capital planning buffer ( CPB ) (known as Pillar 2B), also to be held in the form of CET1 capital. This was reconfirmed in the recent PRA consultation on the Pillar 2 framework. It is proposed that a PRA buffer will avoid duplication with CRD IV buffers and will be set for a particular firm depending on its vulnerability in a stress scenario or where the PRA has identified risk management and governance failings. In order to address weaknesses in risk management and governance, the PRA propose a scalar applied to firms CET1 Pillar 1 and Pillar 2A capital requirements. Where the PRA considers there is overlap between the CRD IV buffers and the PRA buffer assessment, the PRA proposes to set the PRA buffer as the excess capital required over and above the CCB and relevant systemic buffers. The PRA buffer will, however, be in addition to the CCyB and sectoral capital requirements.

The PRA expects to finalise the Pillar 2 framework in July 2015, with implementation expected from 1 January 2016. Until this consultation is finalised and revised rules and guidance issued, there remains uncertainty as to the exact buffer rate requirements, and their ultimate capital impact.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)**Overall capital requirements**

Following the developments outlined above, details are beginning to emerge of the various elements of the capital requirements framework. However, there remains residual uncertainty as to what HSBC's precise end point CET1 capital requirement will be. Elements of the capital requirements that are known or quantified to date are set out in the diagram below. Time-varying elements such as the macro-prudential tools, the Pillar 2 requirements, and systemic buffers are subject to change.

*Capital requirements framework (end point)*

In addition to the capital requirements tabulated above, we will need to consider the effect of FSB proposals published in November 2014 in relation to total loss absorbing capacity ( TLAC ) requirements. For further details, see page 256.

**Regulatory stress testing**

The Group is subject to supervisory stress testing in many jurisdictions. These supervisory requirements are increasing in frequency and in the granularity with which results are required. As such, stress testing represents a key focus for the Group.

In October 2013, the Bank of England published an initial discussion paper 'A framework for stress testing the UK banking system'. The framework replaces the current stress testing for the capital planning buffer with annual concurrent stress tests, the results of which are expected to inform the setting of the PRA buffer, the CCyB, sectoral capital requirements and other FPC recommendations to the PRA. In April 2014, the Bank of England published details of the UK stress testing exercise, which the Group subsequently participated in. The results of this exercise were published in December 2014.

Throughout 2014, the Group participated in various stress testing exercises in a number of different jurisdictions. For further details on all stress testing exercises, see page 122.

**RWA developments**

Throughout 2014, regulators issued a series of recommendations and consultations designed to revise the various components of the RWA regime and increase related reporting and disclosures.

**UK**

In March 2014, the FPC published that it was minded to recommend that firms report and disclose capital ratios using the standardised approach to credit risk as soon as practicable in 2015 following a Basel review of the standardised approach.

In June 2014, the PRA issued its consultation CP12/14, which proposed changes to the credit risk rules in two areas. Firstly, a proposal that exposures on the advanced internal ratings-based ( AIRB ) approach for central governments, public sector entities, central banks and financial sector entities would be moved to the foundation approach from June 2015. Secondly, a proposal to introduce stricter criteria for the application of the standardised risk weight for certain commercial real estate ( CRE ) exposures located in non-EEA countries, which would be dependent upon loss rates in these jurisdictions over a representative period. In October, the PRA published a policy statement ( PS 10/14 ) containing final rules on the second proposal, which introduces more stringent criteria for the application of risk weights to non-EEA CRE exposures from April 2015.

## EU

In May 2014, the EBA published a consultation on benchmarks of internal approaches for calculating own funds requirements for credit and market risk exposures in RWAs. This follows a series of benchmarking exercises run in 2013 to better understand the drivers of differences observed in RWAs across EU institutions. The future annual benchmarking exercise outlined in the consultation paper aims to improve the comparability of capital requirements calculated using internal modelled approaches and will be used by regulators to inform their policy decisions.

In June 2014, the EBA published a consultation on thresholds for the application of the standardised approach for exposures treated under permanent partial use and the IRB roll-out plan. The finalised Regulatory Technical Standards ( RTS ) is yet to be published.

In December 2014, the list of non-EEA countries deemed to have equivalent regulatory regimes for CRD IV purposes was published in the EU s Official Journal, and became effective on 1 January 2015. This equivalence evaluation affects the treatment of exposures across

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Financial Review (continued)**

a number of different areas in CRD IV, such as the treatment of exposures to third country investment firms, credit institutions and exchanges; standardised risk weights applicable to exposures to central governments, central banks, regional governments, local authorities and public sector entities; and the calculation of RWAs for exposures to corporates, institutions, central governments and central banks under the IRB approach.

### **International**

Throughout 2014, the Basel Committee published proposals across all Pillar 1 risk types, to update standardised, non-modelled approaches for calculating capital requirements and to provide the basis for the application of a capital floor.

In particular, in March 2014, the Basel Committee published finalised proposals for the standardised approach for calculating counterparty credit risk exposures for OTC derivatives, exchange traded derivatives and long settlement transactions. Following this, another technical paper on the foundations of the new standard was published in August 2014. The new approach is proposed to replace both the current exposure measure and the standardised method and is expected to come into effect on 1 January 2017.

In October 2014, the Basel Committee also published a consultation and a Quantitative Impact Study ( QIS ) to revise the standardised approach for calculating operational risk. The proposals seek to establish a new unitary standardised approach to replace the current non-model-based approaches, which comprise the basic indicator approach and the standardised approach, including its variant the alternative standardised approach. An implementation date is yet to be proposed.

In December 2014, the Basel Committee undertook a further consultation on its fundamental review of the trading book. This included revisions to the market risk framework that was published for consultation in October 2013. The Committee intends to carry out a further QIS in early 2015 to inform finalised proposals expected at the end of 2015.

In December 2014, the Basel Committee published a revised framework for securitisation risk, which will come into effect on 1 January 2018.

In December 2014, the Basel Committee also published a consultation paper on revisions to the Standardised Approach for credit risk. Proposals include a reduced reliance on external credit ratings; increased granularity and risk sensitivity; and updated risk weight calibrations. Proposed calibration for risk weights are indicative only and will be further informed by responses from this consultation and results from a QIS.

Additionally, in December 2014, the Basel Committee published a consultation on the design of a capital floor framework, which will replace the Basel I floor. The calibration of the floor is, however, outside the scope of this consultation. The Committee has stated its intention

to publish final proposals including calibration and implementation timelines by the end of 2015.

All finalised Basel Committee proposals for standardised approaches for calculating risk requirements and the introduction of a revised capital floor would need to be transposed into EU requirements before coming into legal effect.

### **Leverage ratio proposals**

In October 2014, the FPC published final recommendations on the design of a UK specific leverage ratio framework and calibration. This followed an earlier FPC consultation in July 2014 on the design of the framework. The FPC finalised recommendations included a minimum leverage ratio of 3% to be implemented as soon as practicable for UK G-SIBs and major UK banks and building societies, a supplementary leverage ratio buffer applied to systemically important firms of 35% of the relevant risk-weighted systemic risk buffer rates, and a further countercyclical leverage ratio buffer ( CCLB ) of 35% of the relevant risk-weighted CCyB. The minimum leverage ratio is to be met 75% with CET1 and 25% with AT1, and both the supplementary leverage ratio buffer and CCLB are to be met 100% with CET1. The FPC recommended that HM Treasury provide the FPC with the necessary powers to direct the PRA to set leverage ratio requirements implementing the above mentioned calibration and framework.

HM Treasury published a consultation paper in November 2014, which responded to and agreed with the FPC recommendations in relation to the design of the leverage ratio framework. Specifically, HM Treasury agreed that the FPC should be granted powers to direct the PRA on a minimum requirement, additional leverage ratio buffer (for G-SIBs, major UK banks and building societies, including ring fenced banks) and a CCLB. HM Treasury did not, however, provide any views on the calibration. The consultation paper included legislative changes to provide the FPC with new powers. In February 2015, HM Treasury published a summary of responses, alongside the draft instrument which was laid before Parliament.

### **Banking structural reform and recovery and resolution planning**

In the EU, the Bank Recovery and Resolution Directive ( BRRD ) was finalised and published in June 2014. This came into effect from 1 January 2015, with the option to delay implementation of bail-in provisions until 1 January 2016. Regardless of this, the UK introduced bail-in powers from 1 January 2015. The UK transposition of the BRRD builds on the resolution framework already in place in the UK. In January 2015, the PRA published a policy statement containing updated requirements for recovery and resolution planning which revises PRA rules that have been in force since 1 January 2014. In addition, the EBA has produced a number of RTS, some of which are yet to be finalised, that will further inform the BRRD requirements.

HSBC HOLDINGS PLC



---

**Table of Contents****Report of the Directors: Financial Review** (continued)

In December 2013, the UK's Financial Services (Banking Reform) Act 2013 received royal assent, which implements ring-fencing recommendations of the ICB. This has been supplemented through secondary legislation which was finalised in July 2014. In October 2014, the PRA published a consultation paper on ring-fencing rules. The PRA intends to undertake further consultation and finalise ring-fencing rules in due course, with implementation by 1 January 2019.

In January 2014, the European Commission also published legislative proposals on ring-fencing trading activities from deposit taking and a prohibition on proprietary trading in financial instruments and commodities. This is currently under discussion in the European Parliament and the Council.

*For further details of the policy background and the Group's approach to recovery and resolution planning, see page 14.*

**Total loss absorbing capacity proposals**

In November 2014, as part of the 'too big to fail' agenda, the FSB published proposals for total loss absorbing capacity (TLAC) for G-SIBs.

The FSB proposals include a minimum TLAC requirement in the range of 16-20% of RWAs and a TLAC leverage ratio of at least twice the Basel III tier 1 leverage ratio. The TLAC requirement is to be applied in accordance with individual resolution strategies, as determined by the G-SIB's crisis management group. A QIS is currently underway, the results of which will inform finalised proposals. The conformance period for the TLAC requirement will also be influenced by the QIS, but will not be before 1 January 2019. Once finalised, it is expected that any new TLAC standard should be met alongside the Basel III minimum capital requirements.

The draft proposals require G-SIBs to be subject to a minimum TLAC requirement with the precise requirement to be informed by the QIS. There are a number of requirements relating to the types of liabilities which can be used to meet the TLAC requirement, the composition of TLAC, and the location of liabilities within a banking group, in accordance with its resolution strategy. The TLAC proposals are expected to be finalised in 2015 and will then need to be implemented into national legislation.

**Other regulatory updates**

In January 2015, the EBA published revised final draft RTS on prudent valuation. Finalised requirements will need to be adopted by the European Commission and published in the EU's Official Journal before coming into effect.

In June 2014, the EBA and Basel Committee each issued a consultation on the Pillar 3 disclosures. The final EBA guidelines were issued in December 2014 and entail additional process and governance around the Pillar 3 report, as well as semi-annual or quarterly disclosure of key capital, ratio, RWA, leverage and risk model information, exceeding the scope of our current interim disclosures. The guidelines are subject to implementation by national supervisors and are expected to enter into force in 2015.

The final Basel standards on Revised Pillar 3 disclosure requirements were issued in January 2015. They mandate extensive use of standardised templates to enhance comparability between banks disclosures as well as requiring a considerable volume of disclosures to be produced semi-annually, rather than annually as hitherto. The revised framework calls for disclosure at the latest from 2016 year-ends, concurrently with financial reports.

## Footnotes to Capital

*1 Operational risk RWAs, under the standardised approach, are calculated using an average of the last three years revenues. For business disposals, the operational risk RWAs are not removed immediately on disposal, but diminish over a period of time. The RWAs for the CRS business represent the remaining operational risk RWAs for the business.*

*2 RWAs are non-additive across geographical regions due to market risk diversification effects within the Group.*

*3 From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (see Note 23 on the Financial Statements for further details). Comparative data have been re-presented to reflect this change.*

*4 CRD IV opening balances as at December 2013 were estimated based on the Group's interpretation of final CRD IV legislation and final rules issued by the PRA, details of which can be found in the basis of preparation on page 324 of the Annual Report and Accounts 2013.*

*5 This includes dividends on ordinary shares, quarterly dividends on preference shares and coupons on capital securities, classified as equity.*

*6 Includes externally verified profits for the year to 31 December 2014.*

*7 Mainly comprise unrealised gains/losses in available-for-sale debt securities related to SPEs.*

*8 Unrealised gains/losses in available-for-sale securities are net of tax.*

*9 Includes own credit spread on trading liabilities.*

*10 Under Basel 2.5 rules, any defined benefit asset is derecognised and a defined benefit liability may be substituted with the additional funding that will be paid into the relevant schemes over the following five-year period.*

*11 Mainly comprise investments in insurance entities.*

HSBC HOLDINGS PLC

---

**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Appendix to Capital**

**Capital management**

*(Audited)*

**Approach and policy**

Our approach to capital management is driven by our strategic and organisational requirements, taking into account the regulatory, economic and commercial environment in which we operate. Pre-tax return on risk-weighted assets ( RoRWA ) is an operational metric by which the global businesses are managed on a day-to-day basis. The metric combines return on equity and regulatory capital efficiency objectives. It is our objective to maintain a strong capital base to support the risks inherent in our business and invest in accordance with our six filters framework, exceeding both consolidated and local regulatory capital requirements at all times.

Our policy on capital management is underpinned by a capital management framework which enables us to manage our capital in a consistent manner. The framework, which is approved by the GMB annually, incorporates a number of different capital measures including market capitalisation, invested capital, economic capital and regulatory capital. Given that CRD IV has been in effect since 1 January 2014, during 2014 we managed our internal capital ratio target on an end point CRD IV CET1 basis of greater than 10%. We have since reviewed this and in 2015 expect to manage group capital to meet a medium-term target for return on equity of more than 10%. This is modelled on CET1 ratio on an end point basis in the range of 12% to 13%.

**Capital measures**

market capitalisation is the stock market value of HSBC;

invested capital is the equity capital invested in HSBC by our shareholders, adjusted for certain reserves and goodwill previously amortised or written off;

economic capital is the internally calculated capital requirement which we deem necessary to support the risks to which we are exposed; and

regulatory capital is the capital which we are required to hold in accordance with the rules established by the PRA for the consolidated Group and by our local regulators for individual Group companies.

Our assessment of capital adequacy is aligned to our assessment of risks, including: credit, market, operational, interest rate risk in the banking book, pensions, insurance, structural foreign exchange risk and residual risks.

### Stress testing

In addition to our internal stress tests, the Group is subject to supervisory stress testing in many jurisdictions. Supervisory requirements are increasing in frequency and in the granularity with which the results are required. These exercises include the programmes of the PRA, the FRB, the EBA, the ECB and the HKMA, as well as stress tests undertaken in other jurisdictions. We take into account the results of all such regulatory stress testing when assessing our internal capital requirements.

### Risks to capital

Outside the stress-testing framework, a list of top and emerging risks is regularly evaluated for their effect on our CET1 capital ratio. In addition, other risks may be identified which have the potential to affect our RWAs and/or capital position. These risks are also included in the evaluation of risks to capital. The downside or upside scenarios are assessed against our capital management objectives and mitigating actions are assigned as necessary. The responsibility for global capital allocation principles and decisions rests with the GMB. Through our internal governance processes, we seek to maintain discipline over our investment and capital allocation decisions and seek to ensure that returns on investment meet the Group's management objectives. Our strategy is to allocate capital to businesses and entities on the basis of their ability to achieve established RoRWA objectives and their regulatory and economic capital requirements.

### Risk-weighted asset targets

RWA targets for our global businesses are established in accordance with the Group's strategic direction and risk appetite, and approved through the Group's annual planning process. As these targets are deployed to lower levels of management, action plans for implementation are developed. These may include growth strategies; active portfolio management; restructuring; business and/or customer-level reviews; RWA accuracy and allocation initiatives and risk mitigation. Our capital management process is articulated in the annual Group capital plan which forms part of the Annual Operating Plan that is approved by the Board.

Business performance against RWA targets is monitored through regular reporting to the Group ALCO. The management of capital deductions is also addressed in the RWA monitoring framework through additional notional charges for these items.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

Analysis is undertaken within the RWA monitoring framework to identify the key drivers of movements in the position, such as book size and book quality. Particular attention is paid to identifying and segmenting items within the day-to-day control of the business and those items that are driven by changes in risk models or regulatory methodology.

**Capital generation**

HSBC Holdings is the primary provider of equity capital to its subsidiaries and also provides them with non-equity capital where necessary. These investments are substantially funded by HSBC Holdings' own capital issuance and profit retention. As part of its capital management process, HSBC Holdings seeks to maintain a prudent balance between the composition of its capital and its investment in subsidiaries.

**Capital measurement and allocation**

*(Unaudited)*

The PRA supervises HSBC on a consolidated basis and therefore receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Individual banking subsidiaries are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements. In 2013, we calculated capital at a Group level using the Basel II framework as amended for CRD III, commonly known as Basel 2.5, and also estimated capital on an end point CRD IV basis. From 1 January 2014, our capital at Group level is calculated under CRD IV and supplemented by PRA rules to effect the transposition of directive requirements.

Our policy and practice in capital measurement and allocation at Group level is underpinned by the CRD IV rules. However, local regulators are at different stages of implementation and some local reporting is still on a Basel I basis, notably in the US for the reporting of RWAs for some institutions during 2014. In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

The Basel III framework, similarly to Basel II, is structured around three pillars: minimum capital requirements, supervisory review process and market discipline. The CRD IV legislation implemented Basel III in the EU and, in the UK, the PRA rulebook CRR Firms Instrument 2013 transposed the various national discretions under the CRD IV legislation into UK law. The CRD IV and PRA legislation came into force on 1 January 2014.

**Regulatory capital**

For regulatory purposes, our capital base is divided into three main categories, namely common equity tier 1, additional tier 1 and tier 2, depending on their characteristics.

Common equity tier 1 capital is the highest quality form of capital, comprising shareholders' equity and related non-controlling interests (subject to limits). Under CRD IV various capital deductions and regulatory adjustments are made against these items which are treated differently for the purposes of capital adequacy – these include deductions for goodwill and intangible assets, deferred tax assets that rely on future profitability, negative amounts resulting from the calculation of expected loss amounts under IRB, holdings of capital securities of financial sector entities and surplus defined benefit pension fund assets.

Additional tier 1 capital comprises eligible non-common equity capital securities and any related share premium; it also includes qualifying securities issued by subsidiaries subject to certain limits. Holdings of additional tier 1 securities of financial sector entities are deducted.

Tier 2 capital comprises eligible capital securities and any related share premium and qualifying tier 2 capital securities issued by subsidiaries subject to limits. Holdings of tier 2 capital securities of financial sector entities are deducted.

### **Pillar 1 capital requirements**

Pillar 1 covers the capital resources requirements for credit risk, market risk and operational risk. Credit risk includes counterparty credit risk and securitisation requirements. These requirements are expressed in terms of RWAs.

### **Credit risk capital requirements**

CRD IV applies three approaches of increasing sophistication to the calculation of Pillar 1 credit risk capital requirements. The most basic, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties. Other counterparties are grouped into broad categories and standardised risk weightings are applied to these categories. The next level, the internal ratings-based ( IRB ) foundation approach, allows banks to calculate their credit risk capital requirements on the basis of their internal assessment of a counterparty's probability of default ( PD ), but their estimates of exposure at default ( EAD ) and loss given default ( LGD ) are subject to standard supervisory parameters. Finally, the IRB advanced approach allows banks to use their own internal assessment in both determining PD and quantifying EAD and LGD.

The capital resources requirement, which is intended to cover unexpected losses, is derived from a formula specified in the regulatory rules which incorporates PD, LGD, EAD and other variables such as maturity and correlation. Expected losses under the IRB approaches are calculated by multiplying PD by EAD and LGD. Expected losses are deducted from capital to the extent that they exceed total accounting impairment allowances.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Financial Review** (continued)

For credit risk we have adopted the IRB advanced approach for the majority of our portfolios, with the remainder on either IRB foundation or standardised approaches.

Under our CRD IV rollout plans, a number of our Group companies and portfolios are in transition to advanced IRB approaches. At the end of 2014, global models for sovereigns, banks, large corporates and portfolios in most of Europe, Asia and North America were on advanced IRB approaches. Others remain on the standardised or foundation approaches pending definition of local regulations or model approval, or under exemptions from IRB treatment. In some instances, regulators have allowed us to transition from advanced to standardised approaches for a limited number of portfolios.

*Counterparty credit risk*

Counterparty credit risk ( CCR ) arises for OTC derivatives and securities financing transactions. It is calculated in both the trading and non-trading books and is the risk that the counterparty to a transaction may default before completing the satisfactory settlement of the transaction. Three approaches to calculating CCR and determining exposure values are defined by CRD IV: standardised, mark-to-market and internal model method. These exposure values are used to determine capital requirements under one of the credit risk approaches: standardised, IRB foundation and IRB advanced.

We use the mark-to-market and internal model method approaches for CCR. Our longer-term aim is to migrate more positions from the mark-to-market to the internal model method approach.

In addition, CRD IV applies a capital requirement for CVA risk. Where we have both specific risk VaR approval and internal model method approval for a product, the CVA VaR approach has been used to calculate the CVA capital charge. Where we do not hold both approvals, the standardised approach has been applied.

*Securitisation*

Securitisation positions are held in both the trading and non-trading books. For non-trading book securitisation positions, CRD IV specifies two methods for calculating credit risk requirements, the standardised and the IRB approaches. Both rely on the mapping of rating agency credit ratings to risk weights, which range from 7% to 1,250%.

Within the IRB approach, we use the ratings-based method for the majority of our non-trading book securitisation positions, and the internal assessment approach for unrated liquidity facilities and programme-wide enhancements for asset-backed securitisations.

The majority of securitisation positions in the trading book are treated for capital purposes as if they are held in the non-trading book under the standardised or IRB approaches. Other traded securitisation positions, known as correlation trading, are treated under an internal model approach approved by the PRA.

### **Market risk capital requirement**

The market risk capital requirement is measured using internal market risk models where approved by the PRA, or the standard rules of the EU Capital Requirement Regulation. Our internal market risk models comprise VaR, stressed VaR and the incremental risk charge. Since the sale of our correlation portfolio in September 2014, there is no market risk capital requirement associated with the comprehensive risk measure.

### **Operational risk capital requirement**

CRD IV includes a capital requirement for operational risk, again utilising three levels of sophistication. The capital required under the basic indicator approach is a simple percentage of gross revenues, whereas under the standardised approach it is one of three different percentages of total operating income less insurance premiums allocated to each of eight defined business lines. Both these approaches use an average of the last three financial years' revenues. Finally, the advanced measurement approach uses banks' own statistical analysis and modelling of operational risk data to determine capital requirements. We have adopted the standardised approach in determining our operational risk capital requirements.

### **Pillar 2 capital requirements**

We conduct an internal capital adequacy assessment process ( ICAAP ) to determine a forward looking assessment of our capital requirements given our business strategy, risk profile, risk appetite and capital plan. This process incorporates the Group's risk management processes and governance framework. A range of stress tests are applied to our base capital plan. These, coupled with our economic capital framework and other risk management practices, are used to assess our internal capital adequacy requirements.

The ICAAP is examined by the PRA as part of its supervisory review and evaluation process, which occurs periodically to enable the regulator to define the individual capital guidance or minimum capital requirements for HSBC and our capital planning buffer where required.

HSBC HOLDINGS PLC



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

**Pillar 3 disclosure requirements**

Pillar 3 of the Basel regulatory framework is related to market discipline and aims to make firms more transparent by requiring them to publish, at least annually, wide-ranging information on their risks and capital, and how these are managed. Our *Pillar 3 Disclosures 2014* are published on our website, [www.hsbc.com](http://www.hsbc.com), under Investor Relations.

**RWA movement by key driver basis of preparation and supporting notes**

*(Unaudited)*

**Credit risk drivers definitions and quantification**

The causal analysis of RWA movements splits the total movement in IRB RWAs into six drivers, described below. The first four relate to specific, identifiable and measurable changes. The remaining two, book size and book quality, are derived after accounting for movements in the first four specific drivers.

**1. Foreign exchange movements**

This is the movement in RWAs as a result of changes in the exchange rate between the functional currency of the HSBC company owning each portfolio and US dollars, being our presentation currency for consolidated reporting. Our structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that our consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question. We hedge structural foreign exchange exposures only in limited circumstances.

**2. Acquisitions and disposals**

This is the movement in RWAs as a result of the disposal or acquisition of business operations. This can be whole businesses or parts of a business. The movement in RWAs is quantified based on the credit risk exposures as at the end of the month preceding a disposal or following an acquisition.

**3. Model updates**

*New/updated models*

RWA movements arising from the implementation of new models and from changes to existing parameter models are allocated to this driver. This figure will also include changes which arise following review of modelling assumptions. Where a model recalibration reflects an update to more recent performance data, the resulting RWA changes are not assigned here, but instead reported under book quality.

RWA changes are estimated based on the impact assessments made in the testing phase prior to implementation. These values are used to simulate the effect of new or updated models on the portfolio at the point of implementation, assuming there were no major changes in the portfolio from the testing phase to implementation phase.

#### *Portfolios moving onto IRB approach*

Where a portfolio moves from the standardised approach to the IRB approach, the RWA movement by key driver statement shows the increase in IRB RWAs, but does not show the corresponding reduction in standardised approach RWAs as its scope is limited to IRB only.

The movement in RWAs is quantified at the date at which the IRB approach is applied, and not during the testing phase as with a new/updated model.

#### **4. Methodology and policy**

##### *Internal regulatory updates*

This captures the effect on RWAs of changing the internal treatment of exposures. This may include, but is not limited to, a portfolio or a part of one moving from an existing IRB model onto a standardised model, identification of netting and credit risk mitigation.

##### *External regulatory updates*

This specifies the effect of additional or changing regulatory requirements. This includes, but is not limited to, regulatory-prescribed changes to the RWA calculation. The movement in RWAs is quantified by comparing the RWAs calculated for that portfolio under the old and the new requirements.

#### **5. Book size**

RWA movements attributed to this driver are those we would expect to experience for the given movement in exposure, as measured by EAD, assuming a stable risk profile. These RWA movements arise in the normal course of business, such as growth in credit exposures or reduction in book size from run-offs and write-offs.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Financial Review** (continued)

The RWA movement is quantified as follows:

RWA and EAD changes captured in the four drivers above are excluded from the total movements to create an adjusted movement in EAD and RWA for the period.

The average RWA to EAD percentage is calculated for the opening position and is applied to the adjusted movement in EAD. This results in an estimated book size RWA movement based on the assumption that the EAD to RWA percentage is constant throughout the period.

As the calculation relies on averaging, the output is dependent upon the degree of portfolio aggregation and the number of discrete time periods for which the calculation is undertaken. For each quarter of 2014 this calculation was performed for each HSBC company with an IRB portfolio by global businesses, split by the main Basel categories of credit exposures, as described in the table below:

**Basel categories of IRB credit exposures within HSBC**

Central governments and central banks	Corporate foundation IRB	Qualifying revolving retail exposures
Institutions	Other advanced IRB	Retail SME
Corporate advanced IRB	Retail mortgages	Other retail

The total of the results is shown in book size within the RWA movement by key driver table.

**6. Book quality**

This represents RWA movements resulting from changes in the underlying credit quality of customers. These are caused by changes to IRB risk parameters which arise from actions such as, but not limited to, model recalibration, change in counterparty external rating, or the influence of new lending on the average quality of the book. The change in RWAs attributable to book quality is calculated as the balance of RWA movements after taking account of all drivers described above.

The RWA movement by key driver statement includes only movements which are calculated under the IRB approach. Certain classes of credit risk exposure are treated as capital deductions and therefore reductions are not shown in this statement. If the treatment of a credit risk exposure changes from RWA to capital deduction in the period, then only the reduction in RWAs would appear in the RWA movement by key driver tables. In this instance, a reduction in RWAs does not necessarily indicate an improvement in the capital position.

### Counterparty risk drivers definitions and quantification

The RWA movement by key driver for counterparty credit risk calculates the credit risk drivers 5 and 6 at a more granular level, by using transaction level details provided by regional sites. Foreign exchange movement is not a reported layer for counterparty risk drivers, as there is cross currency netting across the portfolio.

### Market risk drivers definitions and quantification

The RWA movement by key driver for market risk combines the credit risk drivers 5 and 6 into a single driver called Movements in risk levels .

### Leverage ratio: basis of preparation

*(Unaudited)*

The numerator, capital measure, is calculated using the end point definition of tier 1 capital applicable from 1 January 2022, which is set out in the final CRD IV rules. This is supplemented with the EBA's Own Funds RTS to the extent that these have been published in the EU's Official Journal of the European Commission as at the reporting date, as well as making reference to the PRA Rulebook where appropriate. The denominator, exposure measure, is calculated on the basis of the Leverage Ratio Delegated Act adopted by the European Commission in October 2014 and published in the EU's Official Journal in January 2015, which is aligned to the Basel 2014 leverage ratio framework. This follows the same scope of regulatory consolidation used for the risk-based capital framework, which differs to the 2010 Basel text that required banks to include items using their accounting balance sheet. The exposure measure generally follows the accounting value, adjusted as follows:

on-balance sheet, non-derivative exposures are included in the exposure measure net of specific provisions or accounting valuation adjustments (e.g. accounting credit valuation adjustments);

loans are not netted with deposits;

the scope of netting for derivatives is extended to all scenarios where we would recognise a netting agreement for regulatory purposes;

the scope for offsetting of cash variation margin against derivative assets and liabilities is extended subject to certain additional conditions including the requirement that the margin be exchanged daily and be in the same currency as the currency of settlement of the derivative contract. For these purposes we have considered this to include any currency that can be used to make payments under the derivative contract, the governing qualifying master netting agreement, or its associated credit support annex. Such offsetting is not permitted under the Basel 2010 text;



**Table of Contents**

**Report of the Directors: Financial Review** (continued)

the approach to netting securities financing transactions ( SFT s) is aligned to that permitted under IFRS, though for the purposes of the leverage ratio there is an additional counterparty credit risk add-on to the extent that an SFT is under collateralised. This represents a stricter requirement compared with the Basel 2010 text;

there is an add-on for potential future exposure for both OTC and exchange-traded derivatives;

the notional amount of written credit derivatives is included in the exposure measure, subject to offsets for purchased protection. This represents a stricter requirement compared with the Basel 2010 text;

off-balance sheet items are converted into credit exposure equivalents through the use of credit conversion factors ( CCF s). Depending on the risk category of the exposure a CCF of 10%, 20%, 50% or 100% is applied. In contrast, the Basel 2010 text requires that off-balance sheet items are included in full except for commitments that are unconditionally cancellable at any time by HSBC without prior notice, where only 10% of the exposures are included; and

items deducted from the end point tier 1 capital such as goodwill and intangible assets, are excluded.

HSBC HOLDINGS PLC

262

**Table of Contents****Report of the Directors: Corporate Governance (continued)**

<b>Corporate Governance</b>	<b>Page</b>	<b>App<sup>1</sup></b>
<b><u>Corporate Governance Report</u></b>	263	
<b><u>Letter from the Group Chairman</u></b>	263	
<b><u>Directors</u></b>	264	
<b><u>Secretary</u></b>	268	
<b><u>Group Managing Directors</u></b>	268	
<b><u>Board of Directors</u></b>	270	
<b><u>Directors</u></b>	270	
<b><u>Corporate governance codes</u></b>	275	
<b><u>Board committees</u></b>	276	
<b><u>Group Management Board</u></b>	276	
<b><u>Group Audit Committee</u></b>	277	
<b><u>Group Risk Committee</u></b>	280	

<u>Financial System Vulnerabilities Committee</u>	282
<u>Group Remuneration Committee</u>	284
<u>Nomination Committee</u>	284
<u>Conduct &amp; Values Committee</u>	286
<u>Chairman's Committee</u>	288
<u>Philanthropic and Community Investment Oversight Committee</u>	288
<b><u>Internal control</u></b>	288
<b><u>Going concern</u></b>	290
<b><u>Employees</u></b>	291
<u>Reward</u>	291
<u>Employee relations</u>	291
<u>Diversity and inclusion</u>	291
<u>Employee development</u>	291
<u>Employment of disabled persons</u>	291
<u>Health and safety</u>	291



<u>Remuneration policy</u>	292
<u>Employee share plans</u>	292
<b><u>Other disclosures</u></b>	<b>293</b>
<u>Share capital</u>	294
<u>Directors' interests</u>	297
<u>Dividends and shareholders</u>	298
<b><u>2014 Annual General Meeting</u></b>	<b>293</b>
<i>1 Appendix to Report of the Directors.</i>	

## Corporate Governance Report

The statement of corporate governance practices set out on pages 263 to 333 and information incorporated by reference constitutes the Corporate Governance Report of HSBC Holdings. The reports of Board Committees are contained within the Corporate Governance Report.

## Letter from the Group Chairman

Dear Shareholder

This year, 2015, marks the 150th anniversary of our foundation in Hong Kong and Shanghai. In these days of companies ascending to the top ranks of valuation within a decade or so of being formed and often descending as rapidly, we should reflect positively on the enormous skill and foresight of those who built this firm sustainably from modest beginnings to its position as one of the leading international banking groups in the world. Given the history of the world over this period and the episodic intensity of financial market crises, this could not have been achieved without strong governance and a prudent character. It is among the Board's primary responsibilities to ensure that the firm's governance and character are such as to underpin its continuing success. Describing what good governance and a prudent character look like is relatively simple; understanding how to embed these and to measure success in so doing is the greater challenge and one which lies firmly within the Board's accountability.

At the heart of good governance lie three responsibilities reserved to the Board. Firstly, selection of the appropriate business model and countries within which to pursue all or elements of that model; secondly, determining the appropriate risk appetite of the firm across the variety of risks to which each business line is exposed; and finally, and most importantly, ensuring that the composition of the management team is best placed to deliver the right outcome for all stakeholders, is aligned in its incentives with the interests of shareholders and is committed to building long-term sustainable success, including in planning for its own succession.

Over the last four years, as the industry emerged from the global financial crisis and fresh regulatory requirements were determined, the Board has engaged actively with management on all these areas. Through this governance process, the Board has been able to endorse the progressive redefinition and clarity brought to HSBC's business model, its geographic representation and its risk appetite proposed by Stuart Gulliver and his management team. At the same time, the Board has been able to assess the composition and quality of the most senior management team; the Board continued to be impressed by their dedication and commitment as well as their success in meeting the objectives set for them by the Board.

The Board also has a critical role in overseeing the performance of management, including oversight of the transformation agenda which is underway to simplify and control more effectively the management of the Group. This agenda reflects HSBC's three strategic priorities: to implement Global Standards, grow the business and simplify and streamline processes. At each of its meetings and through its committees, the Board reviews progress made on implementation of this agenda, challenging management over the speed of delivery against agreed milestones and seeking insight into options considered but rejected.

Finally, governance is also about ensuring that the lessons of unexpected outcomes, of mistakes and of control failings are both acknowledged and responded to in a timely and effective manner. More importantly, it imposes a responsibility to ensure actions are taken to ensure that repetition is remote and that pre-emptive controls are established to warn, so far as is possible, of emerging areas of concern.

During 2014, regrettably, there were further instances of legal and regulatory proceedings that reinforced the need for greater governance oversight over conduct and financial crime risk. Indeed 2014 saw a sustained focus on conduct and behaviour

HSBC HOLDINGS PLC

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

risks with the establishment of the Banking Standards Review Council, the setting up of an enquiry by the UK Chancellor into Fair and Effective Markets and an update statement by former members of the Parliamentary Commission on Banking Standards.

HSBC has progressively enhanced its own governance oversight capabilities in these areas through the establishment in 2013 of the Financial System Vulnerabilities Committee to address financial crime matters and, in 2014, the Conduct & Values Committee, demonstrating the importance we place on adhering to high behavioural standards and doing the right thing . Reports from these committees can be found on pages 282 to 283 and 286 to 287, respectively.

Ensuring we have a diverse balance of skills, knowledge and experience on the Board is a fundamental aspect of successful corporate governance. Since my letter of last year the Board was strengthened by the appointments during 2014 of Jonathan Symonds and Heidi Miller as non-executive Directors on 14 April and 1 September, respectively, and Phil Ameen as of 1 January, 2015. These fresh appointments have added considerable experience in financial and governance matters and also in the case of Heidi Miller detailed banking expertise at the top level gained over more than 30 years in the industry. Biographies for all Directors can be found on pages 264 to 268.

Good governance has to extend throughout the Group, not just at the top company level. We address this by bringing together annually non-executives from our major subsidiaries in an NED forum to discuss governance issues and share best practices. Additionally, the chairmen of HSBC's principal subsidiary company committees with responsibility for non-executive oversight of financial reporting and risk-related matters meet each year to share issues and to reinforce consistent standards.

As we view the year ahead, we will see finalisation of the new Senior Managers Regime brought in by the Financial Services (Banking Reform) Act 2013, which is likely to include specific responsibilities in respect of non-executive Directors. Also in this coming year, an update to the UK Corporate Governance Code will apply encompassing certain changes to its principles and provisions relating to remuneration, engagement with shareholders, risk management and going concern. The Board unreservedly supports the evolution of best practice, recognising that good governance is key both to sustainable success and to capturing the business growth opportunities that our distinctive business model affords us.

**Douglas Flint**

*Group Chairman*

23 February 2015

**Directors**

**Douglas Flint**, CBE, 59

**Group Chairman**

**Skills and experience:** Douglas has extensive board-level experience and knowledge of governance, including experience gained through membership of the Boards of HSBC and BP p.l.c. He has considerable knowledge of finance and risk management in banking, multinational financial reporting, treasury and securities trading operations. He joined HSBC as Group Finance Director in 1995.

He is a member of the Institute of Chartered Accountants of Scotland and the Association of Corporate Treasurers and also a fellow of the Chartered Institute of Management Accountants. In 2006 he was honoured with a CBE in recognition of his services to the finance industry.

**Appointed to the Board:** 1995. Group Chairman since 2010.

**Current appointments include:** Douglas is a director of The Hong Kong Association and Chairman of the Institute of International Finance. He is a member of the Mayor of Beijing's International Business Leaders Advisory Council as well as the Mayor of Shanghai's International Business Leaders Advisory Council and the International Advisory Board of the China Europe International Business School, Shanghai. He is also an independent external member of the UK Government's Financial Services Trade and Investment Board, a British Business Ambassador and was appointed a director of the Peterson Institute for International Economics on 10 December 2014.

**Former appointments include:** Douglas was formerly Group Finance Director, Chief Financial Officer and Executive Director, Risk and Regulation of HSBC and non-executive director and Chairman of the Audit Committee of BP p.l.c. He has chaired and been a member of highly influential bodies which set standards for taxation, governance, accounting and risk management. Douglas served as a partner in KPMG.

**Stuart Gulliver**, 55

**Group Chief Executive**

**Chairman of the Group Management Board**

**Skills and experience:** Stuart joined HSBC in 1980. He is a career banker with over 30 years' international experience. He has held a number of key roles in the Group's operations worldwide, including in London, Hong Kong, Tokyo, Kuala Lumpur and the United Arab Emirates. Stuart played a leading role in developing and expanding Global

Banking and Markets.

**Appointed to the Board:** 2008. Group Chief Executive since 2011.

**Current appointments include:** Stuart is Chairman of The Hongkong and Shanghai Banking Corporation Limited and of the Group Management Board. He is a member of the Monetary Authority of Singapore International Advisory Panel and the International Advisory Council of the China Banking Regulatory Commission.

HSBC HOLDINGS PLC

264

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Former appointments include:** Stuart served as Chairman of Europe, Middle East and Global Businesses and of HSBC Bank plc, HSBC Bank Middle East Limited, HSBC Private Banking Holdings (Suisse) SA and HSBC France and Deputy Chairman of HSBC Trinkaus & Burkhardt AG and a member of its supervisory board. He was Head of Global Banking and Markets; Co-Head of Global Banking and Markets; Head of Global Markets; and Head of Treasury and Capital Markets in Asia-Pacific.

**Phillip Ameen**, 66

**Independent non-executive Director**

*Member of the Group Audit Committee with effect from 1 January 2015.*

**Skills and experience:** As a Certified Public Accountant with extensive financial and accounting experience, Phil served as Vice President, Comptroller, and Principal Accounting Officer of General Electric Capital Co. Prior to joining GE, he was a partner of KPMG. He also has a depth of technical knowledge from his participation in accounting standards setting.

**Appointed to the Board:** 1 January 2015

**Current appointments include:** A non-executive director of HSBC North America Holdings Inc., HSBC Bank USA, HSBC Finance Corporation and HSBC USA Inc. He is a non-executive director of Skyonic Corporation and R3 Fusion, Inc. and is a member of the Advisory Board of the Business School, University of North Carolina.

**Former appointments include:** Vice President, Comptroller and Principal Accounting Officer of General Electric Corp; a technical audit partner at Peat Marwick Mitchell & Co (now KPMG). He served on the International Financial Reporting Interpretations Committee of the International Accounting Standards Board, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants, the Financial Accounting Standards Board Emerging Issues Task Force, was Chair of the Committee on Corporate Reporting of Financial Executives International and was a Trustee of the Financial Accounting Foundation.

**Kathleen Casey**, 48

**Independent non-executive Director**

*Member of the Group Audit Committee and the Financial System Vulnerabilities Committee.*

**Skills and experience:** Kathleen has extensive financial regulatory policy experience. She is a former Commissioner of the US Securities and Exchange Commission, acting as the regulator's principal representative in multilateral and bilateral regulatory dialogues, the G-20 Financial Stability Board and the International Organisation of Securities Commissions.

**Appointed to the Board:** 1 March 2014

**Current appointments include:** Kathleen is the Chairman of the Alternative Investment Management Association and a senior adviser to Patomak Global Partners. She is a member of the Board of Trustees of Pennsylvania State University, the Trust Fund Board of the Library of Congress and the Advisory Council of the Public Company Accounting Oversight Board.

**Former appointments include:** Kathleen was a Staff Director and Counsel of the United States Senate Committee on Banking, Housing, and Urban Affairs and Legislative Director and Chief of Staff for a US Senator.

**Safra Catz, 53**

**Independent non-executive Director**

**Skills and experience:** Safra has a background in international business leadership, having helped transform Oracle into the largest producer of business management software and the world's leading supplier of software for information management.

**Appointed to the Board:** 2008

**Current appointments include:** Safra was appointed joint Chief Executive Officer of Oracle Corporation on 18 September 2014, having previously been President and Chief Financial Officer. She joined Oracle in 1999 and was appointed to the board of directors in 2001.

**Former appointments include:** Safra was Managing Director of Donaldson, Lufkin & Jenrette.

**Laura Cha, GBS, 65**

**Independent non-executive Director**

*Chairman of the Philanthropic and Community Investment Oversight Committee since 5 December 2014 and a member of the Conduct & Values Committee and the Nomination Committee.*

**Skills and experience:** Laura has extensive regulatory and policy making experience in the finance and securities sector in Hong Kong and mainland China. She is the former Vice Chairman of the China Securities Regulatory Commission, being the first person outside mainland China to join the Central Government of the People's Republic of China at vice-ministerial rank. Laura was awarded Gold and Silver Bauhinia Stars by the Hong Kong Government for public service.

**Appointed to the Board:** 2011

**Current appointments include:** Laura is a non-executive Deputy Chairman of The Hongkong and Shanghai Banking Corporation Limited and non-official member of the Executive Council of Hong Kong SAR. She is a Hong Kong Delegate to the 12th National People's Congress of China and a non-executive director of China Telecom Corporation Limited, Unilever PLC and Unilever N.V. Laura is also a Senior International Adviser for Foundation Asset Management Sweden AB and a member of the State Bar of California and the China Banking Regulatory Commission's International Advisory Council. She is Chairman of the Financial Services Development Council of Hong Kong SAR and Vice Chairman of the International Advisory Council of the China Securities Regulatory Commission.

HSBC HOLDINGS PLC

265



---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Former appointments include:** Laura was a non-executive director of Bank of Communications Co., Ltd., Baoshan Iron and Steel Co. Limited, Johnson Electric Holdings Limited, Hong Kong Exchanges and Clearing Limited and Tata Consultancy Services Limited. She served as Chairman of the University Grants Committee in Hong Kong and the ICAC Advisory Committee on Corruption. Laura also served as Deputy Chairman of the Securities and Futures Commission in Hong Kong and was a member of the Advisory Board of the Yale School of Management.

**Lord Evans of Weardale, 57**

**Independent non-executive Director**

*Chairman of the Financial System Vulnerabilities Committee and a member of the Conduct & Values Committee and Philanthropic and Community Investment Oversight Committee since 5 December 2014.*

**Skills and experience:** Jonathan has extensive experience in national security policy and operations. Formerly Director General of MI5 with responsibility for the leadership, policy and strategy of the Security Service, including international and domestic counter-terrorism, counter-espionage and counter-proliferation activities and cyber security.

**Appointed to the Board:** 2013

**Current appointments include:** Jonathan is a non-executive director of the UK National Crime Agency and a Senior Adviser of Accenture plc. He is a member of the advisory board of Darktrace Limited and of Facewatch Limited.

**Former appointments include:** Jonathan has held various positions in the UK Security Service over a 30-year career with responsibility for the oversight of the Joint Terrorist Analysis Centre and the Centre for the Protection of National Infrastructure and attended the National Security Council.

**Joachim Faber, 64**

**Independent non-executive Director**

*Chairman of the Group Risk Committee.*

**Skills and experience:** Joachim has experience in banking and asset management with significant international experience, having worked in Germany, Tokyo, New York and London. He is a former Chief Executive Officer of Allianz Global Investors AG and member of the management board of Allianz SE. He has 14 years experience with Citigroup Inc. holding positions in Trading and Project Finance and as Head of Capital Markets for Europe, North America and Japan.

**Appointed to the Board:** 2012

**Current appointments include:** Joachim is Chairman of the supervisory board of Deutsche Börse AG and of the Shareholder Committee of Joh A. Benckiser SARL. He is an independent director of Coty Inc. and a director of Allianz France S.A. Joachim is also a member of the advisory board of the European School for Management

and Technology; and council member of The Hongkong Europe Business Council.

**Former appointments include:** Joachim served as Chairman of various Allianz subsidiaries. He was a member of the supervisory board of Bayerische Börse AG, and of the supervisory board and Chairman of the audit and risk committee of OSRAM Licht AG. He was also a member of the German Council for Sustainable Development and a member of the advisory board of the Siemens Group Pension Board.

**Rona Fairhead, CBE, 53**

**Independent non-executive Director**

*Member of the Financial System Vulnerabilities Committee and the Nomination Committee.*

**Skills and experience:** Rona has a background in international industry, publishing, finance and general management. She was a former Chairman and Chief Executive Officer of the Financial Times Group Limited responsible for its strategy, management and operations and Finance Director of Pearson plc with responsibility for overseeing the day-to-day running of the finance function and directly responsible for global financial reporting and control, tax and treasury.

**Appointed to the Board:** 2004

**Current appointments include:** Rona is Chairman of HSBC North America Holdings Inc. She is a non-executive director of PepsiCo Inc. Rona is also a British Business Ambassador and, since 8 October 2014, Chairman of the BBC Trust.

**Former appointments include:** Rona was an Executive Vice President, Strategy and Group Control of Imperial Chemical Industries plc and Chairman and director of Interactive Data Corporation. She was a member of the board of the UK Government's Cabinet Office until 1 September 2014 and a non-executive director of The Economist Newspaper Limited until 1 July 2014.

**Sam Laidlaw**, 59

**Independent non-executive Director**

*Member of the Group Remuneration Committee and the Nomination Committee.*

**Skills and experience:** Sam has international experience, particularly in the energy sector, having had responsibility for businesses in four continents. He is a qualified solicitor with a Master's in Business Administration.

**Appointed to the Board:** 2008

**Former appointments include:** Sam was the Chief Executive Officer of Centrica plc and the lead non-executive board member of the UK Department for Transport until 31 December 2014. Sam was also an Executive Vice President of Chevron Corporation, non-executive director of Hanson PLC, Chief Executive Officer of Enterprise Oil plc, President and Chief Operating Officer of Amerada Hess Corporation, and a member of the UK Prime Minister's Business Advisory Group.

HSBC HOLDINGS PLC

266

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**John Lipsky, 68**

**Independent non-executive Director**

*Member of the Group Risk Committee, the Nomination Committee and the Group Remuneration Committee.*

**Skills and experience:** John has international experience having worked in Chile, New York, Washington and London and interacted with financial institutions, central banks and governments in many countries. He served at the International Monetary Fund as First Deputy Managing Director, Acting Managing Director and as Special Adviser.

**Appointed to the Board:** 2012

**Current appointments include:** John is a Senior Fellow, Foreign Policy Institute at the Paul H. Nitze School of Advanced International Studies, Johns Hopkins University. He is co-chairman of the Aspen Institute Program on the World Economy and a director of the National Bureau of Economic Research and the Center for Global Development. John is a member of the advisory board of the Stanford Institute for Economic Policy Research and the Council on Foreign Relations. He is Chairman of the World Economic Forum's Global Agenda Council on the International Monetary System.

**Former appointments include:** John served as Vice Chairman of JPMorgan Investment Bank; a director of the American Council on Germany and the Japan Society; a trustee of the Economic Club of New York, and a Global Policy Adviser for Anderson Global Macro, LLC.

**Rachel Lomax, 69**

**Independent non-executive Director**

*Chairman of the Conduct & Values Committee and a member of the Group Audit Committee and the Group Risk Committee.*

**Skills and experience:** Rachel has experience in both the public and private sectors and a deep knowledge of the operation of the UK government and financial system.

**Appointed to the Board:** 2008

**Current appointments include:** Rachel is Chairman of the International Regulatory Strategy Group. She is a director of TheCityUK and Bruegel, a Brussels-based European think tank; a non-executive director of Arcus European Infrastructure Fund GP LLP and Heathrow Airport Holdings Limited. Rachel is also a member of the Council of Imperial College, London and President of the Institute of Fiscal Studies, a Trustee of the Ditchley Foundation, and a non-executive director and chairman of the corporate responsibility committee of Serco Group plc.

**Former appointments include:** Rachel served as Deputy Governor, Monetary Stability, at the Bank of England and member of the Monetary Policy Committee, Permanent Secretary at the UK Government Departments for Transport and Work and Pensions and the Welsh Office, and Vice President and Chief of Staff to the President of the World Bank. She was a non-executive director of Reinsurance Group of America Inc. and The Scottish American Investment Company PLC.

**Iain Mackay, 53**

### **Group Finance Director**

**Skills and experience:** Iain joined HSBC in 2007 as Chief Financial Officer of HSBC North America Holdings Inc. He has extensive financial and international experience, having worked in London, Paris, US, Africa and Asia. Iain is a member of the Institute of Chartered Accountants of Scotland.

**Appointed to the Board:** 2010

**Current appointments include:** Iain is a member of the Group Management Board and was also appointed as a member of the audit committee of the British Heart Foundation on 4 December 2014.

**Former appointments include:** Iain served as a director of Hang Seng Bank Limited, Chief Financial Officer, Asia-Pacific, Vice President and Chief Financial Officer of GE Global Consumer Finance and Vice President and Chief Financial Officer of GE Healthcare Global Diagnostic Imaging.

**Heidi Miller, 61**

### **Independent non-executive Director**

*Member of the Group Risk Committee and Conduct & Values Committee since 1 September 2014.*

**Skills and experience:** Heidi has extensive international banking and finance experience. She is a former President of International at JPMorgan Chase, and was responsible for leading the global expansion and international business strategy across the investment bank, asset management, and treasury and securities services divisions.

**Appointed to the Board:** 1 September 2014

**Current appointments include:** Heidi is a non-executive director of First Data Corporation and General Mills Inc. She is a Trustee of the International Financial Reporting Standards Foundation.

**Former appointments include:** Heidi served as non-executive director of Merck & Co. Inc. and also Progressive Corp until 1 August 2014. She was an Executive Vice President and Chief Executive Officer, Treasury and Securities Services at JPMorgan Chase & Co.; Executive Vice President and Chief Financial Officer of Bank One Corporation; Senior Executive Vice President of Priceline.com Inc.; and Executive Vice President and Chief Financial Officer of Citigroup Inc.

**Marc Moses, 57**

**Group Chief Risk Officer**

**Skills and experience:** Marc joined HSBC in 2005 as Chief Financial and Risk Officer, Global Banking and Markets. He has extensive risk management and financial experience. Marc is a member of the Institute of Chartered Accountants in England and Wales.

**Appointed to the Board:** 1 January 2014

**Current appointments include:** Marc is a member of the Group Management Board. A director of HSBC Private Bank (Suisse) SA and of HSBC Private Banking Holdings (Suisse) SA.

HSBC HOLDINGS PLC

267

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Former appointments include:** Marc served as Chief Financial and Risk Officer, Global Banking and Markets and a director of HSBC Insurance (Bermuda) Limited. He was a European chief financial officer at JP Morgan and audit partner at PricewaterhouseCoopers.

**Sir Simon Robertson, 73**

**Deputy Chairman and senior independent**

**non-executive Director**

*Chairman of the Nomination Committee and the Group Remuneration Committee. Member of the Financial System Vulnerabilities Committee.*

**Skills and experience:** Simon has a background in international corporate advisory work with a wealth of experience in mergers and acquisitions, merchant banking, investment banking and financial markets. He was honoured with a knighthood in recognition of his services to business. Simon has extensive international experience having worked in France, Germany, the UK and the US.

**Appointed to the Board:** 2006. Senior Independent non-executive Director since 2007 and Deputy Chairman since 2010.

**Current appointments include:** Simon is the founding member of Simon Robertson Associates LLP. He is a non-executive director of Berry Bros. & Rudd Limited, The Economist Newspaper Limited and Troy Asset Management. He is also a trustee of the Eden Project Trust and the Royal Opera House Endowment Fund.

**Former appointments include:** Simon served as non-executive Chairman of Rolls-Royce Holdings plc, Managing Director of Goldman Sachs International, Chairman of Dresdner Kleinwort Benson, and non-executive director of Royal Opera House, Covent Garden Limited and NewShore Partners Limited.

**Jonathan Symonds, CBE, 55**

**Independent non-executive Director**

*Chairman of the Group Audit Committee since 1 September 2014. A member of the Group Remuneration Committee from 14 April 2014 until 1 September 2014 and a member of the Conduct & Values Committee.*

**Skills and experience:** Jonathan has extensive international financial experience, having worked in the UK, US and Switzerland. He served as Chief Financial Officer of Novartis AG and AstraZeneca plc. Jonathan is a Fellow of the Institute of Chartered Accountants in England and Wales.

**Appointed to the Board:** 14 April 2014

**Current appointments include:** Jonathan is Chairman of HSBC Bank plc and of Innocoll AG. He is a non-executive director of Genomics England Limited and of Proteus Digital Health Inc.

**Former appointments include:** Jonathan was a partner and managing director of Goldman Sachs, and a partner of KPMG. He was a non-executive director and Chairman of the Audit Committee of Diageo plc.

## Secretary

**Ben Mathews**, 48

### Group Company Secretary

Ben joined HSBC in June 2013 and became Group Company Secretary in July 2013. He is a Fellow of the Institute of Chartered Secretaries and Administrators. Former appointments include: Group Company Secretary of Rio Tinto plc and of BG Group plc.

## Group Managing Directors

**Ann Almeida**, 58

### Group Head of Human Resources and Corporate Sustainability

(due to retire 31 May 2015)

Ann joined HSBC in 1992. A Group Managing Director since 2008. Former HSBC appointments include: Global Head of Human Resources for Global Banking and Markets, Global Private Banking, Global Transaction Banking and HSBC Amanah.



**Samir Assaf**, 54

**Chief Executive, Global Banking and Markets**

Samir joined HSBC in 1994. A Group Managing Director since 2011. He is Chairman of the Global Financial Markets Association and of HSBC France, a director of HSBC Trinkaus & Burkhardt AG and of HSBC Bank plc since 28 March 2014. Former appointments include: director of HSBC Global Asset Management Limited and of HSBC Bank Egypt S.A.E., Head of Global Markets, and Head of Global Markets for Europe, Middle East and Africa.

**Peter Boyles**, 59

**Chief Executive of Global Private Banking**

Peter joined HSBC in 1975. A Group Managing Director since October 2013. He is Chairman of HSBC Private Bank (Monaco) SA. Former appointments include: Chief Executive of HSBC France and Continental Europe. A director of HSBC Bank plc, HSBC Bank Malta p.l.c. and of HSBC Trinkaus & Burkhardt AG. Peter ceased to be a director of HSBC Global Asset Management Limited on 29 September 2014.

HSBC HOLDINGS PLC

268

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Simon Cooper, 47**

**Chief Executive, Global Commercial Banking**

Simon joined HSBC in 1989. A Group Managing Director and Chief Executive of Global Commercial Banking since October 2013. He is a director of HSBC Bank plc. Former HSBC appointments include: Chairman of HSBC Bank Egypt S.A.E. and of HSBC Bank Oman; Chairman and Chief Executive of HSBC Bank Middle East and Chief Executive of HSBC Korea. Head of Corporate and Investment Banking of HSBC Singapore. A director of The Saudi British Bank and of HSBC Bank Middle East Limited.

**John Flint, 46**

**Chief Executive, Retail Banking and Wealth Management**

John joined HSBC in 1989. A Group Managing Director since January 2013. He is a director of HSBC Private Banking Holdings (Suisse) SA. Former appointments include: a Director of HSBC Bank Canada, Chief of Staff to the Group Chief Executive and Group Head of Strategy and Planning, Chief Executive Officer, HSBC Global Asset Management, Group Treasurer, and Deputy Head of Global Markets.

**Pam Kaur, 51**

**Group Head of Internal Audit**

Pam joined HSBC and became a Group Managing Director in April 2013. She is a co-opted member of The Institute of Chartered Accountants in England & Wales. Former appointments include: Global Head of Group Audit for Deutsche Bank AG, Chief Financial Officer and Chief Operating Officer, Restructuring and Risk Division, Royal Bank of Scotland Group plc, Group Head of Compliance and Anti-Money Laundering, Lloyds TSB, and Global Director of Compliance, Global Consumer Group, Citigroup.

**Alan Keir, 56**

**Chief Executive, HSBC Bank plc**

Alan joined HSBC in 1981. A Group Managing Director since 2011. He is a director of HSBC Bank Middle East Limited, HSBC Trinkaus & Burkhardt AG and of HSBC France. Alan is a member of the Advisory Council of TheCityUK and of the Advisory Board of Bradford University School of Management. Former appointments include: Global Head, Global Commercial Banking; director of HSBC Bank A.S. and HSBC Bank Polska S.A.

**Stuart Levey, 51**

**Chief Legal Officer**

Stuart joined HSBC and became a Group Managing Director in 2012. Former appointments include: Under Secretary for Terrorism and Financial Intelligence in the US Department of the Treasury, Senior Fellow for National Security and Financial Integrity at the Council on Foreign Relations, Principal Associate Deputy Attorney General at the US Department of Justice, and Partner at Miller, Cassidy, Larroca & Lewin LLP and Baker Botts LLP.

**Antonio Losada, 60**

**Chief Executive, Latin America**

Antonio joined HSBC in 1973. A Group Managing Director since December 2012. He is a director of HSBC Latin America Holdings (UK) Limited, HSBC Bank Argentina S.A., HSBC Argentina Holdings S.A., HSBC Mexico, S.A., Institucion de Banca Multiple, Grupo Financiero HSBC, Grupo Financiero HSBC, S.A. de C.V. and of HSBC North America Holdings Inc. Former appointments include: Chief Executive Officer, HSBC Argentina; Chairman of HSBC Bank (Panama) S.A. and of HSBC Argentina Holdings S.A., and Deputy Head, Personal Financial Services, Brazil.

**Sean O Sullivan, 59**

**Group Chief Operating Officer**

(due to retire 31 March 2015)

Sean joined HSBC in 1980. A Group Managing Director since 2011. Former appointments include: Group Chief Technology and Services Officer, director and Chief Operating Officer of HSBC Bank plc, and Chief Operating Officer of HSBC Bank Canada.

**Peter Wong**, 63

**Deputy Chairman and Chief Executive, The Hongkong and Shanghai Banking Corporation Limited**

Peter joined HSBC in 2005. A Group Managing Director since 2010. He is Chairman of HSBC Bank (China) Company Limited and HSBC Bank Malaysia Berhad, and a non-executive director of Hang Seng Bank Limited, Shek O Development Company Limited and Bank of Communications Co. Ltd. He is also an independent non-executive director of Cathay Pacific Airways Limited. Former appointments include: Vice Chairman of HSBC Bank (Vietnam) Ltd, director of HSBC Bank Australia Limited and of Ping An Insurance (Group) Company of China, Ltd.

HSBC HOLDINGS PLC

269

## **Table of Contents**

### **Report of the Directors: Corporate Governance (continued)**

#### **Board of Directors**

The Board of Directors of HSBC Holdings (the Board) exists to promote the long-term success of the Company and deliver sustainable value to our shareholders. Led by the Group Chairman, it sets the strategy and risk appetite for the Group and approves capital and operating plans presented by management for the achievement of the strategic objectives. Implementation of the strategy is delegated to the Group Management Board (GMB) which, in turn, is led by the Group Chief Executive.

#### **Directors**

HSBC Holdings has a unitary Board. The authority of the Directors is exercised in Board meetings where the Board acts collectively. The Directors who served during the year were Kathleen Casey (appointed 1 March 2014), Safra Catz, Laura Cha, Marvin Cheung (retired 1 August 2014), John Coombe (retired 23 May 2014), Lord Evans of Weardale, Joachim Faber, Rona Fairhead, Renato Fassbind (retired 1 September 2014), Douglas Flint, Stuart Gulliver, James Hughes-Hallett (retired 23 May 2014), Sam Laidlaw, John Lipsky, Rachel Lomax, Iain Mackay, Heidi Miller (appointed 1 September 2014), Marc Moses (appointed 1 January 2014), Sir Simon Robertson and Jonathan Symonds (appointed 14 April 2014).

Phillip Ameen was appointed with effect from 1 January 2015.

At the date of approval of the *Annual Report and Accounts 2014*, the Board comprised the Group Chairman, Group Chief Executive, Group Finance Director, Group Chief Risk Officer and 13 non-executive Directors.

The names and brief biographical details of the Directors are included on pages 264 to 268.

#### **Executive Directors**

The Group Chairman, Group Chief Executive, Group Finance Director and Group Chief Risk Officer are HSBC employees.

#### **Non-executive Directors**

Non-executive Directors are not HSBC employees and do not participate in the daily management of HSBC; they bring an independent perspective, constructively challenge and help develop proposals on strategy, scrutinise the performance of management in meeting agreed goals and objectives and monitor the Group's risk profile and the reporting of performance. The non-executive Directors bring a wide variety of experience from the public and private sectors, including the leadership of large complex multinational enterprises.

#### **Non-executive Directors terms of appointment**

The Board has determined the minimum time commitment expected of non-executive Directors to be about 30 days per annum. Time devoted to the Company could be considerably more, particularly if serving on Board committees.

Non-executive Directors are appointed for an initial three-year term and, subject to re-election by shareholders at annual general meetings, are typically expected to serve two three-year terms. The Board may invite a director to serve additional periods. All Directors are subject to annual election by shareholders.

Letters setting out the terms of appointment of each of the non-executive Directors are available for inspection at the Company's registered office.

### **Group Chairman and Group Chief Executive**

The roles of Group Chairman and Group Chief Executive are separate, with a clear division of responsibilities between the running of the Board and the executive responsibility for running HSBC's business. Descriptions of the roles and responsibilities of the Group Chairman and the Group Chief Executive are available at [www.hsbc.com/investor-relations/governance/board-committees](http://www.hsbc.com/investor-relations/governance/board-committees). Their key responsibilities are set out below.

#### *Key responsibilities*

#### **Group Chairman Douglas Flint**

Leads the Board and ensures its effectiveness.

Develops relationships with governments, regulators and investors.

Leads the Group's interactions on matters of public policy and regulatory reform with regard to the banking and financial services industry.

Maintains corporate reputation and character.

Undertakes performance management of the Group Chief Executive.

#### **Group Chief Executive Stuart Gulliver**

Develops, and delivers performance against, business plans.

Develops Group strategy, in agreement with the Group Chairman, for recommendation to the Board.

As Chairman of the GMB, drives performance within strategic goals and commercial objectives agreed by the Board.

**Deputy Chairman and senior independent non-executive Director**

A description of the roles and responsibilities of the Deputy Chairman and senior independent non-executive Director, which has been approved by the Board, is available at [www.hsbc.com/investor-relations/governance/board-committees](http://www.hsbc.com/investor-relations/governance/board-committees). His key responsibilities are set out below.

HSBC HOLDINGS PLC

270

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

*Key responsibilities*

**Deputy Chairman and senior independent non-executive Director Sir Simon Robertson**

Deputises for the Group Chairman at meetings of the Board or shareholders and supports the Group Chairman in his role.

Acts as an intermediary for other non-executive Directors when necessary.

Leads the non-executive Directors in the oversight of the Group Chairman.

Ensures there is a clear division of responsibility between the Group Chairman and Group Chief Executive.

**Appointment, retirement and re-election of Directors**

The Board may at any time appoint any person who is willing to act as a Director, either to fill a vacancy or as an addition to the existing Board, but the total number of Directors shall not be less than five or exceed 25. Any Director so appointed by the Board shall retire at the Annual General Meeting following his or her appointment and shall be eligible for election but would not be taken into account in determining the number of Directors who are to retire by rotation at such meeting in accordance with the Articles of Association. The Board may appoint any Director to hold any employment or executive office and may revoke or terminate any such appointment. Shareholders may, by ordinary resolution, appoint a person a Director or remove any Director before the expiration of his or her period of office. On the recommendation of the Nomination Committee and in compliance with the UK Corporate Governance Code, the Board has decided that all of the Directors should be subject to annual re-election by shareholders. Accordingly, all of the Directors will retire at the forthcoming Annual General Meeting and offer themselves for election or re-election.

**Powers of the Board**

The Board is responsible for overseeing the management of HSBC globally and, in so doing, may exercise its powers, subject to any relevant laws and regulations and to the Articles. The Board has adopted terms of reference which are



available at [www.hsbc.com/1/2/about/board-of-directors](http://www.hsbc.com/1/2/about/board-of-directors). The Board reviews its terms of reference annually.

In particular, the Board may exercise all the powers of the Company to borrow money and to mortgage or charge all or any part of the undertaking, property or assets (present or future) of HSBC Holdings and may also exercise any of the powers conferred on it by the Companies Act 2006 and/or by shareholders. The Board is able to delegate and confer on any executive Director any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it thinks fits. In addition, the Board may establish any local or divisional boards or agencies for managing the business of HSBC Holdings in any specified locality and delegate and confer on any local or divisional board, manager or agent so appointed any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it thinks fit. The Board may also, by power of attorney or otherwise, appoint any person or persons to be the agent of HSBC Holdings and may delegate to any such person or persons any of its powers, authorities and discretions (including the power to sub-delegate) for such time and on such terms as it thinks fit.

The Board delegates the day-to-day management of HSBC Holdings to the GMB but reserves to itself approval of certain matters including operating plans, risk appetite and performance targets, procedures for monitoring and controlling operations, credit, market risk limits, acquisitions, disposals, investments, capital expenditure or realisation or creation of a new venture, specified senior appointments and any substantial change in balance sheet management policy.

HSBC Holdings was registered in Hong Kong under part XI of the Companies Ordinance on 17 January 1991.

### Board meetings

Eight Board meetings and two one-day strategy meetings were held in 2014. At least one Board meeting each year is held in a key strategic location outside the UK. During 2014, Board meetings were held in Hong Kong and Beijing.

The table below shows each Director's attendance at meetings of the Board during 2014.

During 2014, the non-executive Directors and the Group Chairman met once without the other executive Directors. The non-executive Directors also met four times without the Group Chairman, including to appraise the Group Chairman's performance.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Corporate Governance (continued)***2014 Board attendance record*

	<b>Meetings attended</b>	<b>Meetings eligible to attend as a Director</b>
Kathleen Casey <sup>1,8</sup>	5	5
Safra Catz	8	8
Laura Cha	8	8
Marvin Cheung <sup>2</sup>	4	5
John Coombe <sup>3</sup>	4	4
Lord Evans of Weardale <sup>8</sup>	7	7
Joachim Faber	8	8
Rona Fairhead <sup>8</sup>	7	7
Renato Fassbind <sup>4</sup>	7	7
Douglas Flint	8	8
Stuart Gulliver	8	8
James Hughes-Hallett <sup>3</sup>	4	4
Sam Laidlaw	8	8
John Lipsky <sup>8</sup>	7	7
Rachel Lomax	8	8
Iain Mackay	8	8
Heidi Miller <sup>5,8</sup>	2	2
Marc Moses <sup>6</sup>	8	8
Sir Simon Robertson	8	8
Jonathan Symonds <sup>7</sup>	6	6
<b>Meetings held in 2014<sup>8</sup></b>		<b>8</b>

1 Appointed a Director on 1 March 2014.

2 Retired as a Director on 1 August 2014.

3 Retired as a Director on 23 May 2014.

4 Retired as a Director on 1 September 2014.

5 Appointed a Director on 1 September 2014.

6 Appointed a Director on 1 January 2014.

7 Appointed a Director on 14 April 2014.

8 *A meeting was called at short notice. Those Directors not able to attend were briefed prior to the meeting.*

### Board balance and independence of Directors

The Board comprises a majority of independent non-executive Directors. The size of the Board is considered to be appropriate given the complexity and geographical spread of our business and the significant time demands placed on the Directors.

The Nomination Committee regularly reviews the structure, size and composition of the Board (including skills, knowledge, experience, independence and diversity) and makes recommendations to the Board with regard to any changes.

The Board has adopted a policy on Board diversity which is consistent with the Group's strategic focus on ethnicity, age and gender diversity for the employee base. Further information on the Board diversity policy can be found on page 285.

The Board considers all of the non-executive Directors to be independent. When determining independence the Board considers that calculation of the length of service of a non-executive Director begins on the date of his or her election by shareholders following their appointment as a Director of HSBC Holdings. Rona Fairhead has served on the Board for more than nine years and, in that respect only, does not meet the usual criteria for independence set out in the UK Corporate Governance Code. The Board has determined Rona Fairhead to be independent in character and judgement,

notwithstanding her length of service, taking into account her continuing level of constructive challenge of management and strong contribution to Board discussions. Rona Fairhead will stand for re-election at the 2015 Annual General Meeting. It is our view that the experience of current and previous service on an HSBC subsidiary company board can be a considerable benefit but that such service does not detract from a non-executive Director's independence. The Board has concluded that there are no relationships or circumstances which are likely to affect a non-executive Director's judgement and any relationships or circumstances which could appear to do so are not considered to be material.

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

### Information and support

The Board regularly reviews reports on performance against financial and other strategic objectives, business developments and investor and external relations. The chairmen of Board committees and the Group Chief Executive report to each meeting of the Board on the activities of the committees since the previous Board meeting. The Board receives regular reports and presentations on strategy and developments in the global businesses and principal geographical areas. Regular reports are also provided on the Group's risk appetite, top and emerging risks, risk management, credit exposures and the Group's loan portfolio, asset and liability management, liquidity, litigation, financial and regulatory compliance and reputational issues.

The Directors have free and open contact with management at all levels. When attending Board offsite meetings and when travelling for other reasons, non-executive Directors are encouraged to take opportunities to see local business operations at first hand and to meet local management.

### Role of the Group Company Secretary

All Directors have access to the advice and services of the Group Company Secretary, who is responsible to the Board for ensuring that Board procedures and all applicable rules and regulations are complied with.

## Edgar Filing: HSBC HOLDINGS PLC - Form 20-F

Under the direction of the Group Chairman, the Group Company Secretary's responsibilities include ensuring good information flows within the Board and its committees and between senior management and non-executive Directors, as well as facilitating induction and assisting with professional development as required.

The Group Company Secretary is responsible for advising the Board through the Group Chairman on corporate governance matters.

The agenda and supporting papers are distributed in advance of all Board and Board committee meetings to allow time for appropriate review and to facilitate full discussion at the meetings. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary at HSBC Holdings' expense.

HSBC HOLDINGS PLC

272

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Induction**

Formal, tailored induction programmes are arranged for newly appointed Directors. The programmes are based on an individual Director’s needs and vary according to the skills and experience of each Director. Typical induction programmes consist of a series of meetings with other Directors and senior executives to enable new Directors to familiarise themselves with the business. Directors also receive comprehensive guidance from the Group Company Secretary on directors’ duties and liabilities.

**Training and development**

We provide training and development for Directors with sessions often arranged in conjunction with scheduled Board meetings. Executive Directors develop and refresh their skills and knowledge through day-to-day

interactions and briefings with senior management of the Group’s businesses and functions. Non-executive Directors have access to internal training and development resources and personalised training is provided where necessary. All newly appointed Directors attended a tailored induction programme. The Chairman regularly reviews the training and development of each Director.

During the year, Directors received training on the following topics:

The Dodd-Frank Act;

UK Financial Services (Banking Reform) Act 2014 including Senior Managers Regime; and

the changing financial and regulatory reporting landscape.

The table below shows a summary of training and development undertaken by each Director during 2014.

*Training and development*

Training areas			
Regulatory updates	Corporate Governance	Financial	Briefings on

			industry developments	Board committee related topics
<b>Executive Directors</b>				
Douglas Flint	ü	ü	ü	ü
Stuart Gulliver	ü	ü	ü	ü
Iain Mackay	ü	ü	ü	ü
Marc Moses	ü	ü	ü	ü
<b>Non-executive Directors</b>				
Kathleen Casey	ü	ü		ü
Safra Catz	ü			ü
Laura Cha	ü	ü	ü	
Lord Evans of Weardale	ü	ü	ü	
Joachim Faber	ü	ü	ü	ü
Rona Fairhead	ü	ü	ü	
Sam Laidlaw	ü	ü		
John Lipsky	ü	ü		
Rachel Lomax	ü	ü	ü	
Heidi Miller	ü	ü		
Sir Simon Robertson	ü	ü		ü
Jonathan Symonds	ü	ü		ü

### Board performance evaluation

The Board is committed to regular evaluation of its own effectiveness and that of its committees. In 2012 and 2013, the review of the effectiveness of the Board and its committees was undertaken by Bvalco Ltd<sup>1</sup>, an independent third-party firm. The 2013 review process mirrored that of 2012 with Bvalco conducting in-depth interviews with the members of the Board and a number

of other senior executives. The findings of the 2013 review were presented to the Board, an action plan developed and progress against these actions reported to the Board during 2014. The 2013 review concluded that the Board continues to operate effectively and is well positioned to address the challenges faced by the Group. Themes emerging from the 2013 review and the actions taken included:

<sup>1</sup> A legal firm which is engaged from time to time by the Company to provide legal services holds a 20% shareholding in Bvalco Ltd. Bvalco Ltd has confirmed that it does not have any other connection with the Company.

**Table of Contents****Report of the Directors: Corporate Governance (continued)****2013 Review of Board effectiveness**

<b>Theme</b>	<b>Action taken</b>
Ensuring an appropriate balance between regulatory, business and strategic issues at Board meetings.	<p>Key issues have been further prioritised.</p> <p>More time has been provided for the debate of these issues at Board meetings.</p>
Providing further opportunities for the executive and non-executive Directors to meet outside of the formal setting of the boardroom.	<p>Informal executive and non-executive Directors events have been planned around Board meetings providing additional forums for discussion.</p> <p>Non-executive Directors have been invited to a number of events attended by executive Directors.</p> <p>Arrangements made for non-executive Directors to meet senior members of local management teams in HSBC local offices when travelling.</p>
Ensuring increased time and opportunity for non-executive Director meetings.	<p>Non-executive Director-only sessions are scheduled around Board meetings.</p> <p>A number of informal non-executive Director events were organised throughout the year.</p>
Maintaining focus on succession planning.	

Succession planning remains a key area of focus with formal governance processes in place.

Those named in succession plans are scheduled to present to Board meetings.

A third and final review was facilitated by Bvalco during the year, providing continuity and allowing for progress against prior year themes to be evaluated.

### Director performance evaluation

Evaluation of the individual performance of each non-executive Director is undertaken annually by the Group Chairman. During this evaluation, the Group Chairman discusses the individual contribution of the Director, explores training and development needs, seeks input on areas where the Director feels he or she could make a greater contribution and discusses whether the time commitment required of the Director can continue to be delivered. Based upon their individual evaluation, the Group Chairman has confirmed that all of the non-executive Directors continue to perform effectively, contribute positively to the governance of HSBC and demonstrate full commitment to their roles.

Evaluation of the individual performance of each executive Director is undertaken as part of the performance management process for all employees, the results of which are considered by the Group Remuneration Committee when determining variable pay awards each year.

The non-executive Directors, led by the Deputy Chairman and senior independent non-executive Director, are responsible for the evaluation of the performance of the Group Chairman.

The Board monitors the implementation of actions arising from each performance evaluation.

It is the intention of the Board to continue to undertake an evaluation of its performance and that of its committees and individual Directors annually, with independent external input to the process, as appropriate, at least every third year.

### Relations with shareholders

All Directors are encouraged to develop an understanding of the views of major shareholders. Non-executive Directors are invited to attend analyst presentations and other meetings with institutional investors and their representative bodies. Directors also meet representatives of institutional shareholders annually to discuss corporate governance matters.

All executive Directors and certain other senior executives hold regular meetings with institutional investors. The Board receives a regular investor relations activity report which provides feedback from meetings with institutional shareholders and brokers, analysts' forecasts, information from research reports and share price performance data. The Board also receives regular reports from one of our corporate brokers.

The Group's shareholder communication policy is available on [www.hsbc.com/governance](http://www.hsbc.com/governance).



On several occasions during 2014, non-executive Directors, including the Deputy Chairman and senior independent non-executive Director, met or corresponded with institutional investors and their representatives to discuss corporate governance topics and executive remuneration.

As Deputy Chairman and senior independent non-executive Director, Sir Simon Robertson is available to shareholders should they have concerns which contact through the normal channels of Group Chairman, Group Chief Executive, Group Finance Director, Group Chief Risk Officer, or other executives cannot resolve or for which such contact would be inappropriate. He may be contacted through the Group Company Secretary at 8 Canada Square, London E14 5HQ.

HSBC HOLDINGS PLC

274

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Conflicts of interest, indemnification of Directors and contracts of significance**

The Board has adopted a policy and procedures relating to Directors' conflicts and potential conflicts of interest and can determine the terms of authorisation for such situations. The Board's powers to authorise conflicts are operating effectively and the procedures are being followed. A review of situational conflicts which have been authorised from time-to-time and the terms of those authorisations are undertaken by the Board annually.

The Articles of Association provide that Directors are entitled to be indemnified out of the assets of HSBC Holdings against claims from third parties in respect of certain liabilities. Such provisions have been in place during the financial year but have not been utilised by the Directors. All Directors have the benefit of directors' and officers' liability insurance.

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

**Corporate governance codes**

HSBC is committed to high standards of corporate governance. During 2014, HSBC has complied with the applicable code provisions of: (i) The UK Corporate Governance Code issued by the Financial Reporting Council in September 2012; and (ii) the Hong Kong Corporate Governance Code set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock

Exchange of Hong Kong Limited, save that the Group Risk Committee is responsible for the oversight of internal control (other than internal control over financial reporting) and risk management systems (Hong Kong Corporate Governance Code provision C.3.3 paragraphs (f), (g) and (h)). If there were no Group Risk Committee, these matters would be the responsibility of the Group Audit Committee. The UK Corporate Governance Code is available at [www.frc.org.uk](http://www.frc.org.uk) and the Hong Kong Corporate Governance Code is available at [www.hkex.com.hk](http://www.hkex.com.hk).

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

All Directors are routinely reminded of their obligations under the code of conduct for transactions in HSBC Group securities.



---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Board committees**

- 1 *Established on 17 January 2014.*
- 2 *Established on 5 December 2014.*

The Board has established a number of committees consisting of Directors, Group Managing Directors and, in the case of the Financial System Vulnerabilities Committee, co-opted non-director members. The key roles of the Board committees are described above. The Chairman of each non-executive Board committee reports to each meeting of the Board on the activities of the committee since the previous Board meeting.

**Group Management Board**

**Role and members**

The GMB exercises all of the powers, authorities and discretions of the Board of Directors in so far as they concern the management and day-to-day running of the Company and its subsidiaries.

**Members**

Stuart Gulliver (Chairman), Iain Mackay and Marc Moses who are executive Directors, and Ann Almeida, Samir Assaf, Peter Boyles, Simon Cooper, John Flint, Pam Kaur (non-voting), Alan Keir, Stuart Levey, Antonio Losada, Sean O Sullivan and Peter Wong, all of whom are Group Managing Directors.

The Group Chief Executive chairs the GMB. The head of each global business and global function and the chief executive of each region attend GMB meetings, either as members or by invitation.

The GMB is a key element of our management reporting and control structure such that all of our line operations are accountable either to a member of the GMB or directly to the Group Chief Executive, who in turn reports to the Group Chairman. The Board has set objectives and measures for the GMB. These align senior executives' objectives and measures with the strategy and operating plans throughout HSBC.

The Chairman of the GMB reports to each meeting of the Board on the activities of the GMB.

The Group Chief Risk Officer chairs regular Risk Management Meetings of the GMB. The Risk Management Meetings provide strategic direction and oversight of enterprise-wide management of all risks and establish, maintain and periodically review the policy and guidelines for the management of risk within the Group. The Risk Management Meeting also reviews the development and implementation of Global Standards reflecting best practices which must be adopted and adhered to consistently throughout the Group. The Head of Group Financial Crime Compliance and Group Money Laundering Reporting Officer attends this section of the Risk Management Meeting.

HSBC HOLDINGS PLC

276

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Group Audit Committee**

**Chairman's Statement**

The GAC has non-executive responsibility for oversight of and provision to the Board of advice on matters relating to financial reporting and internal controls over financial reporting. This report sets out the activities of the GAC that underpin this work and issues faced by the committee during the year.

Key areas of GAC activity during the year include: overseeing the external auditor transition from KPMG Audit Plc ( KPMG ) to PricewaterhouseCoopers LLP ( PwC ); considering provisioning for conduct-related legal and regulatory issues; and integrating the approach to financial reporting and internal controls to ensure consistency across committees of the Board.

In 2015, an area of focus for the GAC will be to monitor the implementation of recovery and resolution plans, which are designed to ensure that the effects of a banking failure are mitigated, thus avoiding severe systemic disruption, while protecting the economic functions provided by the relevant banking entity. The GAC will also monitor the financial control and reporting implications of ring-fencing the retail banking operations in the UK and the establishment of operating companies globally. A further area of focus in 2015 will be the implementation of revised International Financial Reporting Standard 9 Financial Instruments concerning the classification and measurement of financial instruments ( IFRS 9 ). This is of particular significance given the potential impact IFRS 9 will have on how we classify and measure financial assets.

Kathleen Casey joined the GAC in March 2014 and Phillip Ameen joined the GAC on 1 January 2015, bringing with them extensive experience in US financial regulatory policy and accounting standards setting and reporting, respectively. Further details are provided in Kathleen's and Phillip's biographies on page 265.

Finally, I would like to thank Renato Fassbind, whom I succeeded as Chairman of the GAC, John Coombe and the late Marvin Cheung, all of whom stepped down from the GAC during the year, for their respective contributions to the work of the committee.

**Jonathan Symonds**Chairman, *Group Audit Committee*

23 February 2015

**Role and membership**

The key areas of responsibility for the GAC include:

monitoring the integrity of financial statements;

overseeing the internal controls systems over financial reporting;

monitoring and reviewing the effectiveness of the Internal Audit function;

reviewing the Company's financial and accounting policies and practices; and

oversight and remuneration of the external auditor and advising the Board on the appointment of the external auditor.

**Members<sup>1</sup>**Jonathan Symonds (Chairman)<sup>2,7</sup>John Coombe<sup>3</sup>Renato Fassbind<sup>4</sup>Kathleen Casey<sup>5,7</sup>Marvin Cheung<sup>6</sup>Rachel Lomax<sup>7</sup>**Meetings held in 2014**

	<b>Meetings attended</b>	<b>Meetings eligible to attend</b>
	2	2
	4	4
	5	5
	4	4
	4	5
	7	7
		7

1 All members are independent non-executive Directors.

2 Appointed as a member and Chairman on 1 September 2014.

3 Retired as Chairman and member on 23 May 2014.

4 Appointed Chairman on 23 May 2014 and retired as a member and Chairman on 1 September 2014.

5 Appointed as a member on 1 March 2014.

6 Retired as a member on 1 August 2014.

7

*The Board has determined member to be independent according to SEC criteria and may be regarded as audit committee financial experts for the purposes of section 407 of the Sarbanes-Oxley Act and have recent and relevant financial experience for the purposes of the UK Corporate Governance Code.*

## Governance

The table below sets out the governance structure for the Board Committees whose duties relate to the integrity of HSBC s reporting to shareholders and other investors. Each major operating subsidiary has established a board committee with non-executive responsibility for oversight of matters relating to financial reporting.

A forum for the chairmen of our principal subsidiary company committees with non-executive oversight responsibility for financial reporting and risk-related matters was held in June 2014 to share views and to facilitate a consistent approach to the way in which these subsidiary company committees operate. The next forum is scheduled to be held in June 2015.

HSBC HOLDINGS PLC

277



**Table of Contents****Report of the Directors: Corporate Governance (continued)***Governance structure for the oversight of financial reporting*

<b>Authority</b>	<b>Membership</b>	<b>Responsibilities include:</b>
Board	Executive and non-executive Directors	<p>Financial reporting</p> <p>Appointing senior financial officers</p>
Disclosure Committee	Representatives from global businesses, functions and certain Group companies	<p>Reviewing the Group's material communications with investors</p> <p>Assisting the Group Chief Executive and Group Finance Director to discharge their obligations relating to financial reporting under the Securities Exchange Act of 1934</p> <p>Monitoring and reviewing the effectiveness of controls and procedures established to ensure that information is disclosed appropriately and on a timely basis</p> <p>Reporting findings and making recommendations to the Group Chief Executive, Group Finance Director and the GAC</p>
Subsidiary board committees responsible for oversight of financial reporting and global business audit committees	Independent non-executive directors and/or HSBC Group employees with no line of functional responsibility for the activities of relevant subsidiary or global business, as appropriate	<p>Providing reports to the GAC on financial statements and internal controls over financial reporting of relevant subsidiaries or businesses, as requested</p>

### How the Committee discharged its responsibilities

Throughout the year, the GAC received regular reports on a number of matters including internal audit findings and follow-up work, accounting issues and judgements, and legal and regulatory matters. The GAC received presentations from a number of members of the senior management including the Group Finance Director, Group Chief Accounting Officer and Group Head of Internal Audit. The Chairman of the GAC also had meetings with a number of these individuals separately, providing an additional forum to discuss specific issues.

During the year, the GAC held meetings with the Group Head of Internal Audit and with the external auditors in the absence of management.

In discharging its responsibilities the GAC undertakes the following principal activities:

oversight and challenge of the effectiveness of internal control processes that form the internal control framework for financial reporting and also of those internal controls processes that relate to the Sarbanes-Oxley Act. The Group Head of Internal Audit and the external auditor regularly report to the GAC without management present. During the year, the GAC confirmed that the Finance function was adequately resourced and that qualifications and experience of staff in that function were appropriate. Further details on internal control can be found on pages 288 to 290;

the adoption for full implementation in 2015 of the revised Committee of Sponsoring Organisations of the Treadway Commission ( COSO ) framework, an integrated internal control framework to meet our internal controls obligations under the Sarbanes-Oxley Act and also under the UK and Hong Kong corporate governance codes;

review of HSBC's financial and accounting policies and their application to the reporting of the Group's activities and financial performance. Further details of this area of the GAC's work are provided in the Principal activities and significant issues considered table on page 279;

monitoring of the legal and regulatory environment; the GAC received regular reports on litigation and on the application of changes in law, regulation, accounting policies and practices including reports on developments in programmes to implement IFRSs, Basel III/CRD IV and the recommendations of the Parliamentary Commission on Banking Standards, particularly as they relate to accounting policies and financial reporting;

review of the effectiveness of the Internal Audit function. The GAC's effectiveness review encompassed the scope of the Internal Audit function's work and the adequacy of the skills of the internal audit team. The GAC found the Internal Audit function remained effective and this conclusion was supported by the findings of a quality assurance review of the Internal Audit function undertaken by PwC. During the year, the GAC terms of reference and the audit charter of internal audit were updated to clarify the GAC's responsibility for the oversight of the governance of the Internal Audit function and the reporting line of the Group Head of Internal Audit to the Chairman of the GAC. The Audit Charter is available on the HSBC website at [www.hsbc.com/investor-relations/governance/internal-control](http://www.hsbc.com/investor-relations/governance/internal-control).

an annual assessment of the effectiveness of the external auditor which includes assessments by the Group's chief financial officers of its major geographical regions. The GAC also considered the level of scrutiny applied during the audit and the interaction of the auditor with senior management. Following this review the GAC was satisfied that KPMG continued to perform effectively as external auditor; and

an annual review of the independence of the external auditor. All services provided by KPMG during the 2014 were pre-approved by the GAC and were entered into under the pre-approval policies established by the GAC. The pre-approved services

HSBC HOLDINGS PLC

278

**Table of Contents****Report of the Directors: Corporate Governance (continued)**

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

Following its review, the GAC confirmed that it considered KPMG to be independent and KPMG, in accordance with industry standards, has provided the GAC with written confirmation of its independence for the duration of the financial year ended 31 December 2014. The GAC approved the remuneration and terms of engagement and recommended to the Board the re-appointment of KPMG for the financial year ended 31 December 2014.

The GAC's oversight of the audit tender process in 2013 resulted in the GAC's recommendation to the Board that PwC be appointed as the Group's auditor for the financial year beginning on 1 January 2015. The GAC has recommended to the Board that PwC be appointed at the forthcoming Annual General Meeting. PwC provided written confirmation of its independence from HSBC prior to its appointment. During 2014, regular meetings were held with PwC's audit engagement team to assist in developing the 2015 external audit plan.

The Board has approved, on the recommendation of the GAC, a policy for the employment by HSBC of former employees of KPMG and PwC. The GAC receives an annual report on such former employees who are employed and the number in senior positions. This report enables the GAC to consider whether there has been any impairment, or appearance of impairment, of the external auditor's judgement, objectivity or independence in respect of the audit. An analysis of the remuneration paid in respect of audit and non-audit services provided by KPMG for each of the past three years is disclosed in Note 7 on the Financial Statements.

In addition to addressing the matters noted above, the GAC considered the significant accounting issues described below. The GAC considered the appropriateness of management's judgements and estimates, where appropriate discussing these with KPMG, the external auditors, and reviewing the matters referred to in the external auditor's report as risks of material mis-statement.

The GAC undertakes an annual review of its own terms of reference and effectiveness. The terms of reference can be found on our website at [www.hsbc.com/investor-relations/governance/board-committees](http://www.hsbc.com/investor-relations/governance/board-committees).

*Principal activities and significant issues considered include:*

Key area	Action taken
Appropriateness of provisioning for legal proceedings and regulatory matters	The GAC received reports from management on the recognition and amounts of provisions, the existence of contingent liabilities, and the disclosures relating to provisions and contingent liabilities, for legal proceedings and regulatory matters. Specific areas addressed included the legal action brought by the US Federal Housing

	<p>Finance Agency in respect of mortgage-backed securities offerings, and provisioning arising from investigations conducted by the UK Financial Conduct Authority and US regulators and law enforcement agencies relating to trading activities in the foreign exchange market. In 2015, the GAC considered reports and disclosures concerning potential liabilities in connection with investigations of HSBC's Swiss Private Bank by a number of tax administration, regulatory and law enforcement authorities.</p>
Loan impairment, allowances and charges	<p>The GAC reviewed loan impairment allowances for personal and wholesale lending. Significant judgements and estimates reviewed included a review of loss emergence periods across our wholesale loan portfolios, consideration of the effect of falling oil prices on potential wholesale loan impairments, notable individual cases of impairment in wholesale lending and the adequacy of collective impairment allowances on personal lending portfolios.</p>
UK customer remediation	<p>The GAC considered the provisions for redress for mis-selling of payment protection insurance policies, provisions for mis-selling of interest rate hedging products, and liabilities in respect of breaches of the UK Consumer Credit Act.</p>
Valuation of financial instruments	<p>The GAC reviewed developments in market practice regarding accounting for funding costs in the valuation of uncollateralised derivatives. In line with evolving market practice, in the fourth quarter of 2014 we adopted an FFVA to account for the impact of incorporating the cost of funding into the valuation of uncollateralised derivatives.</p>
Bank of Communications Co., Limited ( BoCom ) impairment testing	<p>During the year the GAC considered the regular impairment reviews of HSBC's investment in BoCom and management's conclusions that the investment is not impaired. When testing investments in associates for impairment, IFRS requires the carrying amount to be compared with the higher of fair value and value in use. The GAC reviewed a number of aspects of management's work in this area including the sensitivity of the result of the impairment review to estimates and assumptions of projected future cash flows and the discount rate.</p>
Goodwill impairment testing	<p>No impairment was identified as a result of the annual goodwill impairment test, and the review for indicators of impairment as at 31 December 2014 identified no indicators of impairment. The result for GPB Europe is sensitive to key assumptions and is subject to enhanced disclosure.</p>
Recognition of deferred tax assets	<p>In considering the recoverability of the Group's deferred tax assets, the GAC reviewed the recognition of deferred tax assets in the USA, Brazil and Mexico, and the associated projections of future taxable income.</p>
Non-GAAP financial measures	<p>The GAC considered the change in the non-GAAP financial measures presented from underlying performance to an adjusted performance measure in the 2014 ARA.</p>

HSBC HOLDINGS PLC

279

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Group Risk Committee**

**Chairman's Statement**

The Group Risk Committee ( GRC ) oversees and advises the Board on high level risk-related matters and internal control, other than internal financial controls, which are overseen by the Group Audit Committee. The GRC is responsible for ensuring that Group risk profile and underlying business activity is in line with risk appetite as approved by the Board.

The tone from the top of the Group, which is set by senior management, is critical to effective risk management. During the year the GRC continued to focus on steps taken to communicate and reinforce the Group's commitment to doing the right thing. This focus is reflected in the advice the GRC provides to the Group Remuneration Committee in connection with executive pay.

The implications of an evolving legal and regulatory framework for financial institutions present an ongoing challenge. The 2014 PRA and EBA stress testing programmes were a particular area of focus for the GRC during the year. The nature and pace of legal and regulatory change in 2014 has also led to increased scrutiny by the GRC of the Group's risk appetite profile and management actions to mitigate legal and regulatory risks and exposures.

Geopolitical risk has remained an ongoing theme for the GRC, and during the year, the GRC held a joint meeting with the Group Audit Committee to consider key risks in China and the Asia Pacific region. It is expected that geopolitical risk will also be a theme for the GRC throughout 2015.

Heidi Miller joined the GRC in September 2014 and brings with her significant global financial services experience. Heidi has held a range of senior financial services sector appointments, most recently as President of JPMorgan International. Further details are provided in Heidi's biography on page 267.

Toward the end of 2014 a regulatory driven industry-wide review of IT infrastructure commenced which will continue into 2015.

**Joachim Faber**Chairman, *Group Risk Committee*

23 February 2015

**Role and membership**

The GRC is responsible for:

advising the Board on high-level risk-related matters and risk governance, including current and forward looking risk exposures, future risk strategy and management of risk within the Group;

advising the Board on risk appetite and risk tolerance;

reviewing the effectiveness of the Group's risk management systems framework and internal control systems (other than internal financial control systems which is the responsibility of the Group Audit Committee);

monitoring executive control and management of risk including top and emerging risks; and

advising the Group Remuneration Committee on the alignment of remuneration with risk appetite.

The GRC is comprised of independent non-executive Directors as listed below.

**Members**

Joachim Faber (Chairman)

John Coombe<sup>1</sup>

John Lipsky

Rachel Lomax

Heidi Miller<sup>2</sup>**Meetings held in 2014**

	<b>Meetings attended</b>	<b>Meetings eligible to attend</b>
	13	13
	5	5
	13	13
	13	13
	4	4
		13

<sup>1</sup> Retired as a Director and member on 23 May 2014.

<sup>2</sup> Appointed a member on 1 September 2014.

By invitation, John Trueman, a non-executive director of HSBC Bank plc, attended meetings of the GRC throughout 2014. Safra Catz, a non-executive Director of HSBC Holdings plc, attended two presentations given to the GRC on



IT-related matters.

### Governance of risk

All of HSBC's activities involve the measurement, evaluation, acceptance and management of risk or combinations of risks. The Board, advised by the GRC, requires and encourages a strong risk governance culture which shapes the Group's attitude to risk. The Board and the GRC oversee the maintenance and development of a strong risk management framework by continually monitoring the risk environment, top and emerging risks facing the Group and mitigating actions planned and taken.

The governance structure of the Board and its committees for the management of risk is set out in the table on page 24. The GRC has overall non-executive responsibility for oversight of risk across the Group. The Conduct & Values and the Financial System Vulnerabilities committees are responsible for the oversight of specific areas of risk which include the promotion and embedding of HSBC Group Values and HSBC Group principles and the oversight of matters relating to anti-money laundering, sanctions, terrorist financing and proliferation financing. The Conduct & Values and the Financial System Vulnerabilities committees regularly update the GRC on their activities.

Each major Group operating subsidiary has established a board committee with non-executive responsibility for oversight of risk-related matters and an executive committee with responsibility for risk-related matters. The GRC has set core terms of reference for subsidiary company non-executive risk and audit committees.

Further details of the structures in place for the management of risk across the Group are provided on pages 112 to 118.

### How the GRC discharged its responsibilities

The GRC discussed top and emerging risks and the Group's risk profile with management at each of its meetings. In monitoring top and emerging risks the GRC received reports and presentations from the Group Chief

HSBC HOLDINGS PLC

280

**Table of Contents****Report of the Directors: Corporate Governance (continued)**

Risk Officer (an executive Director), the Global Head of Financial Crime Compliance and Group Money Laundering Reporting Officer, and the Global Head of Regulatory Compliance. During the year, other members of the senior management attended GRC meetings including the Group Chief Operating Officer, the Global Head of Risk Strategy and Chief of Staff, the Head of Group Performance and Reward and the Group Chief Data Officer.

The Group Chief Risk Officer provided regular reports and presentations to the GRC, including at each meeting a presentation of the risk map which describes our risk profile by risk type in the global businesses and regions, the Group Risk Appetite Statement, and the top and emerging risks report which summarised the

mitigating actions for identified risks. The GRC requested reports and updates from management on risk-related issues identified for in-depth consideration and also received regular reports on matters discussed at Risk Management Meetings of the GMB.

Page 118 provides further information on the top and emerging risks for the Group.

Throughout the year, the GRC Chairman met with the Group Chief Risk Officer, the Group Head of Internal Audit, the Group Finance Director, the Chief Legal Officer and other senior executives as required.

In addition to addressing the matters noted above, the GRC focused on a number of key areas including those set out in the table below.

*Principal activities and significant issues considered include:*

Key area	Action taken
The Group Risk Appetite Statement and monitoring of the Group risk profile against the Risk Appetite Statement	<p>The GRC reviewed management proposals for revisions to the Group Risk Appetite Statement metrics for 2014. Following review, the Committee recommended a number of refinements to the Group Risk Appetite Statement to the Board including the cost efficiency, Common Equity Tier 1 Capital and sovereign exposure ratios.</p> <p>The GRC regularly reviews the Group's risk profile against the key performance metrics set out in the Risk Appetite Statement. The GRC reviewed management's assessment of risk and provided scrutiny of management's proposed mitigating actions.</p>

PRA and EBA concurrent stress tests	<p>The GRC monitored the PRA and EBA stress testing exercises and reviewed the results of stress testing prior to submission to the respective regulators. It received reports over the course of the PRA and EBA stress testing exercises and met three times during the year solely to consider stress testing related matters. At these meetings the GRC reviewed the stress test scenarios as set by the PRA and EBA and the enhancements to these scenarios where appropriate. The GRC oversaw a review of the lessons learnt from this stress testing exercise.</p> <p>Internal Audit assessed progress on the regulatory stress tests programmes and reported its conclusions and recommendations to the GRC.</p>
Execution risk	<p>Execution risk is the risk relating to the delivery of the Group strategy and is a standing agenda item for the GRC. Monitoring of this risk and challenging management's assessment of execution risk and corresponding mitigating actions remain a priority for the GRC.</p> <p>In addition to the regular reports received and deep-dive reviews conducted on specific issues identified, the GRC requested reports from Internal Audit on the themes identified during the course of its work.</p>
Legal and regulatory risks	<p>The legal and regulatory environment continues to evolve in both complexity and the level of requirements placed on financial services sector firms.</p> <p>The GRC received regular reports on legal and regulatory risks, reviewed management actions to mitigate these risks and considered the potential impact of future developments in this area on the Group. In 2015, these included reports concerning risks related to investigations of HSBC's Swiss Private Bank by a number of tax administration, regulatory and law enforcement authorities. A particular area of focus for the GRC remains the uncertainty in respect of capital adequacy regulatory requirements; further time has been scheduled for the GRC to address this matter.</p>
IT and data-related risks	<p>During the year, the GRC considered a number of IT and data-related risks including internet crime and fraud, data management and aggregation, and information security. The GRC reviewed management's assessment of these risks and management actions to mitigate them.</p> <p>IT and data-related risks are expected to remain an area of focus for the GRC during the course of 2015.</p>
Geopolitical risk	<p>The GRC received regular reports on geopolitical risks including the crises in the Middle East and Ukraine and the continued tensions in respect of maritime sovereignty in the South China Sea. Management provided regular updates on the implementation of mitigating actions in</p>

response to these matters which included the augmentation of anti-money laundering, sanctions and financial crime compliance controls. The GRC also held a joint meeting with the Group Audit Committee which focused on issues faced in mainland China and the Asia-Pacific region.

*Further information on the identification, management and mitigation of the risks set out above is provided on pages 114 to 117.*

HSBC HOLDINGS PLC

281

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Financial System Vulnerabilities Committee**

**Chairman's Statement**

The Financial System Vulnerabilities Committee ( FSVC ) oversees the implementation by management of policies aimed at mitigating financial crime and system abuse risks which HSBC faces in the execution of its strategy. In doing so, it provides thought leadership, governance, oversight and policy guidance over the framework of controls and procedures which has been designed to address these risks to which HSBC, and the financial system more broadly, may be exposed. More formally, the Committee oversees our compliance with regulatory orders, including oversight of the Group's relationship with the Monitor, with whom the Committee regularly meets and engages to ensure alignment of our respective priorities and interests.

We recognise that in the past HSBC did not consistently identify, and so prevent, misuse and abuse of the financial system through its network. However, the adoption of the highest or most effective global compliance standards allied with the highest standards of behaviour forms part of our strategy to address the possibility of this happening again, and will address our obligations under the various regulatory orders entered into in 2012.

As you will read in this report, during 2014, the Committee has made considerable progress in the achievement of its objective, reviewing and adopting new global policies on anti-money laundering and sanctions compliance, agreeing and setting milestones regarding the enhancement of transaction monitoring and customer due diligence systems and processes and routinely engaging with the Monitor for this purpose. An equally important aspect of the FSVC's role in 2014 has been to provide the Group with a forward-looking perspective on financial crime risk. As an example, the Committee undertook a deep dive review in 2014 to ascertain the actions being taken to mitigate the risks associated with the vast amount of data to which the firm is exposed in the delivery of products to its customers. The five subject matter experts appointed to the FSVC have provided invaluable guidance and advice in identifying risk areas where the Group could become exposed, working with us to mitigate those risks.

Building on this, the FSVC will continue to focus in 2015 on the controls and procedures which will underpin our high behavioural and compliance standards. A strong compliance culture is essential to the success of our strategy and this will remain a focus area for the FSVC during the year.

I would like to take this opportunity to thank Rona Fairhead for her leadership of the Committee from the period since its establishment in early 2013 and I am delighted to have inherited from her in May last year a Committee with a clear intent and purpose to address the challenges facing HSBC.

**Lord Evans of Weardale**

Chairman, *Financial System Vulnerabilities Committee*

23 February 2015

*1 See page 27 for further details on the Monitor.*

**Role and membership**

The FSVC has non-executive responsibility for:

governance, oversight and policy guidance over the framework of controls and procedures designed to identify areas where HSBC and the financial system more broadly may become exposed to financial crime or system abuse;

oversight of matters relating to anti-money laundering, sanctions, terrorist financing and proliferation financing, including the establishment, implementation, maintenance and review of adequate policies and procedures sufficient to ensure the continuing obligations to regulatory and law enforcement agencies are met and oversight of implementation of the actions necessary to build assurance in these areas;

provision of advice as applicable on the implementation of the Global Standards programme; and

provision of a forward-looking perspective on financial crime risk to the Board.

**Members**

Lord Evans of Weardale (Chairman)<sup>1</sup>  
 Kathleen Casey<sup>2</sup>  
 Rona Fairhead<sup>3</sup>  
 Nick Fishwick<sup>4</sup>  
 Dave Hartnett<sup>4</sup>  
 Bill Hughes<sup>4</sup>

	<b>Meetings attended</b>	<b>Meetings eligible to attend</b>
	<b>6</b>	<b>7</b>
	<b>5</b>	<b>5</b>
	<b>7</b>	<b>7</b>
	<b>7</b>	<b>7</b>
	<b>7</b>	<b>7</b>
	<b>7</b>	<b>7</b>

Sir Simon Robertson  
 Leonard Schrank<sup>4</sup>  
 Juan Zarate<sup>4,5</sup>

	7		7
	7		7
	7		7
			7

**Meetings held in 2014**

- 1 *Appointed Chairman on 23 May 2014.*
- 2 *Appointed a non-executive Director and member on 1 March 2014.*
- 3 *Retired as Chairman on 23 May 2014.*
- 4 *Co-opted non-director member.*
- 5 *Also provides advisory services to the board of HSBC North America Holdings Inc.*

Five co-opted non-director members have been appointed advisers to the Committee to support its work. Brief biographies are set out below:

**Nick Fishwick, CMG:** Former senior official in the Foreign and Commonwealth Office, specialising in security, intelligence and counter-terrorism; seconded from 2001 to 2004 to HM Customs and Excise as Head of Intelligence (Law Enforcement), focusing on international counter-narcotics, tax and excise fraud; awarded the CMG in 2009.

HSBC HOLDINGS PLC

## Table of Contents

### **Report of the Directors: Corporate Governance** (continued)

**Dave Hartnett, CB:** Former Permanent Secretary for Tax at HM Revenue and Customs; focused on tax policy development, compliance and enforcement and international tax issues during his 36-year career in tax administration; former deputy chairman of the Organisation for Economic Co-operation and Development's Forum on Tax Administration.

**Bill Hughes, CBE QPM:** Former head of the UK's Serious Organised Crime Agency; international experience in the disruption, dismantling and criminal investigation of organised crime.

**Leonard Schrank:** Former chief executive officer of SWIFT, the industry-owned, global financial messaging system; oversaw SWIFT's relationship with the US Treasury Department and other countries on counter-terrorism issues. Member of MIT Corporation.

**The Honourable Juan Zarate:** Senior Advisor at the Center for Strategic and International Studies; the Senior National Security Analyst for CBS News; a Visiting Lecturer of Law at the Harvard Law School; national security consultant; former Deputy Assistant to the President and Deputy National Security Advisor for Combating Terrorism responsible for developing and implementing the US Government's counter-terrorism strategy and policies related to transnational security threats; former Assistant Secretary of the Treasury for Terrorist Financing and Financial Crime; and former federal prosecutor who served on terrorism prosecution teams.

### **How the FSVC discharged its responsibilities**

The FSVC has agreed areas of focus where HSBC and the financial system more broadly may become exposed to financial crime or system abuse, with the GRC retaining responsibility for high-level risk related matters and risk governance. Particular areas of focus for FSVC included: cyber security; technology and data systems; transaction

monitoring systems for anti-money laundering; sanctions and other financial crime related risks; and customer due diligence and know your customer procedures. Regular reports and updates on these focus areas were provided to the FSVC by the adviser members and relevant executives.

The FSVC also maintained oversight of obligations under the US and UK agreements and updates on HSBC's interactions with the Monitor.

The Chief Legal Officer, Group Chief Risk Officer, Global Head of Financial Crime Compliance, the Group Money Laundering Reporting Officer, Global Head of Regulatory Compliance and the Group Head of Internal Audit provided reports to the FSVC including on meetings held with, and reports submitted to, regulators on the Group's compliance-related initiatives made both in connection with the resolution of the investigations by US and UK regulatory and law enforcement authorities in December 2012 and also more generally. In addition to the scheduled Committee meetings, the Chairman met regularly with the Group Chairman, the adviser members of the Committee and senior executives as required.

During the year, the FSVC received regular updates on the Compliance Plan, which documents the Group's strategy to augment HSBC's anti-money laundering and sanctions compliance programme, which covers the related policies,



procedures and enhanced training. Regular reports are also submitted to the FSVC on Group-wide whistleblowing disclosures and anti-bribery and corruption matters.

In addition to its reports to the Board, the FSVC also regularly updates the Group Risk Committee on specified matters to raise areas for its consideration as appropriate.

During the year, the FSVC focused on a number of key areas, as set out in the table below.

*Principal activities and significant issues considered include:*

<b>Key area</b>	<b>Action taken</b>
Financial crime-related issues	The FSVC reviewed and adopted a Group policy on anti-money laundering which is now being implemented across all of HSBC's businesses. It received regular updates on the implementation of the IT strategy agreed as part of the work to manage and mitigate financial crime risks. A particular area of focus was on enhancements proposed by management in respect of the Group's transaction monitoring systems.
Sanctions	The FSVC reviewed and adopted a Group policy on sanctions compliance which is now being implemented, whilst the Group's ongoing sanctions compliance programmes and management's strategy to respond to the expansion of global sanctions were also routinely monitored by the Committee during the year.
Cyber security	During 2014, the FSVC reviewed cyber-security risks and strategy in this area and proposed enhancements to the Group's cyber security capabilities. The reviews included briefings on the Group's ability to predict, respond and recover from cyber-attacks. Metrics and timelines were agreed with management to monitor progress in this area.
FATCA and tax transparency	The FSVC received updates to tax transparency initiatives undertaken by HSBC and the Group-wide implementation of the requirements under the Foreign Account Tax Compliance Act.

**Table of Contents****Report of the Directors: Corporate Governance (continued)****Group Remuneration Committee**

The Group Remuneration Committee is responsible for approving remuneration policy. As part of its role, it considers the terms of fixed pay, annual incentive plans, share plans, other long-term incentive plans, benefits and the individual remuneration packages of executive Directors and other senior Group employees and in doing so takes into account the pay and conditions across the Group. No Directors are involved in deciding their own remuneration.

**Members<sup>1</sup>**

Sir Simon Robertson (Chairman)

John Coombe <sup>2</sup>Renato Fassbind<sup>3</sup>John Lipsky<sup>4</sup>

Sam Laidlaw

Jonathan Symonds<sup>5</sup>**Meetings held in 2014**

	Meetings attended	Meetings eligible to attend
	11	11
	6	6
	7	7
	5	5
	10	11
	2	3
		11

1 All members are independent non-executive Directors.

2 Retired as a Director and member on 23 May 2014.

3 Resigned as a Director and member on 1 September 2014.

4 Appointed a member on 23 May 2014.

5 A member from 14 April 2014 until 1 September 2014.

*The Directors' Remuneration Report is set out on pages 300 to 327.*

**Nomination Committee****Chairman's Statement**

A key responsibility of the Nomination Committee (Nomco) is to ensure there is an appropriate balance of skills, knowledge, experience, diversity and independence on the Board. Following Nomco's recommendation, the Board appointed in 2014 four independent non-executive Directors, namely, Phillip Ameen, Kathleen Casey, Heidi Miller and Jonathan Symonds. They have brought different expertise and experience to the Board. HSBC now surpasses the

target set under the Board's own diversity policy, which states that 30% of the Board members should be female by 2020.

Another important responsibility of Nomco is to ensure that plans are in place for the selection, appointment and orderly succession of executive Directors and senior executives. Nomco met once last year to undertake with the Group Chief Executive an in-depth review of succession plans and concluded that they are sufficient and appropriate but need to be kept under annual review.

Nomco continues to monitor regulatory developments as they may require changes to the composition of the Board. Nomco has considered in detail the new requirements under the EU's Capital Requirements Directive IV which came into effect on 1 July 2014 and which restrict the number of directorships that may be held by member of the Board. The ramifications of these new requirements for the current Board have been reviewed and the requirements are routinely kept under review.

### Sir Simon Robertson

Chairman, *Nomination Committee*

23 February 2015

### Role and membership

Nomco has non-executive responsibility for leading the process for Board appointments and for identifying and nominating, for approval by the Board, candidates for appointment to the Board. Nomco is responsible for succession planning of Directors to the Board. In the course of this, it also oversees senior management succession planning.

### Members<sup>1</sup>

Sir Simon Robertson (Chairman)  
 Laura Cha<sup>2</sup>  
 Rona Fairhead  
 James Hughes-Hallett<sup>3</sup>  
 Sam Laidlaw<sup>2</sup>  
 John Lipsky

### Meetings held in 2014

	Meetings attended	Meetings eligible to attend
Sir Simon Robertson (Chairman)	4	4
Laura Cha <sup>2</sup>	2	2
Rona Fairhead	4	4
James Hughes-Hallett <sup>3</sup>	2	2
Sam Laidlaw <sup>2</sup>	2	2
John Lipsky	4	4
<b>Meetings held in 2014</b>	<b>4</b>	<b>4</b>

<sup>1</sup> All members are independent non-executive Directors.

<sup>2</sup> Appointed a member on 23 May 2014.

3 *Retired as a Director and member on 23 May 2014.*

HSBC HOLDINGS PLC

284

**Table of Contents****Report of the Directors: Corporate Governance (continued)****How Nomco discharged its responsibilities**

Nomco undertook the following key activities in the discharge of its responsibilities:

*Principal activities and significant issues considered include:*

Key area	Action taken
Appointments of new Directors	<p>Following a rigorous selection process, Nomco recommended to the Board the appointment of four non-executive Directors during 2014: Phillip Ameen (with effect from 1 January 2015), Kathleen Casey, Heidi Miller and Jonathan Symonds; and an executive Director: Marc Moses, Group Chief Risk Officer.</p> <p>An external search consultancy, MWM Consulting, was used in relation to the appointment of three of the four non-executive Directors (Kathleen Casey, Heidi Miller and Jonathan Symonds). MWM Consulting has no additional connection with HSBC other than as search consultant for certain senior executive hires. Phillip Ameen was identified by the Committee through his existing role as an independent Director of HSBC North America Holdings Inc. since 2012 (where he chairs the Audit Committee and serves on the Risk Committee). He also brings extensive financial and accounting experience gained from a long career at General Electric (ultimately as Vice President, Comptroller and Principal Accounting Officer of General Electric Corp.), as well as a depth of technical knowledge from his participation in the accounting standard setting world.</p>
Forward planning	<p>Nomco adopts a forward-looking approach to potential candidates for appointment to the Board that takes into account the needs and development of the Group's businesses and the expected retirement dates of current Directors.</p>

Size, structure and composition of the Board and its committees	<p>Nomco monitors the size, structure and composition of the Board (including skills, knowledge, experience, diversity and independence).</p> <p>Nomco considered the election or re-election of Directors at the 2014 Annual General Meeting. It has also recommended to the Board that all Directors should stand for election or re-election at the 2015 Annual General Meeting.</p>
Regulatory developments	<p>Nomco monitors regulatory developments as they may affect Board composition. During 2014, Nomco considered the implications of the corporate governance requirements of the EU's Capital Requirements Directive IV and the Equality and Human Rights Commission's guidance on the equality law framework.</p>
Diversity	<p>Nomco believes that one of its important duties is to ensure that there is a proper balance on the Board to reflect diversity and the geographical nature of its business. Appointments to the Board are made on merit and candidates are considered against objective criteria, having due regard to the benefits of diversity on the Board. The Board diversity policy is available at <a href="http://www.hsbc.com/investor-relations/governance/corporate-governance-codes">www.hsbc.com/investor-relations/governance/corporate-governance-codes</a>.</p> <p>Nomco regularly monitors the implementation of the Board's diversity policy using the following measurable objectives: at least 25% of the Board should be female, with a target of 30% to be achieved by 2020; only external search consultants who are signatories to the Executive Search Firms Voluntary Code of Conduct should be engaged by Nomco; and at least 30% of candidates, proposed by search firms for consideration as non-executive Directors, should be women. We comply with these requirements and, as at the date of this report, 35.3% of the Board is female.</p>
Director training and development	<p>Nomco reviews and monitors the training and continuous professional development of Directors and senior management.</p>
Time commitment and independence of non-executive Directors	<p>Nomco assessed the independence of, and time required from, non-executive Directors. Nomco is satisfied that all non-executive Directors have the time to fulfil their fiduciary responsibilities to provide oversight of the business of the Group; and to serve on the relevant Committees of the Board. All Directors are asked to identify any other significant commitments they may have and confirm they have sufficient time to discharge what is expected of them as members of the Board.</p>

---

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

**Conduct & Values Committee**

**Chairman's Statement**

The Conduct & Values Committee ( CVC ) was established in January 2014 to provide Board oversight of the Group's multiple efforts to raise standards of conduct and to embed the behavioural values the Group stands for. The delivery of fair outcomes for customers and upholding market integrity is a prime driver of a sustainable and profitable business. Whilst conduct risk is not a new concept, the Board recognises it is one receiving increasing global regulatory and industry focus and that it is therefore right to establish a committee whose objective is to oversee how conduct risk is being managed.

The need for greater emphasis on this area has become apparent in the last few years with the establishment of the Consumer Financial Protection Bureau in the US in 2011; the Financial Conduct Authority in the UK listing among its objectives ensuring appropriate protection of consumers and enhancing the integrity of the financial system; and the Hong Kong Monetary Authority introducing a charter on treating customers fairly. Additionally, fine levels have escalated, most significantly in the US, with a developing trend of out of court settlements. These facts reaffirm our belief that delivering higher standards of conduct is essential to restoring consumer confidence and rebuilding society's trust in banking.

Since its establishment, the CVC has taken a systematic approach focussing on the global businesses and global functions, with a number of deep dives into its home and priority markets, with a particular focus to date on the UK. The business on the agenda for each meeting is closely mapped to the terms of reference and ensures that key responsibilities are adequately addressed at least once a year.

I have chaired the CVC since its establishment, with Laura Cha, chair of the former Corporate Sustainability Committee, Lord Evans of Weardale, Heidi Miller and Jonathan Symonds as members.

In 2015, the CVC will continue to focus on implementation of the Group's conduct and market risk programme, with a particular interest in employee training and customer communication. It aims to take a forward looking approach to assessing conduct risk and anticipated further changes in public policy relating to conduct will be received with interest.

The Committee will additionally address its sustainability responsibilities, as inherited from the now-demised Corporate Sustainability Committee, so as to ensure that HSBC acts responsibly towards the communities within which it operates.

**Rachel Lomax**

Chairman, *Conduct & Values Committee*

23 February 2015

**Role and membership**

The CVC is responsible for:

HSBC policies, procedures and standards to ensure that the Group conducts business responsibly and consistently adheres to HSBC Values. It aims to align its work to HSBC's purpose of connecting customers to opportunities, enabling businesses to thrive and economies to prosper, and ultimately helping people to fulfil their hopes and realise their ambitions; and ensuring that in the conduct of its business, HSBC treats customers fairly and openly, does business with the right clients and in the right way, is a responsible employer, acts responsibly towards the communities in which HSBC operates and treats other stakeholders fairly.

The CVC is comprised of independent non-executive Directors as listed below.

**Members**

- Rachel Lomax (Chairman)<sup>1</sup>
- Laura Cha<sup>2</sup>
- Lord Evans of Weardale<sup>2</sup>
- Heidi Miller<sup>3</sup>
- Jonathan Symonds<sup>4</sup>

**Meetings held in 2014**

	Meetings attended	Meetings eligible to attend
	4	4
	4	4
	4	4
	2	2
	4	4
<b>Meetings held in 2014</b>		<b>4</b>

1 Appointed Chairman on 17 January 2014.  
 2 Appointed a member on 17 January 2014.  
 3 Appointed a member on 1 September 2014.  
 4 Appointed a member on 14 April 2014.



## Governance

The CVC exercises non-executive responsibility for the oversight of the promotion and embedding of HSBC Values and our required global conduct outcomes. Additionally, the CVC will input as appropriate into the Group Remuneration Committee on the alignment of remuneration with conduct. It reports regularly to the Board on its activities.

### How the CVC discharged its responsibilities

During the course of 2014 the CVC received regular reports and presentations from the Chief Executive, RBWM, the Chief Executive, CMB, the Global Head of Regulatory Compliance, the Group Head of Development, the Head of Group Corporate Sustainability and the Group Head of Internal Audit. During the year, other members of senior management attended CVC meetings including the Chief Executive, GB&M, the Global Head of Financial Crime Compliance, the Global Head of Communications, the Global Head of Anti-Bribery and Corruption and the Global Head of Marketing.

The Chief Executive, RBWM and the Chief Executive, Global Commercial Banking provide regular reports and presentations to the CVC, including an analysis of customer complaint trends at each meeting. The CVC also receives regular reports on whistleblowing cases, the outcomes of internal audits and the Group's initiatives being undertaken to deliver against key values and culture initiatives.

In addition to the scheduled Committee meetings, the Chairman met regularly with the Group Chairman and senior executives as required.

HSBC HOLDINGS PLC

286

**Table of Contents****Report of the Directors: Corporate Governance (continued)**

The Committee is additionally responsible for advising the Board, its committees and executive management on corporate sustainability policies across the Group including environmental, social and ethical issues. From this year, our progress on sustainability policies and performance is reported in the *Strategic Report* and on our website at [hsbc.com/sustainability](http://hsbc.com/sustainability).

We will no longer publish a separate Sustainability Report as part of a progression towards an integrated approach to sustainability reporting. This change reflects best practice in reporting as well as the ongoing integration of sustainability matters into the strategy and management of HSBC.

During the year the CVC focused on a number of key areas, as set out in the table below.

*Principal activities and significant issues considered include:*

Key area	Action taken
Global approach to conduct	The CVC endorsed a global approach to the management of conduct which defines and sets out required outcomes. It received regular reports from the Global Head of Regulatory Compliance on how conduct is being managed consistently across the Group to deliver the required outcomes. It also sets out the programmes and governance to deliver conduct improvements. In developing this approach, Management has given consideration to strategy, business models and decision making, culture and behaviours, interactions with customers, the impact of activities in financial markets and governance structures, oversight frameworks and management information. There is close alignment between this and the work being done to promote and embed HSBC Values.
Values	<p>The CVC oversees the promotion and embedding of HSBC Values. In 2013, the Group launched a project to better understand how HSBC Values drive everyday behaviours. This included interviews with leadership teams and functional specialists, focus groups with line managers and staff, and reviews of management information and local documentation.</p> <p>The CVC received regular reports from management on this project and contributed to the subsequent action plan. It will continue to monitor the implementation of cultural change into 2015.</p>

Customer experience	<p><b>Customer complaints.</b> The CVC reviewed reports regarding customer experience, complaint trends and complaint handling. It considered improvements to the quality of complaint handling processes and root cause analysis.</p> <p><b>Sales processes and incentive schemes.</b> The CVC considered the review mechanism established by RBWM management, the aim of which is to ensure that the RBWM product range is appropriately positioned to fulfil customers' needs. The CVC also reviewed the changes implemented to sales processes and sales incentive schemes in the RBWM and CMB businesses and the effectiveness of new quality assurance programmes. This will continue into 2015.</p>
Whistleblowing	<p>The CVC has assumed responsibility for the governance of the Group's whistleblowing policies and procedures, including the protection of whistleblowers. This responsibility does not extend to matters relating to financial reporting and associated auditing matters, which remain the responsibility of the Group Audit Committee. The CVC reviewed current whistleblowing processes and disclosures and received reports on an ongoing enhancement programme which takes account of recommendations made by the UK Parliamentary Commission on Banking Standards, regulatory guidance and emerging industry best practices.</p>
Employee engagement	<p>The CVC monitored employee engagement across the Group and received the results of quarterly Snapshot engagement surveys which were conducted during 2014. It will continue to monitor these survey results in 2015, as well as the results of a Group People Survey planned to take place later in the year.</p>

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Corporate Governance (continued)**

#### **Chairman's Committee**

##### **Role and membership**

The Chairman's Committee has the power to act on behalf of the Board between scheduled Board meetings to facilitate ad hoc unforeseen business requiring urgent Board approval. The Committee meets with such frequency and at such times as it may determine, the quorum for meetings is dependent upon the nature of the business to be transacted, as set out in its terms of reference.

#### **Philanthropic and Community Investment Oversight Committee**

##### **Role and membership**

The Philanthropic and Community Investment Oversight Committee, established by resolution of the Board in December 2014, will focus on the Group's philanthropic activity, being monetary donations made to charitable organisations and the contribution of staff time toward voluntary activities.

The Committee has non-executive responsibility for the oversight of HSBC's philanthropic and community investment activities in support of the Group's corporate sustainability objectives.

The Committee will meet for the first time in 2015 and will meet at least twice each year.

#### **Members**

Laura Cha<sup>1</sup> (Chairman)  
Lord Evans of Weardale<sup>1</sup>  
Sir Malcolm Grant<sup>2,4</sup>  
Ruth Kelly<sup>3,4</sup>  
Stephen Moss<sup>3,4</sup>

*1 Appointed on 5 December 2014.*

*2 Independent member.*

*3 Employee member.*

*4 Appointed on 19 February 2015.*

#### **Internal control**

##### **Procedures**

The Directors are responsible for maintaining and reviewing the effectiveness of risk management and internal control systems and for determining the nature and extent of the significant risks it is willing to take in achieving its strategic

objectives. To meet this requirement and to discharge its obligations under the FCA Handbook and PRA Handbook, procedures have been designed for safeguarding assets against unauthorised use or disposal; for maintaining proper accounting records; and for ensuring the reliability and usefulness of financial information used within the business or for publication. These procedures can only provide reasonable but not absolute assurance against material mis-statement, errors, losses or fraud.

These procedures are designed to provide effective internal control within HSBC and accord with the Financial Reporting Council's guidance for directors issued in its revised form in 2005. HSBC's procedures have been in place throughout the year and up to 23 February 2015, the date of approval of the *Annual Report and Accounts 2014*. This guidance was amended following consultations undertaken by the Financial Reporting Council in November 2013 and April 2014, resulting in revised guidance on risk management, internal control and related financial and business reporting. The revised guidance applies to companies with financial years beginning on or after 1 October 2014.

In the case of companies acquired during the year, the risk management and internal controls in place are being reviewed against HSBC's benchmarks and integrated into HSBC's processes.

In 2014 the GAC and GRC endorsed the adoption of the COSO 2013 framework for the monitoring of risk management and internal control systems to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, the UK Corporate Governance Code and the Hong Kong Corporate Governance Code. Full implementation of the COSO 2013 framework will be completed in 2015. HSBC continued to evaluate its internal control over financial reporting under the Financial Reporting Council's Internal Control Revised Guidance for Directors and the original 1992 Framework for the year ended 31 December 2014.

HSBC's key risk management and internal control procedures include the following:

**Group Standards.** Functional, operating, financial reporting and certain management reporting standards are established by global function management committees, for application throughout HSBC. These are supplemented by operating standards set by functional and local management as required for the type of business and geographical location of each subsidiary.

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Corporate Governance (continued)**

**Delegation of authority within limits set by the Board.** Authority is delegated within limits set by the Board to each relevant Group Managing Director to manage the day to day affairs of the business or function for which he or she is accountable. Delegation of authority from the Board requires those individuals to maintain a clear and appropriate apportionment of significant responsibilities and to oversee the establishment and maintenance of systems of control that are appropriate to their business or function. Appointments to the most senior positions within HSBC requires the approval of the Board.

**Risk identification and monitoring.** Systems and procedures are in place to identify, control and report on the major risks facing HSBC (see page 21) including credit, market, liquidity and funding, capital, financial management, model, reputational, pension, strategic, sustainability, operational (including accounting, tax, legal, regulatory compliance, financial crime compliance, fiduciary, security and fraud, systems operations, project and people risk) and insurance risk. Exposure to these risks is monitored by risk management committees, asset, liability and capital management committees and executive committees in subsidiaries and, for the Group, in Risk Management Meetings ( RMM ) of the GMB which are chaired by the Group Chief Risk Officer. RMM meets regularly to discuss enterprise-wide risk management issues. Asset, liability and capital management issues are monitored by the Group ALCO, which also reports to the RMM. HSBC's operational risk profile and the effective implementation of the Group's operational risk management framework is monitored by the Global Operational Risk Committee ( GORC ), which reports to the RMM. Model risks are monitored by the Model Oversight Committee which also reports to the RMM. The minutes of the GMB meetings and the RMM are provided to members of the GAC, the GRC and the Board.

**Changes in market conditions/practices.** Processes are in place to identify new risks arising from changes in market conditions/practices or customer behaviours, which could expose HSBC to heightened risk of loss or reputational damage. During 2014, attention was focused on:

economic outlook and government intervention;

increased geopolitical risk;

regulatory developments affecting our business model and Group profitability;

regulatory investigations, fines, sanctions commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand;

dispute risk;

heightened execution risk;

people risk;

third party risk management;  
internet crime and fraud;

information security risk;

data management; and

model risk.

**Strategic plans.** Periodic strategic plans are prepared for global businesses, global functions and certain geographical regions within the framework of the Group's strategy. Annual Operating Plans, informed by detailed analysis of risk appetite describing the types and quantum of risk that we are prepared to take in executing our strategy, are prepared and adopted by all major HSBC operating companies and set out the key business initiatives and the likely financial effects of those initiatives.

**Disclosure Committee.** The Disclosure Committee reviews material public disclosures made by HSBC Holdings for any material errors, misstatements or omissions. The membership of the Disclosure Committee, which is chaired by the Group Company Secretary, includes the heads of Global Finance, Legal, Risk (including Financial Crime Compliance and Regulatory Compliance), Communications, Investor Relations, and Internal Audit functions and representatives from the principal regions and global businesses. The integrity of disclosures is underpinned by structures and processes within the Global Finance and Global Risk functions that support expert and rigorous analytical review of financial reporting complemented by certified reviews by heads of global businesses, global functions and certain legal entities.

**Financial reporting.** The Group financial reporting process for preparing the consolidated *Annual Report and Accounts 2014* is controlled using documented accounting policies and reporting formats, supported by a chart of accounts with detailed instructions and guidance on reporting requirements, issued by Group Finance to all reporting entities within the Group in advance of each reporting period end. The submission of financial information from each reporting entity to Group Finance is subject to certification by the responsible financial officer, and analytical review procedures at reporting entity and Group levels.

**Responsibility for risk management.** Management of global businesses and global functions are primarily accountable for measuring, monitoring, mitigating and managing their risks and controls. Processes are in place to ensure weaknesses are escalated to senior management and addressed, supported by our three lines of defence model.

**IT operations.** Centralised functional control is exercised over all IT developments and operations. Common systems are employed for similar business processes wherever practicable.

**Functional management.** Global functional management is responsible for setting policies, procedures and standards for the following risks: credit, market, liquidity and funding, capital, financial

HSBC HOLDINGS PLC

289



**Table of Contents****Report of the Directors: Corporate Governance (continued)**

management, model, reputational, pension, strategic, sustainability and operational risk (including accounting, tax, legal, financial crime compliance, regulatory compliance, fiduciary, information security, security and fraud, systems and people risk) and insurance risk. Authorities to enter into credit and market risk exposures are delegated with limits to line management of Group companies. The concurrence of the appropriate global function is required, however, to credit proposals with specified higher risk characteristics. Credit and market risks are measured and reported at subsidiary company level and aggregated for risk concentration analysis on a Group-wide basis.

**Internal Audit.** The establishment and maintenance of appropriate systems of risk management and internal control is primarily the responsibility of business management. The Global Internal Audit function, which is centrally controlled, provides independent and objective assurance in respect of the adequacy of the design and operating effectiveness of the Group's framework of risk management, control and governance processes across the Group, focusing on the areas of greatest risk to HSBC using a risk-based approach. The Group Head of Internal Audit reports to the Chairman of the GAC and administratively to the Group Chief Executive.

**Internal Audit recommendations.** Executive management is responsible for ensuring that recommendations made by the Global Internal Audit function are implemented within an appropriate and agreed timetable. Confirmation to this effect must be provided to Global Internal Audit.

**Reputational risk.** Policies to guide subsidiary companies and management at all levels in the conduct of business to safeguard the Group's reputation are established by the Board and its committees, subsidiary company boards and their committees and senior management. Reputational risks can arise from a variety of causes including environmental, social and governance issues, as a consequence of operational risk events and as a result of employees acting in a manner inconsistent with HSBC Values. HSBC's reputation depends upon the way in which it conducts its business and may be affected by the way in which clients, to which it provides financial services, conduct their business or use financial products and services.

**Role of GAC and GRC**

On behalf of the Board, the GAC has responsibility for oversight of risk management and internal controls over financial reporting and the GRC has responsibility for oversight of risk management and internal controls, other than over financial reporting.

During the year, the GRC and the GAC have kept under review the effectiveness of this system of internal control and have reported regularly to the Board. In carrying out their reviews, the GRC and the GAC receive regular business and operational risk assessments, regular

reports from the Group Chief Risk Officer and the Group Head of Internal Audit; reports on the annual reviews of the internal control framework of HSBC Holdings which cover all internal controls, both financial and non-financial; half yearly confirmations to the GAC from audit and risk committees of principal subsidiary companies regarding whether their financial statements have been prepared in accordance with Group policies, present fairly the state of affairs of

the relevant principal subsidiary, are prepared on a going concern basis; and confirm if there have been any material losses, contingencies or uncertainties caused by weaknesses in internal controls; internal audit reports; external audit reports; prudential reviews; and regulatory reports. The GRC monitors the status of top and emerging risks and considers whether the mitigating actions put in place are appropriate. In addition, when unexpected losses have arisen or when incidents have occurred which indicate gaps in the control framework or in adherence to Group policies, the GRC and the GAC review special reports, prepared at the instigation of management, which analyse the cause of the issue, the lessons learned and the actions proposed by management to address the issue.

### **Effectiveness of internal controls**

The Directors, through the GRC and the GAC, have conducted an annual review of the effectiveness of our system of risk management and internal control covering all material controls, including financial, operational and compliance controls, risk management systems, the adequacy of resources, qualifications and experience of staff of the accounting and financial reporting function and the risk function, and their training programmes and budget. The review does not extend to joint ventures or associates. The annual review of the effectiveness of our system of risk management and internal control was conducted with reference to COSO principles functioning as evidenced by specified entity level controls. A report on the effectiveness of each entity level control and regular risk and control reporting was escalated to the GRC and GAC from certain key management committees.

The GRC and the GAC have received confirmation that executive management has taken or is taking the necessary actions to remedy any failings or weaknesses identified through the operation of our framework of controls.

### **Going concern**

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Group and parent company have the resources to continue in business for the foreseeable future.

In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources.

HSBC's principal activities, business and operating models, strategic direction and top and emerging risks are described in the Strategic Report ; a financial

HSBC HOLDINGS PLC

## **Table of Contents**

### **Report of the Directors: Corporate Governance (continued)**

summary, including a review of the consolidated income statement and consolidated balance sheet, is provided in the Financial Review section; HSBC's objectives, policies and processes for managing credit, liquidity and market risk are described in the Risk section; and HSBC's approach to capital management and allocation is described in the Capital section.

### **Employees**

At 31 December 2014 we had a total workforce of 266,000 full-time and part-time employees compared with 263,000 at the end of 2013 and 270,000 at the end of 2012. Our main centres of employment are the UK with approximately 48,000 employees, India 32,000, Hong Kong 30,000, Brazil 21,000, mainland China 21,000, Mexico 17,000, the US 15,000 and France 9,000.

In the context of the current global financial services operating environment, a high performance and values-led workforce is critical. We encourage open and honest communication in decision making. Employment issues and financial, economic, regulatory and competitive factors affecting HSBC's performance are regularly shared with our employees.

### **Reward**

Our approach to reward is meritocratic and market competitive, underpinned by an ethical and values based performance culture which aligns the interests of our employees, shareholders, regulators and customers.

### **Employee relations**

We negotiate and consult with recognised unions as appropriate. The five highest concentrations of union membership are in Argentina, Brazil, mainland China, Malta and Mexico. It is our policy to maintain well-developed communications and consultation programmes with all employee representative bodies and there have been no material disruptions to our operations from labour disputes during the past five years.

### **Diversity and inclusion**

HSBC is committed to building a values-driven high performance culture where all employees are valued, respected and where their opinions count. We remain committed to meritocracy, which requires a diverse and inclusive culture where employees believe that their views are heard, their concerns are attended to and they work in an environment where bias, discrimination and harassment on any matter, including gender, age, ethnicity, religion, sexuality and disability are not tolerated and where advancement is based on objective criteria. Our inclusive culture helps us respond to our diverse customer base, while developing and retaining a secure supply of skilled, committed employees. Our culture will be strengthened by employing the best people and optimising their ideas, abilities and differences.

Oversight of our diversity and inclusion agenda and related activities resides with executives on the Group Diversity Committee, complemented by the Group People Committee and local People/Diversity Committees.

## **Employee development**

The development of employees in both developed and emerging markets is essential to the future strength of our business. We have implemented a systematic approach to identifying, developing and deploying talented employees to ensure an appropriate supply of high calibre individuals with the values, skills and experience for current and future senior management positions.

In 2014, we continued to build global consistency across our learning curricula and to improve the relevance and quality of learning programmes. We have endeavoured to achieve a standard of excellence focusing on leadership, values and technical capability.

## **Employment of disabled persons**

We believe in providing equal opportunities for all employees. The employment of disabled persons is included in this commitment and the recruitment, training, career development and promotion of disabled persons is based on the aptitudes and abilities of the individual. Should employees become disabled during their employment with us, efforts are made to continue their employment and, if necessary, appropriate training and reasonable equipment and facilities are provided.

## **Health and safety**

HSBC is committed to providing a safe and healthy environment for our employees, customers and visitors and pro-actively managing the health and safety risks associated with our business. Our objectives include compliance with health and safety laws in the countries in which we operate, identifying, removing, reducing or controlling material health and safety risks, reducing the likelihood of fires, dangerous occurrences and accidents to employees, customers and visitors.

The Corporate Real Estate department within HSBC has overall responsibility for health and safety and has set global health and safety policies and standards for use wherever in the world HSBC operates. Achieving these policies and standards is the responsibility of the country Chief Operating Officer.

In terms of physical and geopolitical risk, Global Security and Fraud Risk provide regular security risk assessments to assist management in judging the level of terrorist and violent criminal threat. Regional Security and Fraud Risk functions conduct biannual security reviews of all Group critical buildings to ensure measures to protect our staff, buildings, assets and information are appropriate to the level of threat.

HSBC remains committed to the effective management of health and safety and protecting employees, customers and visitors to HSBC.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Corporate Governance (continued)***Employee health and safety*

	2014	2013	2012
Number of employee workplace fatalities	2 <sup>1</sup>		
Accidents involving more than 3 days absence per 100,000 employees	96	101	58
All accident rate per 100,000 employees	388 <sup>2</sup>	355	375

1 *Non-HSBC staff working on HSBC related activity.*

2 *Reflects higher reporting rate.*

**Remuneration policy**

The quality and commitment of our employees is fundamental to our success and accordingly the Board aims to attract, retain and motivate the very best people. As trust and relationships are vital in our business our goal is to recruit those who are committed to making a long-term career with the organisation.

HSBC's reward strategy supports this objective through balancing both short-term and sustainable performance. Our reward strategy aims to reward success, not failure, and be properly aligned with our risk framework and related outcomes. In order to ensure alignment between remuneration and our business strategy, individual remuneration is determined through assessment of performance delivered against both annual and long-term objectives summarised in performance scorecards as well as adherence to the HSBC Values of being open, connected and dependable and acting with courageous integrity. Altogether, performance is judged, not only on what is achieved over the short and long term, but also on how it is achieved, as the latter contributes to the sustainability of the organisation.

The financial and non-financial measures incorporated in the annual and long-term scorecards are carefully considered to ensure alignment with the long-term strategy of the Group.

*Further information on the Group's approach to remuneration is given on page 300.*

**Employee share plans**

Share options and discretionary awards of shares granted under HSBC share plans align the interests of employees with those of shareholders. The tables on the following pages set out the particulars of outstanding options, including those held by employees working

under employment contracts that are regarded as continuous contracts for the purposes of the Hong Kong Employment Ordinance. The options were granted at nil consideration. No options have been granted to substantial shareholders, suppliers of goods or services, or in excess of the individual limit for each share plan. No options were cancelled by HSBC during the year.

A summary for each plan of the total number of the options which were granted, exercised or lapsed during 2014 is shown in the following tables. Further details required to be disclosed pursuant to Chapter 17 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited are available on our website at [www.hsbc.com/investor-relations/governance/ share-plans](http://www.hsbc.com/investor-relations/governance/share-plans) and on the website of The Stock Exchange of Hong Kong Limited at [www.hkex.com.hk](http://www.hkex.com.hk) or can be obtained upon request from the Group Company Secretary, 8 Canada Square, London E14 5HQ. Particulars of options held by Directors of HSBC Holdings are set out on page 321.

*Note 6 on the Financial Statements gives details on share-based payments, including discretionary awards of shares granted under HSBC share plans.*

#### All-employee share plans

All-employee share option plans have operated within the Group and eligible employees have been granted options to acquire HSBC Holdings ordinary shares. Options under the plans are usually exercisable after three or five years. The exercise of options may be advanced to an earlier date in certain circumstances, for example on retirement, and may be extended in certain circumstances, for example on the death of a participant, the executors of the participant's estate may exercise options up to six months beyond the normal exercise period. The middle market closing price for HSBC Holdings ordinary shares quoted on the London Stock Exchange, as derived from the Daily Official List on 22 September 2014, the day before options were granted in 2014, was £6.58. There will be no further grants under the HSBC Holdings Savings-Related Share Option Plan: International. A new international all-employee share purchase plan was launched in the third quarter of 2013. The all-employee share option plans will terminate on 27 May 2015 unless the Directors resolve to terminate the plans at an earlier date.

HSBC HOLDINGS PLC

**Table of Contents****Report of the Directors: Corporate Governance** (continued)*HSBC Holdings All-employee Share Option Plans*

						HSBC Holdings ordinary shares				
Dates of awards		Exercise price		Exercisable		At	Granted	Exercised <sup>1</sup>	Lapsed	At
from	to	from	to	from	to	1 Jan 2014	during year	during year	during year	31 Dec 2014
<b>Savings-Related Share Option Plan</b>										
30 Apr 2008	23 Sep 2014	(£)	(£)	1 Aug 2013	1 May 2020	53,950,886	28,688,703	25,097,425	3,798,209	53,743,955
<b>Savings-Related Share Option Plan: International</b>										
30 Apr 2008	24 Apr 2012	(£)	(£)	1 Aug 2013	1 Feb 2018	10,022,450		5,625,183	683,208	3,714,059
30 Apr 2008	24 Apr 2012	(US\$)	(US\$)	1 Aug 2013	1 Feb 2018	3,997,069		1,528,838	600,903	1,867,328
30 Apr 2008	24 Apr 2012	( )	( )	1 Aug 2013	1 Feb 2018	1,574,652		935,177	67,973	571,502
30 Apr 2008	24 Apr 2012	(HK\$)	(HK\$)	1 Aug 2013	1 Feb 2018	24,215,341		17,206,998	539,561	6,468,782

1 The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.36.

**Discretionary Share Option Plans**

There have been no grants of discretionary share options under employee share plans since 30 September 2005.

						HSBC Holdings ordinary shares			
Dates of awards		Exercise price		Exercisable		At	Exercised	Lapsed	At
from	to	from	to	from	to	1 Jan 2014	during year	during year	31 Dec 2014
<b>HSBC Holdings Group Share Option Plan<sup>1,2</sup></b>									
30 Apr 2005	20 Apr 2005	7.2181	7.5379	30 Apr 2007	20 Apr 2015	55,025,868	1,434	48,650,452	6,373,982

2004					
<b>HSBC Share Plan<sup>1</sup></b>					
30 Sep					
2005	7.9911	30 Sep 2008	30 Sep 2015	<b>86,046</b>	<b>86,046</b>

- 1 *The HSBC Holdings Group Share Option Plan expired on 26 May 2005 and the HSBC Share Plan expired on 27 May 2011. No options have been granted under the Plan since that date.*
- 2 *The weighted average closing price of the shares immediately before the dates on which options were exercised was £6.09.*

### Other disclosures

Further information about share capital, Directors' interests, dividends and shareholders, and employee diversity is set out in the Appendix to this section on page 294.

### Annual General Meeting

All Directors listed on pages 264 to 268 attended the Annual General Meeting in 2014, with the exception of Heidi Miller and Phillip Ameen who were appointed Directors on 1 September 2014 and 1 January 2015 respectively.

Our Annual General Meeting in 2015 will be held at the Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE on Friday 24 April 2015 at 11.00am.

An informal meeting of shareholders will be held at 1 Queen's Road Central, Hong Kong on Monday 20 April 2015 at 4.30pm.

A live webcast of the Annual General Meeting will be available on [www.hsbc.com](http://www.hsbc.com). A recording of the proceedings will be available shortly after the conclusion of the Annual General Meeting until 22 May 2015 on [www.hsbc.com](http://www.hsbc.com).

On behalf of the Board

**D J Flint**

*Group Chairman*

HSBC Holdings plc

Registered number 617987

23 February 2015

HSBC HOLDINGS PLC



## **Table of Contents**

### **Report of the Directors: Corporate Governance (continued)**

### **Appendix to Corporate Governance Other disclosures**

#### **Share capital**

##### **Issued share capital**

The nominal value of HSBC Holdings issued share capital paid up at 31 December 2014 was US\$9,608,951,630 divided into 19,217,874,260 ordinary shares of US\$0.50 each, 1,450,000 non-cumulative preference shares of US\$0.01 each and 1 non-cumulative preference share of £0.01.

The percentage of the nominal value of HSBC Holdings total issued share capital paid up at 31 December 2014 represented by the ordinary shares of US\$0.50 each, non-cumulative preference shares of US\$0.01 each and the non-cumulative preference share of £0.01 was approximately 99.9998%, 0.0002%, and 0%, respectively.

##### **Rights and obligations attaching to shares**

The rights and obligations attaching to each class of shares in our share capital are set out in our Articles of Association subject to certain rights and obligations that attach to each class of preference share as determined by the Board prior to allotment of the relevant preference shares. Set out below is a summary of the rights and obligations attaching to each class of shares with respect to voting, dividends, capital and, in the case of the preference shares, redemption.

To be registered, a transfer of shares must be in relation to shares which are fully paid up and on which we have no lien and to one class of shares denominated in the same currency. The transfer must be in favour of a single transferee or no more than four joint transferees and it must be duly stamped (if required). The transfer must be delivered to our registered office or our Registrars accompanied by the certificate to which it relates or such other evidence that proves the title of the transferor.

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

#### **Ordinary shares**

Subject to the Companies Act 2006 and the Articles of Association HSBC Holdings may, by ordinary resolution, declare dividends to be paid to the holders of ordinary shares, though no dividend shall exceed the amount

recommended by the Board. The Board may pay interim dividends as appears to the Board to be justified by the profits available for distribution. All dividends shall be apportioned and paid proportionately to the percentage of the nominal amount paid up on the shares during any portion or portions of the period in respect of which the dividend is paid, but if any share is issued on terms providing that it shall rank for dividend as from a particular date, it shall rank for dividend accordingly. Subject to the Articles of Association, the Board may, with the prior authority of an ordinary resolution passed by the shareholders and subject to such terms and conditions as the Board may determine, offer to any holders of ordinary shares the right to elect to receive ordinary shares of the same or a different currency, credited as fully paid, instead of cash in any currency in respect of the whole (or some part, to be determined by the Board) of any dividend specified by the ordinary resolution. At the 2012 Annual General Meeting shareholders gave authority to the Directors to offer a scrip dividend alternative until the earlier of the conclusion of the Annual General Meeting in 2017 or 24 May 2017.

*Further information on the policy adopted by the Board for paying interim dividends on the ordinary shares can be found on page 458.*

### **Preference shares**

There are three classes of preference shares in the share capital of HSBC Holdings, non-cumulative preference shares of US\$0.01 each (the dollar preference shares), non-cumulative preference shares of £0.01 each (the sterling preference shares) and non-cumulative preference shares of 0.01 (the euro preference shares). The Dollar Preference Shares in issue are Series A dollar preference shares and the sterling preference share in issue is a Series A sterling preference share. There are no euro preference shares in issue.

#### *Dollar Preference Shares*

Holders of the dollar preference shares are only entitled to attend and vote at general meetings if any dividend payable on the relevant preference shares in respect of such period as the Board shall determine prior to allotment thereof is not paid in full or in such other circumstances, and upon and subject to such terms, as the Board may determine prior to allotment of the relevant preference shares. In the case of the dollar preference shares in issue at 23 February 2015 the relevant period determined by the Board is four consecutive dividend payment dates. Whenever holders of the dollar

HSBC HOLDINGS PLC

---

**Table of Contents****Report of the Directors: Corporate Governance (continued)**

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

Subject to the Articles of Association, holders of the dollar preference shares have the right to a non-cumulative preferential dividend at such rate, on such dates and on such other terms and conditions as may be determined by the Board prior to allotment thereof in priority to the payment of any dividend to the holders of ordinary shares and any other class of shares of HSBC Holdings in issue (other than (i) the other preference shares in issue and any other shares expressed to rank *pari passu* therewith as regards income; and (ii) any shares which by their terms rank in priority to the relevant preference shares as regards income). A dividend of US\$62 per annum is payable on each dollar preference share in issue at 23 February 2015. The dividend is paid at the rate of US\$15.50 per quarter at the sole and absolute discretion of the Board.

The dollar preference shares carry no rights to participate in the profits or assets of HSBC Holdings other than as set out in the Articles of Association and subject to the Companies Act 2006, do not confer any right to participate in any offer or invitation by way of rights or otherwise to subscribe for additional shares in HSBC Holdings, do not confer any right of conversion and do not confer any right to participate in any issue of bonus shares or shares issued by way of capitalisation of reserves.

Subject to the relevant insolvency laws and the Articles of Association of HSBC Holdings, holders of the dollar preference shares have the right in a winding up of HSBC Holdings to receive out of the assets of HSBC Holdings available for distribution to its shareholders, in priority to any payment to the holders of the ordinary shares and any other class of shares of HSBC Holdings in issue (other than (i) the other relevant preference shares and any other shares expressed to rank *pari passu* there with as regards repayment of capital; and (ii) any shares which by their terms rank in priority to the relevant preference shares as regards repayment of capital), a sum equal to any unpaid dividend on the dollar preference shares which is payable as a dividend in accordance with or pursuant to the Articles of Association and the amount paid up or credited as paid up on the dollar preference shares together with such premium (if any) as may be determined by the Board prior to allotment thereof. In the case of the dollar preference shares in issue at 23 February 2015, the premium is US\$999.99 per dollar preference share.

The dollar preference shares may be redeemed in accordance with the Articles of Association and the terms on which dollar preference shares were issued and allotted. In the case of the dollar preference shares in issue at 23 February 2015, HSBC Holdings may redeem such shares in whole at any time on or after 16 December 2010, subject to the prior consent of the PRA.

*Sterling Preference Shares*

The sterling preference shares carry the same rights and obligations under the Articles of Association as the dollar preference shares, save in respect of certain rights and obligations that attach to sterling preference shares to be determined by the Board prior to allotment of the relevant preference shares and the timing and payment of proceeds from the redemption of each class of share. The one sterling preference share in issue at 23 February 2015 carries the

same rights and obligations as the dollar preference shares in issue at 23 February 2015 to the extent described in the section above save as follows:

- 1 the holder of the sterling preference share is not entitled to attend or vote at general meetings;
- 2 the sterling preference share may be redeemed in whole on any date as may be determined by the Board; and
- 3 the exceptions to the circumstances in which a dividend will not be declared or paid do not apply.  
A dividend of £0.04 per annum is payable on the sterling preference share in issue at 23 February 2015. The dividend is paid at the rate of £0.01 per quarter at the sole and absolute discretion of the Board.

*Euro Preference Shares*

The euro preference shares carry the same rights and obligations under the Articles of Association as the dollar preference shares, save in respect of certain rights and obligations that attach to euro preference shares which are to be determined by the Board prior to allotment of the relevant preference shares and the timing and payment of proceeds from the redemption of each class of share.

HSBC HOLDINGS PLC

295

**Table of Contents****Report of the Directors: Corporate Governance (continued)****Share capital during 2014**

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

*Scrip dividends*

Issued in lieu of	HSBC Holdings		Aggregate		
	ordinary shares issued on	number	nominal value US\$	Market value per share US\$	£
Fourth interim dividend for 2013	30 April 2014	184,047,509	92,023,755	9.9254	5.9788
First interim dividend for 2014	10 July 2014	27,302,240	13,651,120	10.3980	6.1996
Second interim dividend for 2014	9 October 2014	34,787,645	17,393,823	10.6850	6.4478
Third interim dividend for 2014	10 December 2014	22,338,589	11,169,295	10.1178	6.2750

*All-Employee share plans*

	Number	Aggregate		Exercise price	
		nominal value US\$		from	to
<b>HSBC Holdings savings-related share option plans</b>					
HSBC ordinary shares issued in £	30,722,608	15,361,304	£	3.3116	5.9397
HSBC ordinary shares issued in HK\$	17,206,998	8,603,499	HK\$	37.8797	92.5881
HSBC ordinary shares issued in US\$	1,528,838	764,419	US\$	4.8876	11.8824
HSBC ordinary shares issued in	935,177	467,589		3.6361	7.5571
Options over HSBC ordinary shares lapsed	5,689,854	2,844,927			
Options over HSBC ordinary shares granted in response to approximately 24,000 applications from HSBC employees in the UK on	28,688,703	14,344,352			

23 September 2014

**HSBC International Employee Share Purchase Plan****Plan d Epargne**

HSBC ordinary shares issued for the benefit of non-UK resident employees of HSBC France and its subsidiaries

	6,470	3,235	£	5,9290
				6.5770
	1,763,449	881,725		6.7073

*Discretionary share incentive plans*

	HSBC Holdings ordinary shares issued	Aggregate nominal value US\$	Exercise price		Options lapsed
			from (£)	to (£)	
<b>Options exercised under:</b> The HSBC Holdings Group Share Option Plan	1,434	717	7.2181	7.5379	48,650,452

*HSBC share plans*

	HSBC Holdings ordinary shares issued	Aggregate nominal value US\$	Market value per share	
			from (£)	to (£)
Vesting of awards under the HSBC Share Plan and HSBC Share Plan 2011	67,226,264	33,613,132	5.9180	6.6040

**Authorities to allot and to purchase shares**

At the Annual General Meeting in 2014, shareholders renewed the general authority for the Directors to allot new shares up to 12,576,146,960 ordinary shares, 15,000,000 non-cumulative preference shares of £0.01 each, 15,000,000 non-cumulative preference shares of US\$0.01 each and 15,000,000 non-cumulative preference shares of 0.01 each. Within this, the Directors have authority to allot up to a maximum of 943,211,022 ordinary shares wholly for cash to persons other than existing shareholders. Shareholders also renewed the authority for the Directors to make market purchases of up to 1,886,422,044 ordinary shares. The Directors have not exercised this authority.

In addition, shareholders gave authority for the Directors to grant rights to subscribe for, or to convert any security into no more than 4,500,000,000 ordinary shares in relation to any issue by HSBC Holdings or any member of the Group of contingent convertible securities that automatically convert into or are exchanged for ordinary shares in HSBC Holdings in prescribed circumstances. Further details about the issue of contingent convertible securities can be found in Note 35 on the Financial Statements.

Other than as described in the table above headed "Share capital during 2014", the Directors did not allot any shares during 2014.



**Table of Contents****Report of the Directors: Corporate Governance (continued)****Treasury shares**

In accordance with the terms of a waiver granted by the Hong Kong Stock Exchange on 19 December 2005, HSBC Holdings will comply with the applicable law and regulation in the UK in relation to the holding of any shares in treasury and with the conditions of the waiver in connection with any shares it may hold in treasury. Pursuant to Chapter 6 of the UK Companies Act 2006 no shares are currently held in treasury.

**Directors' interests**

Pursuant to the requirements of the UK Listing Rules and according to the register of Directors' interests maintained by HSBC Holdings pursuant to section 352 of the Securities and Futures Ordinance of Hong Kong, the Directors of HSBC Holdings at 31 December 2014 had the following interests, all beneficial unless otherwise stated, in the shares and loan capital of HSBC Holdings and its associated corporations:

*Directors' interests - shares and loan capital*

	At 31 December 2014					Total interests <sup>1</sup>
	At 1 January 2014	Beneficial owner	Child under 18 or spouse	Jointly with another person	Trustee	
<b>HSBC Holdings ordinary shares</b>						
Safra Catz <sup>3</sup>		20,045				20,045
Lord Evans of Weardale	1,495	5,519				5,519
Joachim Faber	10,605	24,105				24,105
Rona Fairhead	21,858			76,524		76,524
Douglas Flint	392,664	400,748				400,748
Stuart Gulliver	2,730,477	2,434,303	176,885			2,611,188
	35,123	35,352			1,416 <sup>2</sup>	36,768



Sam Laidlaw John Lipsky <sup>3</sup>	15,525	15,820				15,820
Rachel Lomax Iain Mackay		15,500				15,500
Heidi Miller <sup>3</sup>		3,575				3,575
Marc Moses	400,753	480,423				480,423
Sir Simon Robertson	9,912	22,981				22,981
Jonathan Symonds		15,940	4,613			20,553
	<b>RMBm</b>	<b>RMBm</b>	<b>RMBm</b>	<b>RMBm</b>	<b>RMBm</b>	<b>RMBm</b>
<b>HSBC Bank 2.875% Notes 2015</b>						
Joachim Faber <sup>4</sup>	5.1					5.1

1 *Executive Directors* other interests in HSBC Holdings ordinary shares arising from the HSBC Holdings savings-related share option plans, the HSBC Share Plan and the HSBC Share Plan 2011 are set out in the Scheme interests in the Directors Remuneration Report on page 320. At 31 December 2014, the aggregate interests under the Securities and Futures Ordinance of Hong Kong in HSBC Holdings ordinary shares, including interests arising through employee share plans were: Douglas Flint 405,683; Stuart Gulliver 5,175,003; Marc Moses 1,775,461; and Iain Mackay 1,086,284. Each Director's total interests represents less than 0.03% of the shares in issue.

2 *Non-beneficial.*

3 *Safra Catz has an interest in 4,009, John Lipsky has an interest in 3,164 and Heidi Miller has an interest in 715 listed American Depositary Shares ( ADS ), which are categorised as equity derivatives under Part XV of the Securities and Futures Ordinance of Hong Kong. Each ADS represents five HSBC Holdings ordinary shares.*

4 *Non-beneficial interest in renminbi ( RMB ) 1.2m 2.875% Notes 2015.*

No Directors held any short position as defined in the Securities and Futures Ordinance of Hong Kong in the shares and loan capital of HSBC Holdings and its associated corporations. Save as stated above, none of the Directors had an interest in any shares or debentures of HSBC Holdings or any associated corporation at the beginning or at the end of the year, and none of the Directors or members of their immediate families were awarded or exercised any right to subscribe for any shares or debentures in any HSBC corporation during the year.

Since the end of the year, the aggregate interests of the following Director has increased by the number of HSBC Holdings ordinary shares shown against his name:

#### HSBC Holdings ordinary shares

1 *The acquisition of shares in the HSBC Holdings UK Share Incentive Plan through regular monthly contributions.* There have been no other changes in the share and loan capital interests of the Directors from 31 December 2014 to the date of this report. Any subsequent changes up to the last practicable date before the publication of the *Notice of Annual General Meeting* will be set out in the notes to that notice.

At 31 December 2014, non-executive Directors and senior management (being executive Directors and Group Managing Directors of HSBC Holdings) held, in aggregate, beneficial interests in 17,531,530 HSBC Holdings ordinary shares (0.09% of the issued ordinary shares).

HSBC HOLDINGS PLC

297

---

**Table of Contents****Report of the Directors: Corporate Governance (continued)**

At 31 December 2014, executive Directors and senior management held, in aggregate, options to subscribe for 28,288 of HSBC Holdings ordinary shares under the HSBC Holdings savings-related share option plans and HSBC Holdings Group Share Option Plan. These options are exercisable between 2015 and 2020 at prices ranging from £4.4621 to £5.1887 per ordinary share.

**Dividends and shareholders****Dividends for 2014**

First, second and third interim dividends for 2014, each of US\$0.10 per ordinary share, were paid on 10 July 2014, 9 October 2014 and 10 December 2014 respectively. Note 9 on the Financial Statements gives more information on the dividends declared in 2014. On 23 February 2015, the Directors declared a fourth interim dividend for 2014 of US\$0.20 per ordinary share in lieu of a final dividend, which will be payable on 30 April 2015 in cash in US dollars, or in sterling or Hong Kong dollars at exchange rates to be determined on 20 April 2015, with a scrip dividend alternative. As the fourth interim dividend for 2014 was declared after 31 December 2014 it has not been included in the balance sheet of HSBC as a debt. The reserves available for distribution at 31 December 2014 were US\$48,883m.

A quarterly dividend of US\$15.50 per 6.20% non-cumulative US dollar preference share, Series A ( Series A dollar preference share ), (equivalent to a dividend of US\$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A dollar preference share), was paid on 17 March, 16 June, 15 September and 15 December 2014.

**Dividends for 2015**

Quarterly dividends of US\$15.50 per Series A dollar preference share (equivalent to a dividend of US\$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A dollar preference share) and £0.01 per Series A sterling preference share were declared on 9 February 2015 for payment on 16 March 2015.

**Communication with shareholders**

Communication with shareholders is given high priority. The Board has adopted a shareholder communication policy which is available on [www.hsbc.com](http://www.hsbc.com). Extensive information about our activities is provided to shareholders in the *Annual Report and Accounts*, the *Strategic Report* and the *Interim Report* which are available on [www.hsbc.com](http://www.hsbc.com). There is regular dialogue with institutional investors and enquiries from individuals on matters relating to their shareholdings and our business are welcomed and are dealt with in an informative and timely manner. All shareholders are encouraged to attend the Annual General Meeting or the informal meeting of shareholders held in Hong Kong to discuss our progress. Shareholders may send enquiries to the Board in writing to the Group Company Secretary, HSBC Holdings plc, 8 Canada Square, London E14 5HQ or by sending an email to [shareholderquestions@hsbc.com](mailto:shareholderquestions@hsbc.com).

Shareholders may require the Directors to call a general meeting, other than an annual general meeting as provided by the UK Companies Act 2006. Requests to call a general meeting may be made by members representing at least 5% of the paid-up capital of the Company as carries the right of voting at general meetings of HSBC Holdings (excluding any paid-up capital held as treasury shares). A request must state the general nature of the business to be dealt with at the meeting and may include the text of a resolution that may properly be moved and is intended to be moved at the meeting. A resolution may properly be moved at a meeting unless it would, if passed, be ineffective (whether by reason of inconsistency with any enactment or the Company's constitution or otherwise); it is defamatory of any person; or it is frivolous or vexatious. A request may be in hard copy form or in electronic form and must be authenticated by the person or persons making it. A request may be made in writing to the postal address referred to in the paragraph above or by sending an email to [shareholderquestions@hsbc.com](mailto:shareholderquestions@hsbc.com). At any meeting convened on such request no business shall be transacted except that stated by the requisition or proposed by the Board.

### Notifiable interests in share capital

At 31 December 2014, we had received the following disclosures (which have not been subsequently changed) of major holdings of voting rights pursuant to the requirements of Rule 5 of the FCA Disclosure Rules and Transparency Rules:

Legal & General Group Plc gave notice on 10 July 2013 that on 9 July 2013 its holding of HSBC Holdings ordinary shares fell below 3.00% of the total voting rights at that date; and

BlackRock, Inc. gave notice on 9 December 2009 that on 7 December 2009 it had the following: an indirect interest in HSBC Holdings ordinary shares of 1,142,439,457; qualifying financial instruments with 705,100 voting rights that may be acquired if the instruments are exercised or converted; and financial instruments with similar economic effect to qualifying financial instruments which refer to 234,880 voting rights, each representing 6.56%, 0.0041% and 0.0013%, respectively, of the total voting rights at that date.

At 31 December 2014, according to the register maintained by HSBC Holdings pursuant to section 336 of the Securities and Futures Ordinance of Hong Kong:

JPMorgan Chase & Co. gave notice on 21 November 2014 that on 18 November 2014 it had the following interests in HSBC Holdings ordinary shares: a long position of 937,591,714 shares; a short position of 99,085,113 shares; and a lending pool of 527,117,024 shares, each representing 4.88%, 0.51% and 2.74%, respectively, of the ordinary shares in issue at that date; and

HSBC HOLDINGS PLC

**Table of Contents**

**Report of the Directors: Corporate Governance (continued)**

BlackRock, Inc. gave notice on 28 October 2014 that on 24 October 2014 it had the following interests in HSBC Holdings ordinary shares: a long position of 1,238,135,870 shares and a short position of 4,572,291 shares, each representing 6.45% and 0.02%, respectively, of the ordinary shares in issue at that date.

In compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited at least 25% of the total issued share capital has been held by the public at all times during 2014 and up to the date of this report.

**Dealings in HSBC Holdings listed securities**

Except for dealings as intermediaries by HSBC Bank and The Hongkong and Shanghai Banking Corporation, which are members of a European Economic Area exchange, neither HSBC Holdings nor any of its subsidiaries have purchased, sold or redeemed any of its securities listed on The Stock Exchange of Hong Kong Limited during the year ended 31 December 2014.

HSBC HOLDINGS PLC

**Table of Contents****Directors Remuneration Report**

<b>Directors Remuneration Report</b>	<b>Page</b>	<b>App<sup>1</sup></b>
<b><u>Annual Statement from the Group Remuneration Committee Chairman</u></b>	300	
<u>Our remuneration strategy and key decisions for 2014</u>	300	
<u>Major decisions on Directors remuneration</u>	302	
<u>Future regulatory change</u>	302	
<b><u>Directors remuneration policy</u></b>	303	
<u>Downward override policy</u>	304	
<u>Differences in policy applied to employees generally</u>	304	
<u>Material factors taken into account when setting pay policy</u>	305	
<u>Adjustments, malus and clawback</u>	306	
<u>Remuneration policy non-executive Directors</u>	306	
<u>Service contracts</u>	306	
<u>Other directorships</u>	307	

<u><b>Annual report on remuneration</b></u>	307
<u>Remuneration Committee</u>	307
<u>Group variable pay pool</u>	309
<u>Single figure of remuneration</u>	311
<u>Remuneration scenarios and outcomes</u>	313
<u>Awards under the GPSP</u>	314
<u>Determining executive Directors' annual performance</u>	315
<u>Total pension entitlements</u>	318
<u>Payments to past Directors</u>	318
<u>Exit payments made in year</u>	318
<u>Scheme interests awarded during 2014</u>	318
<u>Summary of performance</u>	319
<u>CEO remuneration</u>	319
<u>Directors' interests in shares</u>	320
<u>Shareholder context</u>	322
<u>Implementation of remuneration policy in 2015</u>	322
<u>Annual bonus scorecards</u>	323

<u><b>Additional disclosures</b></u>	324
<u>Employee compensation and benefits</u>	324
<u>Emoluments of senior management</u>	324
<u>Emoluments of five highest paid employees</u>	325
<u>Remuneration of eight highest paid senior executives</u>	325
<u>Pillar 3 remuneration disclosures</u>	326

*1 Appendix to Directors Remuneration Report.*

**Annual Statement from the Group Remuneration Committee Chairman**

Dear Shareholder,

I am very pleased to present the Remuneration Report for 2014. In this report we provide details of the HSBC remuneration policy, what we paid our Directors in 2014 and why.

This is the first year in which our remuneration policy, which was approved at last year's Annual General Meeting, has been implemented. I hope this report will give you an understanding of how the Group Remuneration Committee (the Committee) implemented the policy in 2014 and, more importantly, the link between the performance and pay of our executives and the long-term interests of our shareholders.

The report is divided into three sections: my letter to you as Chairman of the Committee, a summary of our remuneration policy, and an annual report on what we paid our Directors for the year ended 31 December 2014. Additional remuneration-related disclosures are provided in the appendix to this report.

**Our remuneration strategy and key decisions for 2014**

Our remuneration strategy is designed to reward competitively the achievement of long-term sustainable performance and attract and motivate the very best people who are committed to a long-term career with the Group in the long-term interests of our shareholders.

The Committee believes that it is important that what we pay our people is aligned to our business strategy. Performance should be judged not only on what is achieved over the short and long-term but also, importantly, on how it is achieved, as we believe the latter contributes to the long-term sustainability of the business.

In 2014, new regulatory requirements were introduced under the EU's Capital Requirements Directive (CRD) IV. The consequential changes to the remuneration rules of the Prudential Regulation Authority (PRA) have influenced how



we pay our senior executives and those of our employees identified by the PRA as having a material impact on the institution's risk profile, being what are termed Material Risk Takers ( MRTs ).

From 2014, CRD IV introduced a cap on variable pay requiring banks in the EU, including HSBC, to restrict variable pay awards of MRTs, if approved by shareholders, to 200% of fixed pay. This authority was sought and given by shareholders at last year's Annual General Meeting.

The CRD IV requirements present challenges for HSBC in ensuring that the total compensation package for our employees in all of the markets in which we operate around the world remains competitive, in particular, relative to other banks not subject to these requirements.

HSBC HOLDINGS PLC

300

---

**Table of Contents****Directors Remuneration Report** (continued)

As a consequence, we introduced fixed pay allowances for our executive Directors and other MRTs to rebalance the fixed and variable components of their total compensation. The Committee believes that the introduction of fixed pay allowances as a component of remuneration was essential to ensure the total compensation package for our employees remains competitive. HSBC must continue to retain and attract talent in key non-EU markets where our international peers and their domestic competitors do not have to comply with the CRD IV pay cap. As required by CRD IV, fixed pay allowances are not linked to the achievement of any performance conditions and we comply with the current guidelines which have been issued by the regulators. Our executive Directors and senior executives receive this allowance in shares which are subject to a retention period in order to maintain a close alignment with the long-term interests of our shareholders.

In July 2014, the PRA introduced a new requirement for firms to ensure that clawback (i.e. a firm's ability to recoup paid and/or vested awards) can be applied to variable pay awards granted on or after 1 January 2015 for a period of at least seven years from the date of award. This requirement is in addition to a firm's ability

to apply malus (i.e. reduction or cancellation of unvested awards prior to the vesting of such awards) in certain circumstances.

To comply with the new PRA requirement, the Committee has established a clawback policy which will apply to all awards we grant to MRTs on or after 1 January 2015. More details of the circumstances in which malus and clawback can be applied is provided later in this report.

The Committee has also adopted a policy enabling it to exercise its discretion to reduce variable pay awards for executive Directors and other senior executives when it believes there has been insufficient yearly progress in developing an effective anti-money laundering and sanctions compliance programme.

In 2014, there were a number of legal and regulatory costs for legacy events, including penalties arising from the investigation of certain behaviour within the foreign exchange markets. These were fully reflected in the level of profits used by the Committee to determine the incentive pool, and resulted in a US\$600m adjustment to the pool. Additionally, there were a number of actions taken, including discretion applied to reduce variable pay proposed for 2014 for Group employees by US\$22m, including members of senior management. More details are provided later in this report.

*Overall performance summary/business context*

**HSBC Holdings plc**

In 2014, the Group maintained a strong balance sheet and robust capital position. Excluding the effect of currency translation, loans and advances grew by US\$28bn and customer accounts increased by US\$47bn, with a ratio of customer advances to customer accounts of 72%.

Profit before tax fell on a reported basis compared with 2013, primarily reflecting lower gains from disposals and reclassifications in 2014 and the effect of other significant items, which included provisions for fines, settlements and UK customer redress of US\$3.7bn. On an adjusted basis, excluding the effect of significant items and currency translation, profit before tax was broadly unchanged from 2013.

Adjusted profit before tax was up in three out of five regions.

CMB reported a record profit in 2014.

Revenue on an adjusted basis was broadly unchanged from 2013. This reflected growth in CMB offset by a fall in revenue in GB&M, together with lower revenue in RBWM and GPB reflecting the remodelling of these businesses.

Net interest margin for the Group stabilised during 2014.

Loan impairment charges were lower, reflecting the changes to our portfolio since 2011.

The reported cost efficiency ratio increased from 59.6% in 2013 to 67.3% in 2014, and on an adjusted basis it increased to 61.1% in 2014 from 57.7%, principally reflecting higher operating expenses due to an increase in Regulatory Programmes and Compliance costs, inflationary pressures, continued investment in strategic initiatives, and a rise in the bank levy. These factors were partly offset by sustainable cost savings in the year of US\$1.3bn.

The return on average ordinary shareholders' equity was 7.3%, down from 9.2% in 2013, primarily reflecting lower gains from disposals and reclassifications, together with higher operating expenses, including provisions for fines, settlements and UK customer redress.

Dividends in respect of 2014 increased from US\$0.49 per ordinary share in 2013 to US\$0.50 per ordinary share.

Our capital position strengthened in 2014 with our CRD IV transitional CET1 ratio increasing to 10.9% from 10.8% in 2013.

**RBWM**

Lower reported profit before tax was principally driven by lower revenue from the continued run-off of our US CML portfolio and higher operating expenses in our Principal RBWM business.

**CMB**

CMB reported an increase in profit before tax reflecting higher revenue performance in our home markets of Hong Kong and the UK, together with lower LICs, mainly in Europe and Latin America.

**GB&M**

GB&M reported lower profit before tax, mainly reflecting an increase in significant items, notably settlements and provisions in connection with foreign exchange investigations, together with lower revenue in part reflecting an adjustment following the introduction of the FFVA and lower Foreign Exchange revenue.

**GPB**

Lower profit before tax on an adjusted basis, mainly reflected a managed reduction in client assets as we continued to reposition the business. Despite a reduction in client assets, we attracted positive net new money of US\$14bn in areas that we have targeted for growth.

HSBC HOLDINGS PLC

**Table of Contents**

**Directors Remuneration Report** (continued)

**Major decisions on Directors remuneration**

The Group Chief Risk Officer, Marc Moses, was appointed an executive Director with effect from 1 January 2014, reflecting the criticality of the Risk function to HSBC, his leadership of that function and his personal contribution to the Group. His remuneration has therefore been brought into line with the executive Directors remuneration policy.

Following consultation with shareholders, the Group Chairman, Douglas Flint, became eligible under the policy to receive a one-time award under the Group Performance Share Plan ( GPSP ). The Committee has subsequently decided that it will not grant a GPSP award to the Group Chairman for 2014. Instead, it has decided to review the base salary of the Group Chairman as part of any future policy change that is proposed to shareholders.

The Committee has concluded that there will be no increase to the base salary of executive Directors in 2015. In light of the feedback received from some of our shareholders, the Committee will review the level of cash pension allowances for executive Directors as part of any future policy change.

The Committee has exercised its discretion to reduce the executive Directors overall variable pay from that which would be justified simply from application of the scorecard weightings. This adjustment is justified in the context of the overall financial results and the legal, compliance and regulatory issues impacting the Group, particularly those related to historical events, including

but not limited to foreign exchange. Further details are set out in this report.

**Future regulatory change**

Looking ahead to 2015/2016, further significant regulatory changes to executive remuneration are expected from the recent PRA and Financial Conduct Authority consultation on Strengthening the alignment of risk and reward: new remuneration rules . In addition, the European Banking Authority is expected to issue for consultation remuneration guidelines which include criteria under which allowances can be treated as fixed remuneration.

The number and volume of regulatory changes that have been and are being proposed in connection with remuneration are, in the Committee s view, excessive and are hindering our ability to communicate with any certainty to our current employees and potential employees the remuneration policies and structures that would apply to them. Regulatory uncertainty and complexity is contributing to a general misunderstanding about how our remuneration policies work and the impact of those policies on employee performance.

The Committee will consider the effect of these various changes as well as shareholder feedback on our policy. In light of these factors, it is possible that we will need to make changes to our remuneration policy in 2016.

**Sir Simon Robertson**

*Chairman of the Group Remuneration Committee*

23 February 2015

HSBC HOLDINGS PLC

302

**Table of Contents**

**Directors Remuneration Report (continued)**

**Directors remuneration policy**

The following section sets out a summary of HSBC's remuneration policy for our executive and non-executive Directors approved at the Annual General Meeting on 23 May 2014. The full policy is available in last year's Directors Remuneration Report in the *Annual Report and Accounts 2013*, a copy of which can be obtained by visiting the following website: <http://www.hsbc.com/investor-relations/financial-and-regulatory-reports>.

The quality and long-term commitment of all of our employees is fundamental to our success. We therefore aim to attract, retain and motivate the very best people who are committed to maintaining a long-term

career with the Group, and who will perform their role in the long-term interests of shareholders.

The key elements of our remuneration policy, fixed pay, benefits and variable pay consisting of the annual incentive and GPSP are shown below. These elements support the achievement of our strategic objectives through balancing reward for both short-term and long-term sustainable performance. Our strategy is designed to reward only success, and to align employees' remuneration with our risk framework and risk outcomes. For our most senior employees, the greater part of their reward is deferred and thereby subject to malus, that is, unvested awards can be reduced or cancelled if warranted by events. In addition, as outlined in the Chairman's statement, the variable pay awards made from 1 January 2015 will be subject to clawback.

*Remuneration policy – executive Directors*

HSBC HOLDINGS PLC

303

**Table of Contents**

**Directors Remuneration Report** (continued)

The following chart provides an overview of the release profile of target performance total compensation for the Group Chief Executive Officer based on the above policy.

*Release profile for target total compensation*

1 *Shares arising from GPSP awards must be retained and cannot be sold for the duration of the participant's employment. For leavers deemed to be good leavers, the retention period applicable to their vested shares will end upon cessation of employment. For leavers not deemed to be good leavers, their vested shares will be released in three equal instalments on or around each anniversary of the date of cessation of employment.*

The Committee will apply the above policy for executive Directors in 2015. In the event that regulatory requirements require changes to be made to the terms of any fixed or variable remuneration outside this policy, the Committee will make the changes necessary to ensure regulatory compliance.

**Downward override policy**

Based on the recommendations received from the independent monitor, the Committee introduced a downward override policy in 2014, to set the circumstances in which it will make a downward adjustment to any variable pay determination for the executive Directors and other senior executives.

Under this policy, the criteria used to determine the downward adjustment will include:

insufficient yearly progress in developing an effective AML and sanctions compliance programme; or

non-compliance with the US DPA and other relevant orders.

The Committee will factor in the Financial System Vulnerabilities Committee's recommendations in deciding the application and degree of any such downward override to reduce variable pay awards.

**Differences in policy applied to employees generally**



The mix of fixed and variable pay granted to an employee is commensurate with the individual's role and experience and local market factors.

Fixed pay allowances are granted to MRTs or individuals identified as having a material impact on the institution's risk profile based on the qualitative and quantitative criteria set out in the EU Regulatory Technical Standard 604/2014.

The fixed pay allowance can also be granted to such other individuals where it is considered a rebalancing of the fixed and variable pay components of their remuneration would be appropriate.

The criteria used for determining fixed pay allowances include the role undertaken, skills, experience, technical expertise, market compensation for the role and other remuneration that the employee may receive in the year.

Group Managing Directors and Group General Managers will receive the fixed pay allowance in shares with the same release profile as the executive Directors. All other employees will receive the fixed pay allowance in cash when it is below a specified threshold. Where the fixed pay allowance is above the specified threshold, all of it will be received in shares that vest immediately. Any shares delivered (net of shares sold to cover any income

HSBC HOLDINGS PLC

304

**Table of Contents****Directors Remuneration Report** (continued)

tax and social security) as part of the fixed pay allowance would be subject to a retention period. 40% of the shares are released in March following the end of the relevant financial year in which the shares were granted. The remaining 60% are released in three equal annual tranches on or around each anniversary of the initial release.

Group Managing Directors participate in both the annual incentive and the GPSP. Group General Managers participate in the annual incentive and may receive other long-term awards. Other employees across the Group are eligible to participate in annual incentive arrangements.

*Elements of remuneration*

	Group				
	Executive Directors	Group Managing Directors	Group General Managers	Other MRTs	Other Employees
Base salary	ü	ü	ü	ü	ü
Fixed pay allowance	ü	ü	ü	ü	ü
Annual incentive	ü	ü	ü	ü	ü
GPSP/long-term awards	ü	ü	ü		
Benefits and pension	ü	ü	ü	ü	ü

**Material factors taken into account when setting pay policy**

The Committee takes into account a variety of factors when determining the remuneration policy for Directors.

**Funding**

Annual incentive and GPSP awards are funded from a single annual variable pay pool.

Funding of the Group's annual variable pay pool is determined in the context of Group profitability, capital strength, shareholder returns, the distribution of profits between capital, dividends and variable pay, risk appetite statement, market competitiveness, and overall affordability.

Details of the calculation of this year's variable pay pool can be found on page 309.

**Pay and employment conditions within the Group** HSBC considers pay across the Group when determining remuneration levels for its executive Directors. In considering individual awards, a comparison of the pay and employment conditions of our employees and senior executives is considered by the Committee.

The Committee invites the Head of Group Performance and Reward to present proposals for remuneration for the wider employee population and to consult on the extent to which the different elements of remuneration are provided to other employees.

Feedback from employee engagement surveys and HSBC Exchange meetings are taken into account in determining the Group's remuneration policy.

**Regulation** There is still a wide divergence in local regulations governing remuneration structures globally. This presents significant challenges to HSBC, which operates worldwide.

In order to deliver long-term sustainable performance, it is important to have market-competitive remuneration which is broadly equivalent across geographical boundaries in order to attract, motivate and retain talented and committed employees around the world.

We aim to ensure that our remuneration policy is aligned with regulatory practices and the interests of shareholders.

HSBC is fully compliant with the FSB, FCA, PRA and HKMA guidance and rules on remuneration which apply at the date of this report.

**Comparator group** The Committee considers market data for executive Directors' remuneration packages from a defined remuneration comparator group.

This group consists of ten global financial services companies, namely Australia and New Zealand Banking Group Limited ( ANZ ), Banco Santander, Bank of America, Barclays, BNP Paribas, Citigroup, Deutsche Bank, JPMorgan Chase & Co, Standard Chartered and UBS. These companies were selected on the basis of their broadly similar business coverage, size and international scope, and are subject to annual review for continuing relevance. ANZ is an additional firm added to the group as part of the Committee s 2014 review.

The Committee can also review other companies where relevant in determining the remuneration policy.

Shareholder views

The Chairman of the Committee, the Head of Group Performance and Reward and the Group Company Secretary meet with key institutional shareholders and other representative bodies. We consider these types of meetings important to gather views on our current and developing remuneration practices to ensure that our reward strategy continues to be aligned with the long-term interests of our shareholders.

HSBC HOLDINGS PLC

**Table of Contents**

**Directors Remuneration Report (continued)**

**Adjustment, malus and clawback**

In order to reward genuine performance, individual awards are made on the basis of a risk-adjusted view of both financial and non-financial performance. The Committee has exclusive discretion to apply the malus and clawback policies that it has adopted, enabling it to take the following actions, taking into consideration an

individual's proximity to, and responsibility for, the event in question. Where practicable, an adjustment will be made to current year variable pay, before the application of malus, then clawback.

This policy is in line with the PRA regulatory requirements.

Type of action	Type of variable pay award affected	Circumstances where it may apply (including, but not limited to):
Adjustment	Current year variable pay	<p>Detrimental conduct or conduct which brings the business into disrepute, such as in 2014 relating to the investigation of certain behaviour within the Foreign Exchange markets.</p> <p>Involvement in Group-wide events resulting in significant operational losses, including events which have caused or have the potential to cause significant harm to HSBC.</p> <p>Non-compliance with HSBC Values and other mandatory requirements.</p> <p>For specified individuals, insufficient yearly progress in developing an effective AML and sanctions compliance programme or non-compliance with the DPA and other relevant orders.</p>

Malus	Unvested deferred awards granted in prior years	<p>Detrimental conduct or conduct which brings the business into disrepute.</p> <p>Past performance being materially worse than originally reported.</p> <p>Restatement, correction or amendment of any financial statements.</p> <p>Improper or inadequate risk management.</p>
Clawback <sup>1</sup>	Vested or paid awards	<p>Participation in or responsibility for conduct which results in significant losses.</p> <p>Failing to meet appropriate standards of fitness and propriety.</p> <p>Reasonable evidence of misconduct or material error that would justify, or would have justified, summary termination of a contract of employment.</p> <p>HSBC or a business unit suffers a material failure of risk management within the context of Group risk management standards, policies and procedures.</p>

*1 Clawback is only applicable to variable pay awards granted to MRTs on or after 1 January 2015. These include, but are not limited to, the awards made in relation to the 2014 performance year.*

**Remuneration policy non-executive Directors**

Non-executive Directors are not employees and receive a fee for their services as Directors. In addition, it is common practice for non-executive Directors to be reimbursed expenses incurred in performing their role and any related tax. They are not eligible to receive a base salary, fixed pay allowance, benefits, pension or any variable pay.

The fee levels payable reflect the time commitment and responsibilities required of a non-executive Director of HSBC Holdings. Fees are determined by reference to other UK companies and banks in the FTSE 30, and to the fees paid by other non-UK international banks.

The Board reviews each component of the fees periodically to assess whether, individually and in aggregate, they remain competitive and appropriate in light of changes in roles, responsibilities, and/or the time commitment required for the non-executive Directors and to ensure that individuals of the appropriate calibre are retained or can be appointed. The Board (excluding the non-executive Directors) may approve changes to the fees within the ranges prescribed in the remuneration policy. The Board may also introduce any new component

of fee for non-executive Directors subject to the principles, parameters and other requirements set out in the remuneration policy.

The Philanthropic and Community Investment Oversight Committee, a new non-executive Board committee, was established on 5 December 2014. In line with its authority under the remuneration policy, the Board approved the following fee levels for this committee: chairman £25,000 per annum; member £15,000 per annum.

No other change has been made or is proposed to the fees of non-executive Directors during the term of this policy. The fees payable to non-executive Directors are set out in last year's Directors' Remuneration Report in the *Annual Report and Accounts 2013*.

### **Service contracts**

#### **Executive Directors**

Our policy is to employ executive Directors on service agreements with 12 months' notice period. Consistent with the best interests of the Group, the Committee will seek to minimise termination payments. Directors may be eligible for a payment in relation to statutory rights.

HSBC HOLDINGS PLC

**Table of Contents****Directors Remuneration Report** (continued)*Service contracts*

<b>Director</b>	<b>Contract date (rolling)(Director &amp; HSBC)</b>	<b>Notice period (rolling)(Director &amp; HSBC)</b>
Douglas Flint	<b>14 February 2011</b>	<b>12 months</b>
Stuart Gulliver	<b>10 February 2011</b>	<b>12 months</b>
Iain Mackay	<b>4 February 2011</b>	<b>12 months</b>
Marc Moses	<b>27 November 2014</b>	<b>12 months</b>

Other than as set out under Directors remuneration policy and Policy on payments for loss of office in the Directors Remuneration Report in the *Annual Report and Accounts 2013*, there are no further obligations which could give rise to remuneration payments or payments for loss of office.

**Non-executive Directors**

Non-executive Directors are appointed for fixed terms not exceeding three years, which may be renewed subject to their re-election by shareholders at annual general meetings. Non-executive Directors do not have a service contract, but are bound by letters of appointment issued for and on behalf of HSBC Holdings plc. Other than as set out in

Remuneration policy non-executive Directors in the Directors Remuneration Report in the *Annual Report and Accounts 2013*, there are no obligations in the non-executive Directors letters of appointment which could give rise to remuneration payments or payments for loss of office. Non-executive Directors current terms of appointment will expire as follows:

in 2015, Joachim Faber, Rona Fairhead, John Lipsky, Rachel Lomax and Sir Simon Robertson;

in 2017, Kathleen Casey, Safra Catz, Laura Cha, Lord Evans of Weardale, Sam Laidlaw and Jonathan Symonds;  
and

in 2018, Heidi Miller and Phillip Ameen<sup>1</sup>.

<sup>1</sup> Appointed with effect from 1 January 2015.

**Other directorships**



Executive Directors may accept appointments as non-executive directors of companies which are not part of HSBC if so authorised by either the Board or the Nomination Committee.

When considering a request to accept a non-executive appointment, the Board or the Nomination Committee will take into account, amongst other things, the expected time commitment associated with the proposed appointment. The time commitment for

Directors' external appointments is also routinely reviewed to ensure that these external appointments will not compromise the Directors' commitment to HSBC.

In accordance with the requirements of CRD IV, Directors who are approved by the PRA to take up certain roles on the Board are subject to the following limits on the number of directorships which they may hold:

one executive directorship with two non-executive directorships; or

four non-executive directorships.

With the consent of the PRA one additional non-executive directorship may be held.

Any remuneration receivable in respect of an external appointment of an executive Director is normally paid to the Group, unless otherwise approved by the Nomination Committee or the Board.

## **Annual report on remuneration**

### **Remuneration Committee**

#### **Role**

Within the authority delegated by the Board, the Committee is responsible for approving the Group's remuneration policy. The Committee also determines the remuneration of executive Directors, senior employees, employees in positions of significant influence and employees whose activities have or could have a material impact on our risk profile and, in doing so, takes into account the pay and conditions across the Group. No executive Directors are involved in deciding their own remuneration.

#### **Membership**

The members of the Group Remuneration Committee during 2014 were Sir Simon Robertson (Chairman), Sam Laidlaw, John Lipsky (appointed 23 May 2014), Jonathan Symonds (appointed 14 April 2014 but stepped down from this Committee on 1 September 2014 to become Chairman of the Group Audit Committee), Renato Fassbind (resigned as a Director on 1 September 2014), and John Coombe (retired as a Director on 23 May 2014).

#### **Activities**

The Committee met 11 times during 2014. The following is a summary of the Committee's key activities during 2014.



**Table of Contents****Directors Remuneration Report** (continued)*Details of the Committee's key activities*

Month	Activities	Month	Activities
January	<p>2013 performance year pay review matters</p> <p>Design of new remuneration policy</p> <p>New shareholding guidelines</p> <p>Governance matters</p>	July	<p>Feedback from the 2014 Annual General Meeting</p> <p>2014 performance year pay review matters</p> <p>Update on notable events</p> <p>Matters regarding Group-wide incentives</p> <p>Employee share plan matters</p>
February	<p>2013 performance year pay review matters</p> <p>2014 GPSP and Annual Scorecards for executive Directors</p> <p>Design of new remuneration policy</p>	September	<p>Governance matters</p> <p>2014 performance year pay review matters</p> <p>Review of PRA/FCA consultation on alignment between risk and reward</p>

March	Matters regarding Group-wide incentives framework	October	Shareholder feedback on remuneration matters
	Employee share plan matters		Update on PRA/FCA consultation on alignment between risk and reward
	New shareholding guidelines		
	Regulatory submissions and disclosures		
	Governance matters	November	Update on EBA's report and opinion on fixed pay allowances
	Provision of response to the monitor's report		2014 Risk Appetite Statement review and Remuneration Code risk assessment
	2013 performance year pay review matters		2014 proposed Group variable pay spend and methodology
	Review of PRA consultation on clawback rules		Approval of clawback policy
Update on notable events		Update on notable events	
Matters regarding retirement benefit arrangements and incentive plans		Regulatory submissions and disclosures	
Regulatory submissions and disclosures		Independent review of HSBC Reward Strategy against the HKMA remuneration guidelines	
April	New remuneration policy matters	December	Risk appetite framework and Financial Crime Compliance updates

May	Preparation for the 2014 Annual General Meeting		Inputs from the Group Risk Committee, Financial System Vulnerabilities Committee, and Conduct & Values Committee
	Matters regarding retirement benefit arrangements and incentive plans		
	Regulatory submissions and disclosures Matters regarding implementation of new remuneration policy		2014 performance year pay review matters
	Preparation for the 2014 Annual General Meeting		2015 GPSP and Annual Scorecards for executive Directors
	2014 performance year pay review matters		Update on notable events
	Employee share plan matters		Regulatory submissions and disclosures
	Governance matters		Employee share plan matters
			Governance matters

HSBC HOLDINGS PLC

**Table of Contents**

**Directors Remuneration Report (continued)**

**Advisers**

In 2014, the Committee did not engage any external adviser, and will only seek specific legal and/or remuneration advice independently as and when it considers this to be necessary.

During the year, the Group Chief Executive provided regular briefings to the Committee. In addition, the Committee received advice from the Group Head of Human Resources and Corporate Sustainability, Ann Almeida, the Head of Group Performance and Reward, Alexander Lowen, the Group Chief Risk Officer, Marc Moses, and the Global Head of Financial Crime Compliance and Group Money Laundering Reporting

Officer, Robert Werner, as part of their executive role as employees of HSBC. The Committee also received advice and feedback from the Group Risk Committee, Financial System Vulnerabilities Committee and Conduct & Values Committee on risk and compliance-related matters relevant to remuneration, and the implementation of the downward override policy.

**Group variable pay pool**

**Variable pay pool determination**

The Committee considers many factors in determining the Group's variable pay pool funding.

*Variable pay pool determination*

Performance and risk appetite statement      The variable pay pool takes into account the performance of the Group which is considered within the context of our risk appetite statement. This helps to ensure that the variable pay pool is shaped by risk considerations and any Group-wide notable events.

The risk appetite statement describes and measures the amount and types of risk that HSBC is prepared to take in executing its strategy. It shapes the integrated approach to business, risk and capital management and supports achievement of the Group's objectives. The Group Chief Risk Officer regularly updates the Committee on the Group's performance against the risk appetite statement.

The Committee uses these updates when considering remuneration to ensure that return, risk and remuneration are aligned.

Counter-cyclical  
funding  
methodology

We use a counter-cyclical funding methodology which is categorised by both a floor and a ceiling and the payout ratio reduces as performance increases to avoid pro-cyclicality risk.

The floor recognises that competitive protection is typically required irrespective of performance levels.

The ceiling recognises that at higher levels of performance it is possible to limit reward as it is not necessary to continue to increase the variable pay pool, thereby limiting the risk of inappropriate behaviour to drive financial performance.

Distribution of  
profits

In addition, our funding methodology considers the relationship between capital, dividends and variable pay to ensure that the distribution of post-tax profits between these three elements is considered appropriate (see next page for the 2014, 2013 and target split).

Commerciality and  
affordability

Finally, the commercial requirement to remain competitive in the market and overall affordability are considered. Both the annual incentive and GPSP are funded from a single annual variable pay pool from which individual awards are considered. Funding of the Group's annual variable pay pool is determined in the context of Group profitability, capital strength, and shareholder returns. This approach ensures that performance-related awards for individual global businesses, global functions, geographical regions and levels of staff are considered in a holistic fashion.

Market competitiveness is one of the inputs in the determination of the variable pay pool. This allows us to address any gaps to market identified when comparing total reward with our global peers. This recognises the challenges which arise from being headquartered in the UK and hereby having to apply more stringent reward practices than those applied in markets outside the EU. Factors which influence our competitive market position in Asia, Latin America and the US in attracting and retaining talent are the discounts applied on their pay by employees arising from regulations covering a variable pay cap, higher and longer deferrals, malus and now clawback.

This year's variable pay pool was established by reference to the Group's reported profit before tax, which is adjusted to exclude movements in the fair value of own debt attributable to credit spread, the gains and losses from disposals, and debit valuation adjustment. Reported profit before tax includes the costs of fines, penalties and other items of redress.

Taking into account all of the above, the Committee decided that in light of performance, the competitive market environment, risk inputs, and other factors, the adjusted pre-tax pre-variable pay profit payout ratio for 2014 would be 16% (15% in 2013). The higher payout ratio reflects stronger performance in Asia and the Middle East, and an increased emphasis on risk and control functions.

HSBC HOLDINGS PLC

309



**Table of Contents****Directors Remuneration Report** (continued)*Variable pay pool outcome (US\$m)*

	Group		Global Banking and Markets	
	2014	2013	2014	2013
Variable compensation incentive pool as a % of pre-tax profit (pre-variable pay) <sup>1</sup>	<b>16%</b>	15%	<b>15%</b>	13%
% of variable pay pool deferred <sup>2</sup>	<b>14%</b>	18%	<b>25%</b>	30%

1 The 2014 Group pre-tax pre-variable pay profit calculation as described on the previous page.

2 The percentage of variable pay deferred for 2014 MRT population is 50%.

*Pro forma post-tax profits allocation*

On a pro-forma basis, attributable post-tax profits (excluding the movements in the fair value of own debt and before pay distributions were allocated in the proportions shown in the chart below. The Group's target policy is for the vast majority of post-tax profit to be allocated to capital and to shareholders.

*Relative importance of spend on pay*

The chart below provides a breakdown of total staff pay relative to the amount paid out in dividends.

1 Dividends per ordinary share in respect of that year. For 2014, this includes the first, second and third interim dividends paid in 2014 of US\$5.8bn (gross of scrip) and a fourth interim dividend of US\$3.8bn.

2 Employee compensation and benefits in 2014 includes fixed pay, benefits and variable pay as outlined on page 303. Employee compensation and benefits in 2013 totalled US\$19,196m which included an accounting gain arising from a change in the basis of delivering ill-health benefits in the UK of US\$430m. Excluding this accounting gain, 2013 employee compensation and benefits totalled US\$19,626m.

- 1 *Inclusive of dividends to holders of other equity instruments and net of scrip issuance based on an assumption of scrip take up for the fourth quarter of 2014 of 20%. Dividends per ordinary share declared in respect of 2014 were US\$0.50, an increase of 2% compared with 2013.*
- 2 *Total variable pay pool net of tax and portion to be delivered by the award of HSBC shares.*

HSBC HOLDINGS PLC

310

**Table of Contents****Directors Remuneration Report (continued)****Single figure of remuneration***Executive Directors*

	Douglas Flint		Stuart Gulliver		Iain Mackay		Marc Moses	
	2014	2013	2014	2013	2014	2013	2014	2013
	£000	£000	£000	£000	£000	£000	£000	£000
Fixed pay								
Base salary	1,500	1,500	1,250	1,250	700	700	700	
Fixed pay allowance			1,700		950		950	
Pension	750	750	625	625	350	350	350	
	2,250	2,250	3,575	1,875	2,000	1,050	2,000	
Variable pay								
Annual incentive			1,290	1,833	867	1,074	1,033	
GPSP			2,112	3,667	1,131	2,148	1,131	
			3,402	5,500	1,998	3,222	2,164	
Total fixed and variable pay	2,250	2,250	6,977	7,375	3,998	4,272	4,164	
Benefits	136	48	589	591	43	33	6	
Non-taxable benefits	105	102	53	67	28	53	33	
Notional return on deferred cash	41	27			11	7	36	
<b>Total single figure of remuneration</b>	<b>2,532</b>	<b>2,427</b>	<b>7,619</b>	<b>8,033</b>	<b>4,080</b>	<b>4,365</b>	<b>4,239</b>	

**Notes to the single figure of remuneration**

Marc Moses was appointed an executive Director with effect from 1 January 2014, so his 2013 figures have not been disclosed.

*Base salary*

Salary paid in year for executive Directors. No fees were paid to executive Directors.

*Fixed pay allowance*

Fixed pay allowance granted in immediately vested shares in the year for executive Directors.

The shares are subject to a retention period. 20% released in the March immediately following the end of the financial year. 80% released after a period of five years from the date of the first release.

Dividends will be paid on the vested shares held during the retention period.

*Pension*

The amounts consist of an allowance of 50% of annual base salary in lieu of personal pension arrangements.

No other benefits were received by the executive Directors from the Group pension plans.

### Benefits

All taxable benefits (gross value before payment of tax). Benefits include provision of medical insurance, accommodation and car, club membership, tax gross-up for accommodation and car benefit, and car allowance. Non-taxable benefits include the provision of life assurance and other insurance cover.

The values of the significant benefits in the above table were as follows:

	Douglas Flint		Stuart Gulliver		Iain Mackay		Marc Moses	
	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000
Car benefit (UK and Hong Kong)	70 <sup>1</sup>	2	88 <sup>1</sup>	79	2	2	2	
Hong Kong bank-owned accommodation <sup>3</sup>			246	229				
Tax expense on car benefit and Hong Kong bank-owned accommodation	58 <sup>1</sup>	2	239 <sup>1</sup>	266	2	2	2	
Insurance benefit (non-taxable)	80	78	2	54	2	2	2	

- 1 The UK car benefit provided for Douglas Flint and Stuart Gulliver in 2014 has not changed from 2013. The valuation of the car benefit has increased as they are no longer deemed pool cars for UK tax purposes, and include driver wages, fuel and all associated costs.*
- 2 The car benefit and tax on car benefit for Douglas Flint in 2013, Marc Moses in 2014 and Iain Mackay is not included in the above table as it was not significant. The insurance benefit for Stuart Gulliver and Marc Moses in 2014 and Iain Mackay is not included in the above table as it was not significant.*
- 3 Based on the current market rental value of the bank-owned property, as estimated by an external lease service provider, plus utility costs, rates, the taxable value of furniture and taking into account the business use of the property, the taxable value of the accommodation is considered to be 70% of the total of these amounts.*

### Annual incentive

Annual incentive awarded (including deferred amounts) as a result of achievement of performance measures for the relevant financial year. 60% of the award is deferred. 50% of both the deferred and non-deferred component of the award is payable in cash and the remaining 50% in shares, subject to a six month retention period on vesting. The deferred element of the 2014 award pays out over a period of three years, subject to service and malus conditions: 33% vests on or around the first and second anniversary of grant and 34% on or around the third anniversary of grant. For the 2014 award the performance measures and the outcomes of the performance conditions can be found on pages 315-317. Outcomes for the 2013 award can be found in the Directors Remuneration Report in the Annual Report and Accounts 2013.

HSBC HOLDINGS PLC

**Table of Contents**

**Directors Remuneration Report (continued)**

The deferred share awards also include a right to receive dividend equivalents. Dividend equivalents on deferred share awards are delivered in the form of additional shares, in the same time and in the same manner and in such proportion as the original deferred award that vests. The expected value of these dividend equivalents is included in the value of deferred share awards.

*Illustration of annual incentives*

*GPSP*

GPSP awarded as a result of achievement of sustainable long-term performance. Figures shown reflect the face value of awards granted in 2014 and 2013 respectively.

Award levels are determined by considering performance against enduring performance measures set out in the long-term performance scorecard. There are no post-grant performance conditions.

The award is subject to a five-year cliff vesting period during which the Committee has the authority to cancel all or part of the award. On vesting, the shares (net of tax) must be retained for the duration of the participant's employment.

For the 2014 award the outcomes of the performance conditions can be found in the section titled Awards under the GPSP on page 314. Outcomes for the 2013 award can be found in the Directors Remuneration Report in the Annual Report and Accounts 2013.

The GPSP awards also include a right to receive dividend equivalents for the period between the grant and the vesting date. Dividend equivalents on the GPSP awards will be delivered when the GPSP awards vest. There was no vesting of historical GPSP awards in 2014. The expected value of these dividend equivalents are included in the value of GPSP awards.

*Illustration of GPSP*

HSBC HOLDINGS PLC

**Table of Contents****Directors Remuneration Report** (continued)*Notional return on deferred cash*

The deferred cash award portion of the annual incentive also include a right to receive notional returns for the period between grant date and vesting date and determined by reference to the dividend yield on HSBC shares, determined annually.

A payment of notional return is made annually in the same proportion as the vesting of the deferred awards on each vesting date. The amount is disclosed on a paid basis in the year in which the payment is made.

**Remuneration scenarios and outcomes**

The charts below show the value and composition of remuneration under three performance scenarios for each of the executive Directors based on the current policy in comparison to the actual 2014 variable pay outcomes.

- 1 *Fixed pay includes base salary, fixed pay allowance and pension allowance for the year, and excludes benefits.*
- 2 *Maximum award level as stated in our remuneration policy Includes deferred portion of award. Target has been defined as 50% of the maximum award. Minimum assumes no annual incentive award.*
- 3 *Maximum award level as stated in our remuneration policy. Target has been defined as 50% of the maximum award. The GPSP scorecard has not been designed with a numeric targeted or expected value of performance. Minimum assumes no GPSP award.*

*Variable pay outcomes*

	Stuart Gulliver	Iain Mackay	Marc Moses
<b>Fixed pay</b>			
Value (£000)	3,575	2,000	2,000
<b>Annual incentive</b>			
Maximum multiple of fixed pay	0.67	0.67	0.67
Performance outcome	54.1%	65.0%	77.5%
Multiple awarded	0.36	0.43	0.52

Value (£000)	1,290	867	1,033
<b>GPSP</b>			
Maximum multiple of fixed pay	1.33	1.33	1.33
Performance outcome	54.8%	54.8%	54.8%
Multiple awarded	0.73	0.73	0.73
Pre-discretion value (£000)	2,612	1,461	1,461
Committee discretion (£000)	(500)	(330)	(330)
Post-discretion value (£000)	2,112	1,131	1,131
<b>Total variable pay</b>			
Maximum multiple of fixed pay	2.00	2.00	2.00
Multiple awarded	0.95	1.00	1.08
Value (£000)	3,402	1,998	2,164

## HSBC HOLDINGS PLC

**Table of Contents****Directors Remuneration Report** (continued)**Awards under the GPSP**

Awards in respect of 2014 were assessed against the 2014 long-term scorecard published in the *Annual Report and Accounts 2013 and reproduced below*.

The performance assessment under the 2014 long-term scorecard took into account achievements under both financial and non-financial objectives, both of which

were set within the context of the risk appetite and strategic direction agreed by the Board.

Notwithstanding the detail or extent of performance delivery against the objectives, an individual's eligibility for a GPSP award requires confirmation of adherence to HSBC Values which acts in effect as a gateway to GPSP participation, which was assessed to have been met for all executive Directors. A summary of the assessment and rationale for the conclusions is set out below.

*Annual assessment GPSP*

Measure	Weighting	Long-term target range	Actual	Assessment	Outcome
			2014 performance		
Capital strength (%) <sup>1</sup>	15%	>10	11.1	100%	15.0%
Progressive dividend payout (%) <sup>2</sup>	15%	40-60	72.5	100%	15.0%
Return on equity (%) <sup>3</sup>	15%	12-15	7.2	0%	
Cost efficiency ratio					
Jaws	7.5%	Positive jaws <sup>1</sup>	(14.7)	0%	
Cost efficiency ratio (%)	7.5%	Mid-50s	67.8	0%	
Financial					