2006

Annual Report and Accounts
HSBC Bank plc

The world's local bank

HSBC

Annual Report and Accounts 2006

Contents

Presentation of Information

This document comprises the *Annual Report and Accounts 2006* for HSBC Bank plc ('the bank') and its subsidiary undertakings (together 'the group'). It contains the Directors' Report and Accounts, together with the Auditors' report, as required by the UK Companies Act 1985. References to 'HSBC' or 'the Group' within this document mean HSBC Holdings Plc together with its subsidiaries.

Cautionary statement regarding forward-looking statements

This *Annual Report* contains certain forward-looking statements with respect to the financial condition, results of operations and business of the bank.

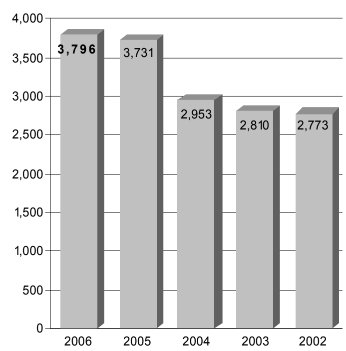
Statements that are not historical facts, including statements about the bank's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and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

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.

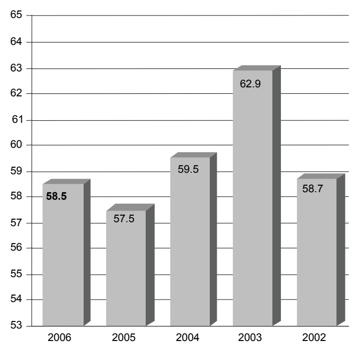
Financial Highlights

	2006 £m	2005[4] £m	2004 £m	2003 £m	2002 £m
For the year [1,2]					
Profit on ordinary activities before tax[3]	**3,796**	3,731	2,953	2,810	2,773
Profit attributable to shareholders of the parent company[3]	**2,722**	2,842	2,057	2,046	1,867
At year-end					
Shareholders' funds of the parent company	**20,399**	19,091	16,828	17,064	16,455
Capital resources	**21,360**	19,677	16,424	14,603	12,768
Customer accounts and deposits by banks	**265,863**	239,673	193,664	175,390	155,234
Total assets	**440,760**	386,422	292,481	246,104	218,378
Ratios (%)					
Return on average shareholders' funds (equity) of the parent company	**13.6**	16.4	12.7	8.5	8.5
Capital ratios					
— total capital	**11.2**	10.8	10.5	10.7	10.3
— tier 1 capital	**7.5**	6.9	7.4	7.4	7.1
Cost:income ratio	**58.5**	57.5	59.5	62.9	58.7
Cost:income ratio including net insurance claims	**58.9**	58.8	64.2	–	–

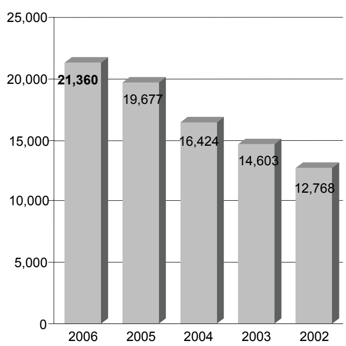
Profit on ordinary activities before tax (£m)



Cost:income ratio (%)



Capital resources (£m)



1 *From 2004 the financial highlights are prepared in accordance with IFRSs as endorsed by the EU.*

2 *2004 financial highlights excludes IAS 32, IAS 39 and IFRS 4. The 2002 and 2003 financial highlights are under UK GAAP as previously reported.*

3 *The profit on ordinary activities before tax and the profit attributable to shareholders for the years 2002 and 2003 exclude goodwill amortisation.*

4 *Restated 2005 income statement and balance sheet figures.*

The financial highlights are influenced by changes in the group structure over the five years. The most significant acquisitions are as follows: in 2002, HSBC Trinkaus & Burkhardt AG, HSBC Republic Bank (UK) Limited and activities of HSBC Investment Bank plc; in 2004, Marks and Spencer Retail Financial Services Holdings Limited.

Board of Directors and Senior Management

Directors

S K Green, Chairman

Age 58. Chairman since 2005 and a Director since 1995. Deputy Chairman from 2003 to December 2004. Group Chairman of HSBC Holdings plc since May 2006. Group Chief Executive of HSBC Holdings plc from 2003 to 26 May 2006. Joined HSBC in 1982. Chairman of HSBC North America Holdings Inc. and HSBC Private Banking Holdings (Suisse) S.A. Deputy Chairman of HSBC Trinkaus & Burkhardt AG. A Director of HSBC France and The Hongkong and Shanghai Banking Corporation Limited. Executive Director, Corporate, Investment Banking and Markets from 1998 to 2003. Group Treasurer of HSBC Holdings plc from 1992 to 1998. Chairman of the British Bankers Association.

M F Geoghegan, CBE, Deputy Chairman

Age 53. Deputy Chairman since 6 March 2006 and a Director since 2004. Chief Executive from 2004 to March 2006. Group Chief Executive of HSBC Holdings plc since 26 May 2006. Joined HSBC in 1973. Chairman of HSBC Bank USA, N.A., HSBC USA Inc. and HSBC Bank Canada. A Director of The Hongkong and Shanghai Banking Corporation Limited, HSBC France, HSBC North America Holdings Inc., and HSBC National Bank USA. President of HSBC Bank Brasil S.A.-Banco Múltiplo from 1997 to 2003 and responsible for all of HSBC's business throughout South America from 2000 to 2003. A non-executive Director and Chairman of Young Enterprise.

D D J John, Chief Executive

Age 56. Chief Executive since 6 March 2006 and a Director since 2003. A Group Managing Director since 6 March 2006. Joined HSBC Bank plc in 1971. Deputy Chief Executive from 2005 to 6 March 2006 and Chief Operating Officer from 2003 to May 2005. A Group General Manager from 2000 to 6 March 2006. Deputy Chairman and Chief Executive Officer, HSBC Bank Malaysia Berhad from 1999 to 2002. Chief Executive Officer, The Hongkong and Shanghai Banking Corporation Limited in India from 1997 to 1999. General Manager for Wales from 1993 to 1997.

D C Budd, Chief Operating Officer

Age 53. Chief Operating Officer and a Director since 2005. A Group General Manager since 2005. Joined HSBC in 1972. A Director of HFC Bank Limited, HSBC Bank Malta p.l.c. and Marks and Spencer Financial Services plc. President and Chief Executive Officer, HSBC Bank Argentina S.A. from 2003 to 2005.

C-H Filippi

Age 54. A Director since 2000. Chairman and Chief Executive Officer of HSBC France. A Group Managing Director since 2004. A member of the Supervisory Board of HSBC Trinkaus & Burkhardt AG. Joined HSBC France in 1987 having previously held senior appointments in the French civil service. A Group General Manager from 2001 to 2004. Global Head of Corporate and Institutional Banking from 2001 to 2004.

J D Fishburn*

Age 60. A Director since 2003. Chairman of HFC Bank Limited and an independent non-executive Director of HSBC Finance Corporation.

S T Gulliver

Age 47. A Director since September 2006. Head of HSBC's Corporate, Investment Banking and Markets and Group Investment Businesses. A Group Managing Director since 2004. Joined HSBC in 1980. A Director of HSBC USA Inc. and The Hongkong and Shanghai Banking Corporation Limited. A Group General Manager from 2000 to 2004. Head of Treasury and Capital Markets in Asia-Pacific from 1996 to 2002, Head of Global Markets from 2002 to 2003 and Co-Head of Corporate, Investment Banking and Markets from 2003 to May 2006.

C M S Jones*

Age 63. A Director since 2001. Formerly Chairman and Managing Director, James Beattie PLC.

R E S Martin*

Age 46. A Director since 2005. General Counsel and Company Secretary of Reuters Group PLC.

A R D Monro-Davies*

Age 66. A Director since 2004. Formerly Chief Executive Officer, Fitch Ratings.

P M Shawyer*

Age 56. A Director since 2004. Formerly a Managing Partner of Deloitte.

J Singh, OBE*

Age 55. A Director since 2001. Chairman and Chief Executive Officer of Edwardian Group Limited. Member of the Board of Warwick Business School.

J F Trueman*

Age 64. A Director since 2004. Formerly Deputy Chairman of S G Warburg & Co. Ltd.

* *Independent Non-Executive Director*

Secretary

J H McKenzie

Age 53. Joined HSBC in 1987.

Registered Office: 8 Canada Square, London E14 5HQ

Senior executives

J P Armstrong

Age 47. Chief Information Officer, HSBC Technology Services Europe. Joined HSBC in 1982.

S Assaf

Age 46. Head of Global Markets, Europe, Middle East and Africa. Joined HSBC in 1994.

M P Brewer

Age 47. General Manager, Strategic Development. Joined HSBC in 1977.

B M Cannon

Age 51. General Manager and Head of Credit and Risk. Joined HSBC in 1982.

I M Dorner

Age 52. General Manager and Head of Premier and Wealth. Joined HSBC in 1986.

J D Garner

Age 37. General Manager, Personal Financial Services and Direct Businesses. Joined HSBC in 2004. A Group General Manager since October 2006.

J E Harding

Age 54. Head of Human Resources. Joined HSBC in 1981.

A M Keir

Age 48. General Manager, Commercial Banking. Joined HSBC in 1981. A Group General Manager since October 2006.

S J Large

Age 54. Head of UK Operations. Joined HSBC in 2006.

C G F Laughton-Scott

Age 50. Deputy Head of Global Banking. Joined HSBC in 1986.

A M Mahoney

Age 44. General Manager and Head of the Network. Joined HSBC in 1983. A Group General Manager since November 2006.

M S McCombe, OBE

Age 40. Chief Executive Officer, HSBC Private Bank UK, Channel Islands and Luxemburg. Joined HSBC in 1987.

R K McGregor

Age 58. Chief Financial Officer. Joined HSBC in 1977.

M P Smith

Age 47. Chief Operating Officer, HSBC France. Joined HSBC in 1982.

R G Spence

Age 47. General Manager and Head of Special Projects. Joined HSBC in 1978.

S G Troop

Age 50. General Manager and Head of Insurance. Joined HSBC in 1979.

Report of the Directors

Results for 2006

The consolidated profit for the year attributable to the shareholders of the bank was £2,722 million.

First and second interim dividends of £700 million and £891 million were paid on the ordinary share capital during the year. The Directors have recommended the payment of an interim dividend of £840 million on the ordinary share capital which has not been included as a liability, having been approved after 31 December 2006.

Further information about the results is given in the consolidated income statement on page 27.

Principal activities

The group provides a comprehensive range of banking and related financial services. The group divides its activities into geographical segments: UK, Continental Europe and Rest of the world. The group also divides its activities into the following business segments: UK Personal Financial Services; UK Commercial Banking; UK Corporate, Investment Banking and Markets; International Banking; HSBC France; Private Banking; and HSBC Trinkaus & Burkhardt.

As at 31 December 2006, the bank had 1,505 branches in the United Kingdom, including 13 branches in the Isle of Man and the Channel Islands. Outside the United Kingdom, it has branches in Australia, Belgium, the Czech Republic, France, Greece, Ireland, Israel, Italy, the Netherlands, Slovakia, South Africa, Spain and Sweden; it has a representative office in Argentina, Chile, Cyprus, Hong Kong, Panama and Venezuela; and its subsidiaries have branches and offices in Armenia, the Channel Islands, the Czech Republic, France, Germany, Greece, Hungary, Ireland, Kazakhstan, Luxembourg, Malta, Poland, Russia, Switzerland and Turkey.

The Summary of Financial Performance is given on pages 5 to 6.

On 1 January 2007, the bank acquired 100 per cent of the share capital of HSBC Insurance Brokers Holdings Limited for a cash consideration of £115 million, which may be subject to revision following final determination of net asset value.

In February 2007, the Board of Directors of the bank agreed to market its property at 8 Canada Square, London, in order to enter into a sale and leaseback transaction on the property.

Summary of Financial Performance

	2006 £m	(Restated) 2005 £m
Net interest income	**4,196**	4,042
Net fee income	**3,742**	3,355
Other income	**3,771**	3,578
Operating income	**11,709**	10,975
Net insurance claims incurred and movement in policyholders' liabilities	**(91)**	(230)
Loan impairment charges	**(938)**	(776)
Net operating income	**10,680**	9,969
Total operating expenses	**(6,844)**	(6,315)
Operating profit	**3,836**	3,654
Share of (loss)/ profit in associates and joint ventures	**(40)**	77
Profit on ordinary activities before tax	**3,796**	3,731
Tax on profit on ordinary activities	**(978)**	(827)
Profit on ordinary activities after tax	**2,818**	2,904
Attributable to shareholders of the parent company	**2,722**	2,842

Net interest income increased by 4 per cent to £4,196 million as balance sheet growth was moderately curtailed by tighter margins.

Customer lending grew by 10 per cent during the year notably in the UK, France and Private Banking. In the UK, interest earned on higher personal mortgages, commercial lending and trading assets was partly offset by narrower margins. To an extent, the tightening of credit criteria in the face of increasing personal insolvency suppressed UK lending growth. Strong growth in property lending in France was more than offset by the impact of tighter margins, while balance sheet growth in Private Banking reflected customer acquisition and an expanded product range.

Customer deposits grew by 11 per cent mainly in the UK. Growth in personal savings and interest bearing current accounts was boosted by higher commercial deposits and current accounts.

Net fee income rose by £387 million, or 12 per cent, with increases across the bank, particularly in the UK, France and Private Banking. The inclusion of fee income from Partnership Cards in 2006[1] was partly offset by the transfer of the operations of the UK vehicle contract hire business to Lex Vehicle Leasing in 2005.

Other income was £193 million, or 5 per cent higher. Excluding the impact of the restatement referred to in Note 2 (ab) of the Notes on the Financial Statements, mark-to-market movements on non effective hedges and the sale of vehicle finance leases to Lex in 2005, other income was broadly flat. Income in 2006 from the sale and leaseback of a number of branches and profits on the MasterCard initial public offering ('IPO') were largely offset by a decrease in profit from private equity disposals year-on-year.

Net insurance claims incurred and movement in policyholders' liabilities fell by £139 million, or 60 per cent, principally due to lower sales of single premium insurance contracts, lower market appreciation of investment assets and the effect of changes in reinsurance arrangements.

Loan impairment charges increased by £162 million, or 21 per cent. Of the increase, 15 per cent was accounted for by the UK Partnership Cards portfolio. The impact of a sharp increase in Individual Voluntary Arrangements ('IVAs') and personal bankruptcies in the UK was moderated by actions taken to tighten underwriting criteria and improve collections. In the UK, Commercial Banking impairment allowances were lower than in the previous year, while a net recovery was reported in the Corporate, Investment Banking and Markets ('CIBM') business segment.

Operating expenses increased by £529 million, or 8 per cent. Excluding the impact of Partnership Cards, operating expenses were 7 per cent higher. This mainly arose on a branch refurbishment and relocation programme in the UK, branch expansion programmes in Turkey and Private Banking together with investment in core systems in France. These were partly offset by the benefits of a cost reduction programme in the UK Cards business.

The bank's share of loss in associates and joint ventures amounted to £40 million. A loss arising

1 In December 2005, the UK Partnership Cards portfolio was acquired from HFC Bank Limited. The business comprises a range of branded affinity credit cards, as well as larger portfolios such as General Motors (GM), Marbles and John Lewis.

Report of the Directors (continued)

from an impairment charge on a private equity investment held by an associate was compounded by the non-recurrence of the benefit from one-off gains in the second half of 2005.

Taxation increased by £151 million, or 18 per cent. The higher effective tax rate in 2006 was due to gains on a number of disposals, primarily in France in 2005, which were not subject to tax.

Environment

Economy

UK Gross Domestic Product ('GDP') increased in 2006 by about 2.7 per cent[2] compared with 1.9 per cent in 2005. This followed a recovery in both household and company spending. Consumer Price Index inflation increased through the year from 1.9 per cent in January to 3.0 per cent in December, following large increases in the price of petrol and gas. The Bank of England raised interest rates from 4.5 per cent to 5.0 per cent citing concerns about spare capacity, rapid money growth and the possibility of inflation staying above target for some time. House price inflation remained strong and consumer spending improved gradually through the year.

Secured lending continued to increase, although unsecured lending plateaued. There were some signs that more households were struggling with the burden of debt, as personal insolvencies and repossessions increased.

Employment rose, although by less than the increase in available workers, as migrant inflows remained strong and the participation rate of UK residents in the labour force increased. As a result, the unemployment rate increased, contributing to subdued wage growth throughout the year, despite relatively high rates of headline inflation.

The recovery in the euro zone economy gathered momentum through the course of 2006. GDP rose by 2.7 per cent, the fastest rate since 2000. Much of the improvement reflected increases in exports and investment, as global demand remained strong and corporate activity and profits rose.

Consumer spending in the euro zone was subdued, despite a gradual rise in employment. German growth improved sharply, while growth in France and Italy was less impressive. Euro zone inflation was heavily affected by rises in energy and food prices. Inflation, excluding energy and food, remained at just 1.7 per cent. The European Central Bank ('ECB') increased the key policy interest rate from 2.25 per cent at the beginning of 2006 to 3.5 per cent in December. The ECB continued to describe monetary policy as 'accommodative', thereby effectively ending the year with a bias towards tightening.

Turkey's economy slowed markedly in the third quarter, with year-on-year GDP growth of 3.4 per cent down from 7.8 per cent in the second quarter. The current account deficit continued to widen, reaching nearly 8.0 per cent of the expected GDP in December.

Competition

The bank operates in very competitive markets. The bank believes that competition in open and well regulated markets improves the experience of its customers and serves to ensure that financial institutions are efficient and transparent.

Across Europe, in both personal and commercial banking, the bank competes with a considerable and increasing range of companies. Regulators in the European markets closely monitor the bank's business and the bank works with them on a daily basis.

Europe

The European Commission commenced an inquiry in 2006 into retail banking across all member states, with which the bank's individual local entities cooperated fully. The full report was published in January 2007 and highlighted some concerns over the ways in which competition in banking was operating in Europe. No single country received any particular attention.

The Single Euro Payments Area programme, which is expected to integrate retail payments through harmonising euro currency transfers, bankers' orders and cards transactions in the euro zone, reached implementation phase. Full implementation is scheduled for 2008, which should offer strong growth opportunities for some banks, but is also expected to lead to more competition. The bank is positioning itself to capitalise fully on the opportunities presented.

The Markets in Financial Instruments Directive comes into effect on 1 November 2007, when it will replace the existing Investment Services Directive. It covers a broader range of investment instruments and market structures and, because conduct of business rules are set at European Union ('EU')

2 Office of National Statistics estimate published 23 February, 2007.

level, should mean fewer additional requirements when passporting[3] into other member states.

UK

The Office of Fair Trading ('OFT') concluded its inquiry into credit card terms under the Unfair Terms in Consumer Contracts Regulations, and announced that it did not intend to intervene further where issuers reduced their default fees to £12 or less. Subsequently the OFT started a fact-finding exercise, in connection with overdraft fees, through the industry's representative body, the British Bankers' Association. This is due to conclude in March 2007, following which the industry and the OFT are to review their respective positions. Media interest has been considerable.

The OFT conducted a market study into Payment Protection Insurance ('PPI') and referred the PPI market in the UK to the Competition Commission. The Commission recently announced they will be working with the Financial Services Authority ('FSA') to investigate whether there is a case for changing the existing rules for the sale of PPI.

The OFT conducted its review of the Small and Medium Enterprise ('SME') market following its report published in 2002. The bank cooperated with this review and awaits its findings.

Following MasterCard's appeal to the Competition Commission Appeals Tribunal, the OFT withdrew its original interchange fee case to concentrate on a new case against both MasterCard and Visa. The European Commission is also investigating interchange fees and the bank has responded to its requests for information.

In November 2006, the winding down of the Payment Systems Taskforce was announced and a new governance body for payment systems, the Payments Industry Association, was established. The bank is positioned to deliver the faster electronic payments introduced by the Payments Systems Taskforce and meets the minimum standards for cheque clearing.

3 *Any UK firm which wishes to carry on business in another European Economic Area ('EEA') state may do so if it is within the scope of a relevant EU Single Market Directive. This is referred to as an EEA right and the exercise of such rights is known as 'passporting'.*

France

Stable interest rates in the euro zone contributed to strong growth in real estate investment in France. Competition between French banks was concentrated on the promotion of real estate mortgage loans, the principal means by which new customers in France are acquired. Market activity increased and consumers continued to enjoy improved pricing to the detriment of bank margins.

The payment of interest on sight deposits authorised since the start of 2005 was introduced by one major mutual French bank, although linked to a quarterly fee for banking services. Market reaction was muted and to date, no other leading French bank has followed suit.

From January 2006, the Banque Postale was able to offer real estate lending and financial services including the sale of investment products manufactured by third party providers. Given the size of the Banque Postale's geographic coverage, this will increase competition in an already competitive market.

The French government reformed the household tax law for 2006/2007, notably introducing a tax exemption on capital gains on equities sold after an eight-year-holding period and a cap on total household taxes (including income, wealth and local taxes) at 60 per cent of income. The higher marginal tax rate has been limited to 40 per cent. These reforms will increase disposable income for wealthier individuals, who form one of HSBC France's key customer segments.

At the end of December 2005, French banks were granted approval, as in the UK, to provide equity release mortgages. This is expected to assist customers in real estate investment and to finance consumption.

Strategy

HSBC Bank plc aligns its strategy closely to the HSBC Group's strategic vision to be the world's leading financial services company, where leading means the HSBC brand is preferred to others.

In working towards delivery of the vision, the bank has developed strategic initiatives for each of its customer groups. The bank's priorities are to improve the customer experience, (continuing to develop the FSA principles of 'Treating Customers Fairly'), to invest in developing HSBC's brand and encourage all staff to live HSBC's brand values in their day-to-day activities, and to improve staff engagement. The bank also focuses on investing in delivery platforms and technology, improving the customer experience, enhancing work practices and taking advantage of HSBC's global reach.

Report of the Directors (continued)

The measures used to assess performance against the strategy are discussed in the Key Performance Indicators section below.

Key performance indicators ('KPIs')

The Board of Directors monitors the bank's progress against its strategic imperatives on a regular basis. Performance is assessed against HSBC Group's Managing for Growth strategy, the bank's operating plan targets and actual historical performance using financial and non-financial measures.

The strategic plan provides the bank with a blueprint for organic growth and development. This began in 2003 and will continue through to 2008. The plan is aimed at guiding the HSBC Group to achieving management's vision.

Financial KPIs

To support the Group strategy and ensure that the bank's performance can be monitored, management use a number of financial KPIs.

The table, below, presents the measures for the period 2005-2006. At a business level, KPIs are complemented by various benchmarks, which are relevant to the planning process and to reviewing business performance.

	2006	(Restated) 2005
Revenue growth (%) …………...	**8.1**	15.8
Revenue mix (%) ………………	**63.9**	62.4
Cost efficiency (%) …………….	**58.9**	58.8
Return on invested capital (%) ...	**13.6**	16.4

Revenue growth[4] provides an important guide to how well the bank is generating business. For management, this measure is a key indicator of the success of the bank in growing income from its businesses. Revenue growth slowed in 2006 partly due to the non-recurrence of one-off gains in 2005.

Revenue mix[5] demonstrates the change in composition of income within the bank and can be used to understand how changing economic factors may influence the bank.

The mix has been broadly stable and to an extent represents market conditions.

4 *The percentage increase in net operating income before loan impairment and other credit risk charges compared with the previous reporting period.*
5 *Net fee income and all other income streams (excluding net interest income) net of claims as a percentage of net operating income before loan impairment and other credit risk charges.*

Cost efficiency[6] is a relative measure that indicates the consumption of cost resources in generating revenue. Management use this statistic to assess future initiatives and to ensure that the bank's operations are cost-efficient. The ratio for 2006 was broadly in line with 2005.

Return on average invested capital[7] measures the return on the capital investment made in the business, enabling management to benchmark the bank against competitors. In 2006, the ratio of 13.6 per cent was lower than that reported in 2005. The lower ratio reflected a reduced return on risk weighted assets, partly due to the one-off gains in 2005 and from higher capital ratios during 2006.

Non-financial KPIs

In addition to the use of financial KPIs, the bank employs a variety of non-financial measures to assess performance against its strategic imperatives.

Employee engagement is a measure of employees' emotional and rational attachment to HSBC that motivates them to remain with the Group and align themselves wholeheartedly with its success.

The bank regularly surveys its employees on a regional or business basis, achieving a response rate of 84 per cent in the UK in 2006 when over 42,000 employees were surveyed, with most departments showing increases in engagement.

Brand perception
HSBC has conducted brand tracking surveys in its major Personal Financial Services markets for five years, assessing the strength of the brand by measuring awareness, consideration, momentum, image and differentiation. From 2007 onwards, the exercise will be extended to include customers in Commercial Banking's major markets. The surveys will be undertaken by accredited third party organisations. They will result in the computation of a blended metric that will indicate the bank's performance against a set of median scores for its competitors in its major markets.

Customer satisfaction
The bank has also regularly conducted customer satisfaction surveys in its various markets over many years. In future, the bank intends to use a consistent measure of recommendation to gauge levels of customer satisfaction with the services provided by its Personal Financial Services and Commercial Banking businesses. It will also benchmark them

6 *Total operating expenses divided by net operating income after insurance claims but before loan impairment and other credit risk charges.*
7 *Profit on ordinary activities after tax divided by average invested capital.*

against those of its main competitors in each of these markets.

IT performance and systems reliability
Two key measures of IT performance are the number of customer transactions processed and the percentage of services meeting availability targets.

The number of customer transactions is a measure that acts as a reasonable proxy for the use of IT developed and supported systems, and reflects the importance of IT in maintaining operational infrastructure that meets customer expectations. The bank's aim is to restrict the percentage increase in IT costs in any given period to less than the percentage increase in customer transaction volumes. In 2006, customer transactions increased by 12 per cent and IT costs by 1 per cent.

The percentage of services meeting availability targets represents the ability of IT to achieve service levels agreed with end-users within the bank. IT aims to meet or exceed 95 per cent of agreed availability targets and during 2006 met or exceeded 98 per cent of these. As part of the establishment of IT as a distinct function, a common measure of IT services has been established Groupwide. It is intended that the trend of this information will be published in future years.

Outlook

In both the euro zone and the UK, a combination of slowing global demand, strong currencies and lacklustre domestic demand are expected to calm current inflation fears and may prompt policy easing in the second half of 2007.

Euro zone GDP is expected to weaken to 1.7 per cent in 2007, from a stronger than expected 2.7 per cent in 2006. This reflects anticipated German growth but weaker expectations for France and Spain. Euro zone GDP exceeded expectations in 2006 due to stronger-than-expected exports and investment. Consumption has failed to accelerate though and does not look set to improve as households enter 2007 with contracting real wage growth.

The bank expects UK growth to slow through 2007. The disinflation that the rest of the developed world has experienced is yet to affect the UK as energy prices are still contributing about one percentage point to headline inflation. The fear that high headline inflation will feed into wage growth is the key near-term upside risk to UK rates but we believe the unprecedented increase in the supply of labour will be sufficient to subdue wage growth.

Beyond this, the bank expects domestic and external consumption growth to slow, dragging with it investment incentives. Subdued demand should contain inflationary pressure so that inflation actually undershoots in the second half of the year.

Report of the Directors (continued)

Segment Performance and Business Review

Profit on ordinary activities before tax

	2006 £m	(Restated) 2005 £m
UK Personal Financial Services	**882**	835
UK Commercial Banking	**951**	814
UK Corporate, Investment Banking and Markets	**498**	382
International Banking	**334**	592
HSBC France	**467**	460
Private Banking	**555**	516
HSBC Trinkaus & Burkhardt	**109**	132
	3,796	3,731

UK Personal Financial Services ('PFS')

Personal Financial Services provides current accounts, savings, personal loans, mortgages, cards, wealth management and general insurance to UK personal customers through a variety of distribution channels under various HSBC brands. These brands include first direct, M&S Money, and the bank's Partnership Cards business.

Pre-tax profit up £47 million, or 6 per cent

Net interest income increased through growth in savings, credit cards, mortgages and current accounts, resulting from targeted sales and marketing. The bank increased its focus on non-credit related income streams, particularly on savings products and high value packaged current accounts.

Net fee income increased due to rising sales of fee-earning packaged current accounts, travel money, unsecured lending and investment products. Transactional and other fees also increased, reflecting growth in the customer base. Other operating income benefited from improved Premier independent financial advisor income, MasterCard IPO proceeds and income from branch sale and leaseback transactions.

High levels of consumer indebtedness, together with growth in personal bankruptcies and IVAs, continued to fuel loan impairment charges on personal loans and credit cards. In 2006, IVAs became the main driver behind impairment growth as the number of companies marketing debt reduction services increased.

Mitigating action undertaken by the bank during 2005 and early 2006, predominantly with regard to underwriting criteria and collections, provided some success in improving credit quality on more recently written debt. The bank also took early action during 2006 with regard to IVAs, which helped reduce average levels of debt forgiveness, as well as highlighting misleading claims by some debt advisors. Predictive modelling using the data from more recent personal insolvencies was developed and applied to the underwriting process.

Operating expenses grew by 13 per cent. Excluding a £38 million non-cash write-down of intangibles attributed to acquired card portfolios and the cost base of Partnership Cards, the increase was 7 per cent, predominantly reflecting investment in capacity and infrastructure.

Unsecured lending balances declined modestly, reflecting the bank's decision to contain growth through stricter underwriting criteria. Mortgage balances rose, predominantly in fixed rate mortgages, driven by competitive pricing and marketing. Growth in credit card balances was strongest in M&S branded cards, driven by increased media advertising.

Current account balances increased with the proportion of packaged current accounts rising markedly. Savings account volumes rose strongly in a highly competitive and buoyant savings market. The bank's market share increased, driven by competitive internet-based products, while balances in first direct's 'e-savings' product doubled and balances in HSBC's 'Online Saver' increased fivefold.

Strategic initiatives and outlook

UK PFS strategy focuses on four main themes: segment, simplify, innovate, and compete. During 2006, initiatives to deliver the strategy included:

Segment: There was considerable strategic focus on enhancing services offered to customers. The bank has adopted a segmented approach to developing propositions, such as the Premier, Passport, and the packaged Plus current accounts.

A major branch refurbishment programme is on track, with upgrades completed on 104 branches in 2006, with zones for Premier, Student and Banking customers. These branches generated a 145 per cent increase in self-service points. Additional counter staff were recruited following an increase in opening hours in certain branches.

Simplify: Customer care was further enhanced by increasing the number of non-branch ATMs by 38 per cent, including 135 in Marks & Spencer stores and the rollout of a further 810 Express Banking kiosks. The internet proposition was also enhanced to enable customers better access to products and services.

Innovate: The bank continues to offer innovative products and services to its customers, including the 25 per cent Cashback Personal Loan, the January Sale and increased ATM functionality.

Attractive products and high levels of customer service continue to underpin HSBC's competitive position. HSBC was voted What Mortgage 'Best Value National Bank' over two, five and ten years for the 5th year running. first direct's 'e-savings' product was introduced at a market leading rate, while customers with whom the bank has deepened its relationship have the highest satisfaction levels compared with the main high street banks.

Treating Customers Fairly ('TCF') is an integral part of the bank's culture. If customers feel they are consistently treated fairly, they will trust the bank, develop loyalty towards the HSBC brand and recommend HSBC as the best place to bank. The bank will develop the brand through TCF.

During 2007, the bank will continue the development and delivery of its strategy along the themes noted above.

UK Commercial Banking ('CMB')

Commercial Banking provides a wide range of products and services to commercial organisations, from sole proprietors to quoted companies with annual turnover greater than £500m. These include current and savings accounts, payments, electronic banking, trade finance, loans, overdrafts, asset finance, card issuing and processing, foreign exchange and other treasury and capital markets instruments, wealth management services and general insurance.

Pre-tax profit up £137 million, or 17 per cent

Revenue grew across most business lines.

CMB invested to expand sales capacity and improve service through recruitment of business specialists and commercial managers and the opening of dedicated commercial centres. Brand awareness increased through media and branch-based marketing which, together with internal incentive campaigns, helped deliver growth.

The bank achieved the landmark of one million commercial banking customers during the year while over 23,000 customers switched their business from other banks, an increase of 17 per cent over 2005. In addition, CMB opened over 98,000 start-up accounts.

Average lending balances rose during the year, but spreads remained flat. However, the rate of growth in lending slowed, largely as a consequence of the bank's focus on credit quality through refinement of underwriting criteria and emphasis on non-lending related revenue streams.

Liabilities rose as increased priority was given to raising deposits through transactional and savings accounts, resulting in increased new accounts and higher average balances per account. Deposit margins widened, in part because of interest rate rises on dollar-denominated accounts.

Results also benefited from a share of income from branch sale and leaseback transactions and the MasterCard IPO.

Operating expenses were lower than in 2005. Excluding the effect of the transfer of the fleet management operations, underlying operating expenses increased, primarily through investment to support business expansion. Cost growth was substantially slower than income growth, resulting in an improvement to the cost efficiency ratio.

Loan impairment charges decreased, as the effect of lending growth was more than offset by improved credit quality, particularly in relation to the bank's larger exposures.

Strategic initiatives and outlook

During 2006, the bank invested to expand sales capacity and improve service through the recruitment of business specialists and the opening of dedicated Commercial Centres.

To support HSBC's strategic intention to lead the market in international commercial banking, a dedicated International Banking Centre was created which, as part of a global network, simplified cross-border account opening. New simplified foreign currency accounts were also launched.

Significant progress was made in enhancing the functionality of Business Internet Banking, which is now the most functionally rich service of its kind in

Report of the Directors (continued)

the UK, as evidenced by a recent comparison carried out by Business Moneyfacts.

Enhanced one-time-password security was rolled out to users from May. Commercial Card balance reporting was added in August and in October, the bank became the first major commercial bank to offer same day high value payments through its mainstream business internet banking system. The success of these investments was acknowledged through winning Best Corporate/Institutional Internet Bank, Europe in Global Finance World's Best Internet Bank Awards 2006.

In September, Business Direct, a new fee-free current account proposition, was launched aimed at businesses with annual sales below £500,000 and limited physical payments requirements. By December, 60 per cent of new account openings for this product were new to the bank and the service had attracted 19,000 customers.

During 2006, more than 30 insurance brokers were relocated to Commercial Centres across the country to improve performance on cross-referrals from those teams.

During 2007, Commercial Banking will continue to pursue the strategies set out above which have generated consistent success in recent years. There will be continued investment in premises and automation and in the bank's award winning e-business platforms. As part of a coordinated global programme, the bank's services for businesses operating internationally will continue to be enhanced.

UK Corporate, Investment Banking and Markets ('CIBM')

Corporate, Investment Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients worldwide. Products and services offered include Global Markets, Global Banking, Balance Sheet Management and Group Investment Businesses.

Pre-tax profit up £116 million, or 30 per cent

Excluding the non-recurrence of gains from the sale of finance leases and adverse mark-to-market movements on non-qualifying hedges in 2005, pre-tax profit was broadly in line with the previous year.

Significant gains from trading activities were partly offset by lower balance sheet management income and a reduced contribution from Private Equity.

Trading income increased with positive revenue trends in Credit and Rates, foreign exchange, structured derivatives and other key product areas where the bank has invested. Credit and Rates revenues increased substantially with interest rate derivatives benefiting from opportunities created from a relatively volatile market.

Additional gains were reported in emerging market bonds due to higher volumes, as investors adjusted to a change in risk appetite and a general improvement in market sentiment towards developing economies. Higher foreign exchange revenue was driven by greater customer volumes from e-commerce and increased trading opportunities offered by a combination of US dollar weakness and more volatile conditions, particularly in emerging markets.

Higher Global Markets revenue in 2006 was primarily due to higher Credit and Rates and structured derivatives income created by relatively volatile markets. Higher foreign exchange revenues from increased customer e-commerce volumes were offset by a decrease in balance sheet management revenues as short-term interest rates continued to rise and yield curves remained flat in the UK.

HSBC Securities Services ('HSS') revenue benefited from the growth in business with the takeover of new clients (mainly former Bank of Bermuda customers) and significant levels of income from value added services such as Securities Lending and Foreign Exchange.

In Global Banking, balance sheet initiatives, including the proactive management of the bank's portfolio, were developed further in 2006 and resulted in an enhanced performance in the lending business. Corporate balances grew due to the bank's participation in a number of high profile leveraged acquisition financing deals. Corporate spreads remained broadly in line with 2005.

Payment and Cash Management ('PCM') income grew due to favourable currency account balances. Other operating income was higher in sterling payments as volume increased in line with greater business activities.

In Global Markets, higher costs reflected an increase in performance-related staff costs and the full year impact of investments in 2005. In both

PCM and HSS, costs were driven higher by business expansion and increased volumes.

Strategic initiatives and outlook

CIBM's strategy is to be the leading emerging markets-led, financing-focused wholesale bank by leveraging the HSBC Group's unique footprint and heritage. The bank's network and client franchise provides the foundation from which CIBM can further develop its hub-and-spoke business model.

CIBM will continue to build skills and capabilities in its major hubs to support the delivery of an advanced suite of services to corporate, institutional and government clients across the HSBC network. Ensuring that this combination of product depth and distribution strength meets the needs of existing and new clients will allow CIBM to achieve its strategic goals.

International Banking

International Banking provides a range of retail financial services, primarily across Europe, to local and expatriate customers, and wholesale banking to corporate and institutional clients.

Pre-tax profit down £258 million, or 44 per cent

Excluding the non-recurrence of investment disposals in 2005, pre-tax profit was 2 per cent higher. Pre-tax profit increased across a number of countries including Malta, Greece, Spain and Italy due to a combination of growth in customer numbers, new product introductions and a stronger performance in wholesale banking. This increase was partly offset by lower profits in Turkey.

Improved asset volumes and yields and higher fee income were partly offset by loan impairments and growth in staff costs in Europe. Net income was also lower in the bank's branch in Australia, which was being wound down prior to transfer to another HSBC Group entity.

In Turkey, pre-tax profit fell by 17 per cent as the bank continued to invest in branch infrastructure, SME centres, relationship staff and service standards. Brand awareness and geographic coverage were increased through the opening of 37 branches during the year, supported by a number of marketing initiatives. Turkey's balance sheet and related revenues grew strongly because of this and, together with customer recruitment, led to 5 per cent growth in customer numbers to 2.4 million at the end of 2006.

The introduction of pre-approved credit limits for existing commercial customers contributed to lending growth, while focus on sales and competitive pricing helped grow deposits in all segments. Higher impairment charges were in line with balance sheet growth, while spending on recruitment and marketing in support of the growing SME initiatives drove expense growth.

Marketing initiatives and cross sales of credit card customers helped increase unsecured lending balances. Mortgage lending was also strong, and although credit card balances increased, growth was dampened by calming measures through increased regulation.

Good progress was made in developing the distribution of retail investment products through the bank's own branch networks and third parties.

Strategic initiatives and outlook

A new regional management team for Central and Eastern Europe has been set up in Prague to oversee development of the bank's existing banking and consumer finance operations. 2007 will see significant investment in new branches, strengthening of the local management team and expansion into new market sectors.

Expansion will also continue in former Commonwealth of Independent States ('CIS') markets such as Armenia and Kazakhstan with new branches enabling stronger growth.

HSBC France

HSBC France offers a wide range of retail, commercial, asset management and insurance products to individuals, companies and institutional customers through a network of banks in France.

Pre-tax profit up £7 million, or 2 per cent

HSBC France is the only bank to be awarded "Best Choice" (amongst the 18 biggest French Banks), for both e-banking solutions and telesales advisors by a major consumer website.[8]

A marked improvement in brand awareness after the 2005 branding to 'HSBC France' was reflected in the 37 per cent increase in new personal customers. This led to balance sheet growth most notably in residential property lending, current account and life insurance products, and increased cross-selling opportunities. The benefits of this growth were offset by a combination of highly competitive pricing and a change in asset mix, together with the lag between the costs of customer acquisition and the incremental benefits of cross sales expected in future periods.

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8 'Testé pour vous' web site – December 2006

Report of the Directors (continued)

In commercial banking, focus on brand awareness led to the recruitment of one third more new customers than in 2005, and for most of these new customers HSBC also became their principal relationship banker. Overall, commercial banking customer numbers increased by 5 per cent.

In CIBM, revenue growth was driven by the successful implementation of HSBC's three global platforms: Interest Rate Structured Derivatives, Equity Structured Derivatives and Rates Platform. HSBC France now has 'Primary Dealer' status for all Euro country bond issues. The increased coverage of French corporate customers resulted in higher turnover and increased participation in French and cross-border transactions and HSBC was ranked 7th in Mergers and Acquisitions[9] and 5th in IPOs[10]. The continued development of asset management activities using specialised vehicles covering specific products, expertise and geographic regions also contributed to these results.

Private banking activities were driven by a new sales impetus following the strengthening of teams and their skills. Assets under management rose by 13 per cent, with increased commercial awareness in the retail network improving referral rates to the Private Bank. Three new private banking branches, opened in target areas, also contributed to the 2006 results.

Tight cost control discipline continued throughout 2006 and the higher level of operating expenses was driven by recruitment of additional sales staff, marketing expenditure to drive customer acquisition and costs associated with the migration to a common IT platform.

Loan impairment costs, while remaining low, returned to more normal levels compared with net releases in 2005. Overall credit quality in HSBC France remained good.

Strategic initiatives and outlook

In 2007, HSBC France will continue its customer acquisition programme, refurbish and upgrade selected major branches, relaunch Premier banking and develop additional on-line sales products.

CIBM will focus on continuing to expand its range of trading activities and increase market share. The implementation of HSBC Investments France will provide an increased range of investment and wealth management solutions addressing customer needs in a number of continental European countries.

The main event in France in 2007 will be the presidential and parliamentary elections. GDP growth, which is expected to be affected by delays in company investments and social reforms that will be dependent on the election, is forecast to fall to 1.5 per cent in 2007.

Lower forecast inflation rate and the expectation of a continued decrease in unemployment rates should lead to higher disposable income and a consequent. Consumer demand is expected to remain one of the principal drivers of growth in 2007.

However, after strong growth over the last few years, the rate of increase of new property related loans is expected to slow as the impact of interest rate rises and high real estate prices are felt. There is potential for longer-term property loans over 50 years, but banks will remain vigilant and lending opportunities will be restricted by household debt levels. The demand for property is expected to remain good given demographic and social trends and tax advantages for residential property acquisition.

In French markets, pressure on banking margins is expected to continue as acquisition of new, and retention of existing, customers can only be achieved through highly competitive pricing strategies.

Private Banking

Private Banking offers an array of client services to high net worth customers, including advisory portfolio management, discretionary asset management, tax, trust and estate planning, mutual funds and currency and securities transactions.

Pre-tax profit up £39 million, or 8 per cent

Gains on the partial disposal of a seed capital investment in a fund were more than offset by the non-recurrence of the sale in 2005 of the Hong Kong trust business to another HSBC Group company. Excluding these, underlying profit growth was 16 per cent, arising from higher client assets, brokerage and sales of structured products, driven by customer acquisition and expansion of the product range.

A strategic move to the growth of discretionary and advisory managed assets contributed to increased fee income. Higher operating expenses

9 Source: Thomson Financial
10 Source: Bookrunner - Bondware

reflected the recruitment of front office staff, increased infrastructure and marketing spend to support business expansion, the launch of regional offices and geographic expansion in Asia.

Strategic initiatives and outlook

Private Bank's priority for 2007 will be to continue its growth strategy. This will be achieved by building greater brand awareness, providing broader product ranges to attract new clients and further growth in intra-group referrals.

Investment in staff and regional offices in 2006 should continue to provide benefits and support growth in 2007, with further investment required to grow the credit book, hedge fund, real estate, estate planning and investment businesses.

HSBC Trinkaus & Burkhardt

HSBC Trinkaus & Burkhardt, based in Düsseldorf, Germany, offers a comprehensive range of services to high net worth individuals, larger companies, institutional clients, public corporations and financial institutions.

Pre-tax profit down £23 million, or 17 per cent

2005 saw a high level of income from non-recurring profits on the sale of financial investments and the sale of the security settlement system to ITS (a joint venture of HSBC Trinkaus & Burkhardt). This was offset by the impact of growth in the German economy in 2006, from which the bank saw robust trading desk performance. Exceptionally strong market demand for equity derivatives saw significant revenues in the first half of 2006, particularly in retail products such as discount or bonus certificates and knock out warrants.

Interest rate and foreign exchange trading desks were also profitable.

Fee income was strong, especially from asset management products in all customer segments. Growth in net interest income reflected increased customer funds.

In addition, higher HSBC Group referral contacts in 2006 led to higher income from derivatives contracts.

Operating expenses grew mainly due to restructuring costs of the ownership of the bank, while loan impairment releases were lower than in 2005.

Strategic initiatives and outlook

Favourable equity market conditions experienced in 2006 might not continue in 2007. The raising of VAT from 16 per cent to 19 per cent at the beginning of the year may have a dampening influence on consumer demand. The increased customer base in private and corporate banking should be a solid foundation to grow net interest income and fee business, whereas a recurrence of the high trading income from retail equity derivative products depends on the conditions of the markets.

Increased integration into the HSBC Group will be reflected in a continued growth in the distribution of HSBC Group products.

Capital management

(audited information except where stated)

Capital measurement and allocation

The Financial Services Authority (FSA) is the supervisor of the bank and the group and, in this capacity, receives information on their capital adequacy and sets minimum capital requirements. Individual banking subsidiaries are directly regulated by the appropriate local banking supervisors, which set and monitor their capital adequacy requirements.

Under the European Union's Banking Consolidation Directive, the FSA requires each bank and banking group to maintain an individually prescribed ratio of total capital to risk-weighted assets. Under the EU's Capital Adequacy Directive the FSA allows banks to calculate capital requirements for market risk in the trading book using value at risk techniques.

The group's capital is divided into two tiers: tier 1 capital comprises shareholders' funds, innovative tier 1 securities and minority interests in tier 1 capital after adjusting for items reflected in shareholders' funds, which are treated differently for the purposes of capital adequacy. The book values of goodwill and intangible assets are deducted in arriving at tier 1 capital. Tier 2 capital comprises collective impairment allowances, reserves arising from revaluation of property, qualifying subordinated loan capital and minority and other interests in tier 2 capital and unrealised gains arising on the fair valuation of equity instruments held as available-for-sale. The amount of innovative tier 1 securities cannot exceed 15 per cent of overall tier 1 capital, qualifying tier 2 capital cannot exceed tier 1 capital, and qualifying term subordinated loan capital may not exceed 50 per cent of tier 1 capital. There are also limitations on the amount of collective impairment allowances which may be included in tier 2 capital. Total capital is calculated by deducting the book values of unconsolidated investments, investments in the capital of banks, and certain regulatory items from the total of tier 1 and tier 2 capital.

Future developments

The Basel Committee on Banking Supervision ('the Basel Committee') has published a new framework for calculating minimum capital requirements. Known as 'Basel II', it will replace the 1988 Basel Capital Accord. Basel II is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. The supervisory objectives for Basel II are to promote safety and soundness in the financial system and maintain at least the current overall level of capital in the system; enhance competitive equality; constitute a more comprehensive approach to addressing risks; and focus on internationally active banks.

With respect to pillar one minimum capital requirements, Basel II provides three approaches, of increasing sophistication, to the calculation of credit risk regulatory capital. The most basic, the standardised approach, requires banks to use external credit ratings to determine the risk weightings applied to rated counterparties, and groups other counterparties into broad categories and applies standardised risk weightings to these categories. In the next level, the internal ratings-based foundation approach allows banks to calculate their credit risk regulatory capital requirement on the basis of their internal assessment of the probability that a counterparty will default, but with quantification of exposure and loss estimates being subject to standard supervisory parameters. Finally, the internal ratings-based advanced approach will allow banks to use their own internal assessment of not only the probability of default but also the quantification of exposure at default and loss given default.

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

The EU Capital Requirements Directive ('CRD') recast the Banking Consolidation Directive and the Capital Adequacy Directive and will be the means by which Basel II will be implemented in the EU. The CRD was formally adopted by the Council and European Parliament on 14 June 2006 and it requires EU Member States to bring implementing provisions into force on 1 January 2007. In the case of the provisions relating to the implementation of the internal ratings-based advanced approach to credit risk and the advanced measurement approach to operational risk, implementation becomes available 1 January 2008.

In October 2006, the FSA published the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU'), which take effect from 1 January 2007 and implement the CRD in the UK. GENPRU introduces changes to the definition of capital and the methodology for calculating capital ratios. Changes include relaxation of the rules regarding the deduction of investments in other banks' capital and proportional rather than full consolidation of associates. In addition, certain deductions from capital, previously taken from total capital will be deducted 50% each from tier 1 and tier 2 for pillar 3 disclosure purposes.

BIPRU includes the Basel II changes to the calculation of credit and operational risk capital requirements. Transitional provisions regarding the implementation of BIPRU mean that unless firms notify the FSA to the contrary, they continue to apply the existing capital requirements calculations until 1 January 2008. Thereafter, the group proposes to adopt the Internal Ratings Board advanced approach for the majority of its business for credit risk purposes. A rollout plan is in place to extend coverage of the advanced approach over the succeeding three years, leaving a small residue of exposures on the standardised approach. For individual banking subsidiaries, the timing and manner of implementation of Basel II varies by jurisdiction and the requirements are set by local banking supervisors. The application of Basel II across the group's geographically diverse businesses, which operate in a large number of different regulatory environments, represents a significant logistical and technological challenge, and an extensive programme of implementation projects is currently in progress. Basel II permits local discretion in a number of areas for determination by local regulators. The extent to which requirements will diverge, coupled with how the FSA and the local host regulators in the other countries in which the group operates interact, will be key factors in completing implementation of Basel II.

Capital management

The group's capital resources policy is to maintain its capital base through the diversification of its sources of capital and the efficient allocation of capital. It seeks to maintain at all times a prudent relationship between its total capital, as measured according to the criteria used by the FSA for supervisory purposes, and the varied risks of its business.

Share capital

In March 2006, HSBC Holdings plc subscribed £400 million for one additional ordinary share of £1 credited as fully paid in the ordinary share capital of the bank. In May 2006, HSBC Holdings plc subscribed £275 million for a further ordinary share.

Save for these, there have been no other changes to the authorised or issued share capital of the bank in the year ended 31 December 2006.

Regulatory capital position *(unaudited information)*

The table below sets out the analysis of regulatory capital

Composition of capital	**2006 £m**	2005 £m
Tier 1:		
Shareholders' funds of the parent company	**20,620**	19,091
Minority interests and preference shares	**984**	985
Innovative tier 1 securities	**1,609**	1,641
Less: goodwill capitalised and intangible assets	**(8,844)**	(9,156)
Other regulatory adjustments	**–**	63
Total qualifying tier 1 capital	**14,369**	12,624
Tier 2:		
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities	**632**	570
Collective impairment allowances	**884**	972
General provisions	**–**	–
Perpetual subordinated loan	**1,015**	1,296
Term subordinated loan	**5,064**	4,525
Minority and other interests in tier 2 capital	**671**	737
Total qualifying tier 2 capital	**8,266**	8,100
Unconsolidated investments	**(432)**	(635)
Investments in other banks and other financial institutions	**(335)**	(316)
Other deductions	**(508)**	(96)
Total capital	**21,360**	19,677
Total risk-weighted assets	**190,860**	182,566
Capital ratios:	**%**	%
Total capital	**11.2**	10.8
Tier 1 capital	**7.5**	6.9

The above figures were computed in accordance with the EU Banking Consolidation Directive and the FSA policy statement PS05/5. The group complied with the FSA's capital adequacy requirements throughout 2006 and 2005.

Tier 1

The increase of £1.7 billion in tier 1 capital was largely due to retained profits of £1.1 billion.

Report of the Directors (continued)

Board of Directors

The objectives of the management structures within the bank, headed by the Board of Directors and led by the Chairman, are to deliver sustainable value to shareholders. Implementation of the strategy set by the Board is delegated to the bank's Executive Committee under the leadership of the Chief Executive.

The Board meets regularly and Directors receive information between meetings about the activities of committees and developments in the bank's business. All Directors have full and timely access to all relevant information and may take independent professional advice if necessary.

The names of Directors serving at the date of this report and brief biographical particulars for each of them are set out on page 2.

Non-executive Directors are appointed for three year terms, subject to their re-election by shareholders at the subsequent Annual General Meeting. Independent non-executive Directors have no service contract.

S T Gulliver was appointed as a Director on 1 September 2006. Having been appointed since the Annual General Meeting in 2006, he will retire at the forthcoming Annual General Meeting and offer himself for re-election.

D C Budd, S K Green, D D J John and J Singh will retire by rotation at the forthcoming Annual General Meeting and, with the exception of J Singh who will retire as a Director, they will offer themselves for re-election.

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 the bank or any of its subsidiary undertakings.

Board committees

The Board has appointed a number of committees consisting of certain Directors and senior executives. The following are the principal committees:

Executive Committee

The Executive Committee meets regularly and operates as a general management committee under the direct authority of the Board.

The members of the Executive Committee are D D J John (Chairman), D C Budd, both of whom are executive Directors and S Assaf, B M Cannon, J D Garner, A M Keir, S J Large, C G F Laughton-Scott, A M Mahoney, M McCombe, R K McGregor and M P Smith, all of whom are senior executives of the bank.

Audit Committee

The Audit Committee meets regularly with the bank's senior financial, internal audit and compliance management and the external auditor to consider the bank's financial reporting, the nature and scope of audit reviews and the effectiveness of the systems of internal control and compliance.

The members of the Audit Committee are A R D Monro-Davies (Chairman), P M Shawyer and J F Trueman. All of the members of the Audit Committee who served during 2006 are independent non-executive Directors.

Remuneration Committee

The functions of the Remuneration Committee are fulfilled by the Remuneration Committee of the Board of the bank's parent company, HSBC Holdings plc.

Internal control

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

The key procedures that the Directors have established are designed to provide effective internal control within the group and accord with the Internal Control Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales. Such procedures have been in place throughout the year and up to 5 March 2007, the date of approval of the *Annual Report and Accounts 2006*. In the case of companies acquired during the year, the internal controls in place are being reviewed against the group's benchmarks and they are being integrated into the group's systems.

The group's key internal control procedures include the following:

- Authority to operate the bank is delegated to the Chief Executive who has responsibility for overseeing the establishment and maintenance of appropriate systems and controls, and has authority to delegate such duties and responsibilities as he deems fit among the Directors and senior management. The appointment of executives to the most senior positions within the group requires the approval of the Board of Directors.
- Functional, operating, financial reporting and certain management reporting standards are established by HSBC Holdings' management for application across the whole HSBC Group. These are supplemented by operating standards set by the bank's management, as required.
- Systems and procedures are in place in the group to identify, control and report on the major risks including credit, changes in the market prices of financial instruments, liquidity, operational error, breaches of law or regulations, unauthorised activities and fraud. Exposure to these risks is monitored by the bank's or major subsidiaries' executive committees, risk management committees and the asset and liability management committees.
- Processes to identify new risks from changes in market practices or customer behaviours which could expose the group to heightened risk of loss or reputational damage.
- Comprehensive annual financial plans setting out the key business initiatives and the likely financial effects of those initiatives are prepared, reviewed and approved by the Board of Directors. Results are monitored regularly and reports on progress as compared with the related plan are prepared monthly.
- Centralised functional control is exercised over all computer system developments and operations. Common systems are employed where possible for similar business processes. Credit and market risks are measured and reported on in the bank and major subsidiaries, and aggregated for review of risk concentrations on an HSBC Group-wide basis.
- Responsibilities for financial performance against plans and for capital expenditure, credit exposures and market risk exposures are delegated with limits to line management. In addition, functional management in HSBC Holdings is responsible for setting policies, procedures and standards in the following areas of risk: credit risk; market risk; liquidity risk; operational risk; IT risk; insurance risk; accounting risk; tax risk; legal and regulatory compliance risk; human resources risk; reputational risk and purchasing risk; and for certain global product lines.
- Policies and procedures have been established to guide the bank, subsidiary companies and management at all levels in the conduct of business to avoid reputational risk which can arise from social, ethical or environmental issues, or as a consequence of operational risk events. As a banking group, HSBC's good reputation depends upon the way in which it conducts its business but it can also be affected by the way in which clients, to which it provides financial services, conduct their business.
- The internal audit function, which is centrally controlled, monitors compliance with policies and standards and the effectiveness of internal control structures across the group. The work of the internal audit function is focused on areas of greatest risk to the group as determined by a risk management approach.
- Management is responsible for ensuring that recommendations made by the internal audit function are implemented within an appropriate and agreed timetable. Confirmation to this effect must be provided to internal audit. Management must also confirm annually to internal audit that offices under their control have taken or are in the process of taking the appropriate actions to deal with all significant recommendations made by external auditors in management letters or by regulators following regulatory inspections.

The Audit Committee has kept under review the effectiveness of this system of internal control and has reported regularly to the Board of Directors. The key processes used by the Committee in carrying out its reviews include regular reports from the heads of key risk functions; the production and regular updating of summaries of key controls measured against group benchmarks which cover all internal controls, both financial and non-financial; annual confirmations from senior executives that there have been no material losses, contingencies or uncertainties caused by weaknesses in internal controls; internal audit reports; external audit reports; prudential reviews; and regulatory reports.

The Directors, through the Audit Committee, have conducted an annual review of the effectiveness of the group's system of internal control covering all material controls, including financial, operational and compliance controls and risk management systems. The Audit Committee

Report of the Directors (continued)

has received confirmation that management has taken or is taking the necessary action to remedy any failings or weaknesses identified through the operation of the group's framework of controls.

Risk management

The group regularly updates its policies and procedures for safeguarding against reputational, strategic and operational risks. This is an evolutionary process.

The safeguarding of the group's reputation is of paramount importance to its continued prosperity and is the responsibility of every member of staff. The group has always aspired to the highest standards of conduct and, as a matter of routine, takes account of reputational risks to its business.

Reputational risks are considered and assessed by the Board, its committees and senior management in adherence with HSBC Holdings plc standards. Policies on all major aspects of business are set for the group and for individual subsidiary companies, businesses and functions. These policies, which form an integral part of the internal control systems, are communicated through manuals and statements of policy and are promulgated through internal communications. The policies cover social, ethical and environmental issues and set out operational procedures in all areas of reputational risk, including money laundering deterrence, environmental impact, anti-corruption measures and employee relations. The policy manuals address risk issues in detail and co-operation between head office departments and businesses is required to ensure a strong adherence to the group's risk management system and its corporate social responsibility practices.

Internal controls are an integral part of how the group conducts its business. HSBC Holdings plc's manuals and statements of policy are the foundation of these internal controls. There is a strong process in place to ensure controls operate effectively. Any significant failings are reported through the control mechanisms, internal audit and compliance functions to the Audit Committee, which keeps under review the effectiveness of the system of internal controls and reports regularly to the Board.

The financial risk management objectives and policies of the bank and its subsidiaries, including those in respect of financial instruments, together with an analysis of the exposure to such risks, as required under the Companies Act and International Financial Reporting Standards are set out in Note 39 'Risk management' of the Notes on the Financial statements.

Health and safety

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

Health and safety policies and HSBC Holdings plc standards and procedures are set by the Group's Fire and Safety Department and are implemented by Health, Safety and Fire Coordinators based in each country in which the Group operates.

Despite the considerable military and law-enforcement successes against terrorist networks, the global threat from terrorism persists. HSBC remains committed to maintaining its preparedness and to ensuring the highest standards of health and safety wherever in the world it operates.

HSBC Group Security provides regular risk assessments in areas of increased risk to assist management in judging the level of terrorist threat. In addition, Regional Security functions conduct regular security reviews to ensure measures to protect the Group.

Directors' emoluments

Details on the emoluments of the Directors of the bank for 2006, disclosed in accordance with the Companies Act, are shown in Note 8 'Employee compensation and benefits' in the Notes on the Financial statements.

Directors' interests

Interests in shares

According to the register of Directors' interests maintained by the bank pursuant to section 325 of the Companies Act 1985, the Directors of the bank at the year-end had the following beneficial interests in the shares and loan capital of HSBC Holdings plc. As Directors of HSBC Holdings plc, the interests of S K Green and M F Geoghegan are disclosed within the financial statements of that company.

HSBC Holdings plc ordinary shares of US$0.50	At 1 January 2006	At 31 December 2006
D C Budd	146,085[1]	188,448[2]
C-H Filippi	265,000	371,408[3]
J D Fishburn	19,728[4]	19,728[5]
S T Gulliver	3,060,825[6]	3,076,408[7]
D D J John	186,868[8]	241,612[9]
P M Shawyer	2,404	2,404

1 *Includes an interest in 49,126 shares held under The HSBC Holdings plc Restricted Share Plan 2000 and 24,151 shares held under The HSBC Share Plan long-term incentive plans in which Mr Budd is beneficially interested but have yet to vest.*
2 *Includes an interest in 38,987 shares held under the HSBC Holdings plc Restricted Share Plan 2000 and 61,808 shares held under The HSBC Share Plan long-term incentive plans in which Mr Budd is beneficially interested but have yet to vest.*
3 *Includes an interest in 106,408 shares held under The HSBC Share Plan long-term incentive plans in which Mr Filippi is beneficially interested but have yet to vest.*
4 *Includes 810 HSBC American Depositary Shares (4,050 ordinary shares) held in the Deferred Non-Qualified Compensation Plan for Directors operated by HSBC Finance Corporation and will be released to J D Fishburn when he retires as a Director of that company, which will be no later than May 2017.*
5 *Includes 810 HSBC American Depositary Shares (4,050 ordinary shares) held in the Deferred Non-Qualified Compensation Plan for Directors operated by HSBC Finance Corporation and will be released to J D Fishburn when he retires as a Director of that company, which will be no later than May 2017.*
6 *Interest as at date of appointment, 1 September 2006, includes an interest in 1,239,353 shares held under The HSBC Holdings plc Restricted Share Plan 2000 and 628,656 shares held under The HSBC Share Plan long-term incentive plans in which Mr Gulliver is beneficially interested but have yet to vest.*
7 *Includes an interest in 1,249,689 shares under The HSBC Holdings plc Restricted Share Plan 2000 and 633,899 shares held under The HSBC Share Plan long-term incentive plans in which Mr Gulliver is beneficially interested but have yet to vest.*
8 *Includes an interest in 130,585 shares held under The HSBC Holdings plc Restricted Share Plan 2000 and 50,401 shares held under The HSBC Share Plan long-term incentive plans in which Mr John is beneficially interested but have yet to vest.*
9 *Includes an interest in 115,969 shares held under The HSBC Holdings plc Restricted Share Plan 2000 and 104,907 shares held under The HSBC Share Plan long-term incentive plans in which Mr John is beneficially interested but have yet to vest.*

Following the acquisition of HSBC France in 2000, HSBC France shares issued following the exercise of options over HSBC France shares became exchangeable for HSBC Holdings plc ordinary shares of US$0.50 each in the same ratio as the exchange offer for HSBC France (13 HSBC Holdings plc ordinary shares for each HSBC France share). HSBC Holdings plc ordinary shares, which may be used to satisfy the exchange of HSBC France shares following exercise of these options, were purchased by The HSBC Holdings Employee Benefit Trust 2001 (No.1). Shares held by the Trust in respect of C-H Filippi's options have been appointed into a sub-trust in respect solely of these options. As at 1 January 2006, Mr Filippi had an interest in 559,000 HSBC Holdings plc ordinary shares held by the sub-Trust. As at 31 December 2006, Mr Filippi had an interest in 546,000 HSBC Holdings plc ordinary shares held by the sub-Trust.

In addition to the interests in the ordinary share capital of HSBC Holdings plc disclosed above, the Directors had the following interests in shares or debentures of subsidiary undertakings of HSBC Holdings plc.

As Directors of HSBC France, C-H Filippi and P M Shawyer each had a beneficial interest in one share of €5 in that company, which they held throughout the year. The Directors have waived their rights to receive dividends on these shares and have undertaken to transfer these Director's qualification shares to the bank on ceasing to be Directors of HSBC France.

As a Director of other French subsidiaries C-H Filippi holds a number of other Director's qualification shares, as is legal practice in France. These are as follows: HSBC Asset Management Holding (1 share of €16.00) and HSBC Private Bank France (1 share of €2.00). Mr Filippi has waived his rights to receive dividends on these shares and has undertaken to transfer these shares to the respective company on ceasing to be a Director.

Save as stated above, none of the Directors had an interest in any shares or debentures of HSBC Holdings plc or any of its subsidiary undertakings at the beginning or at the end of the year.

Share options

At 31 December 2006, the undernamed Directors held options to acquire the number of HSBC Holdings ordinary shares of US$0.50 each set against their respective names. The options were awarded for nil consideration at exercise prices equivalent to the market value at the date of award, except that options awarded under the HSBC Holdings savings-related share option plans before 2001 are exercisable at a 15 per cent discount to the market value at the date of award and those awarded since 2001 at a 20 per cent discount. Except as otherwise indicated, no options were exercised or lapsed during the year and there are no remaining performance criteria conditional upon which the outstanding options are exercisable.

Report of the Directors (continued)

Options over HSBC Holdings plc ordinary shares of US$0.50 each

	Options held at 1 January 2006	Options awarded during year	Options exercised during year	Options held at 31 December 2006
Executive Directors				
D C Budd	-	487[1]	-	487
C-H Filippi	911,071	-	-	911,071
D D J John	23,076	243[2]	499[3]	22,820
Non-executive Directors				
J D Fishburn[4]	90,950	-	-	90,950

1 *Grant of option under the HSBC Holdings plc savings-related share option plan on 26 April 2006.*
2 *Grant of option under the HSBC Holdings plc savings-related share option plan on 26 April 2006.*
3 *Exercise of 499 shares under the HSBC Holdings plc savings-related share option plan on 1 August 2006.*
4 *Options granted in respect of services as a non-executive Director of HSBC Finance Corporation (formerly Household International, Inc.) during the period 1998 to 2001 prior to its acquisition by HSBC Holdings plc. Post acquisition, this interest in stock options of HSBC Finance Corporation has been converted to options over HSBC Holdings plc ordinary shares.*

At 31 December 2006, C-H Filippi held the following options to acquire HSBC France shares of €5 each. On exercise of these options, each HSBC France share will be exchanged for 13 HSBC Holdings plc ordinary shares of US$0.50 each. The options were granted by HSBC France for nil consideration at a 5 per cent discount to the market value at the date of award. There are no remaining performance criteria conditional upon which the outstanding options are exercisable. No options over HSBC France shares of €5 each were awarded to or exercised by C-H Filippi during the year, except as otherwise indicated.

Options over HSBC France shares of €5 each

	Options held at 1 January 2006	Equivalent HSBC Holdings ordinary shares of US$0.50 each at 1 January 2006	Options exercised during the year	Equivalent HSBC Holdings ordinary shares of US$0.50	Options held at 31 December 2006	Equivalent HSBC Holdings ordinary shares of US$0.50 each at 31 December 2006
C-H Filippi	43,000	559,000	1,000[1]	13,000	42,000	546,000

1 *Part exercise of option over 1,000 HSBC France shares on 13 December 2006 subsequently exchanged for 13,000 HSBC Holdings plc ordinary shares.*

Save as stated above, none of the Directors or members of their immediate families were awarded or exercised any right to subscribe for any shares or debentures during the year.

Employee involvement

During 2006, the bank involved its employees in a much more systematic way through the launch of a programme called 'Best Place to Work' that used intranet, 'meet the top leadership team' sessions, TV debates and postcard questions and feedback. This led to a structured response and the identification of 15 items for improvement that the banks's Chief Executive committed to deliver, some of which are already complete, some of which are in progress. The annual employee survey had a response rate of 84 per cent, the highest ever, which made the feedback given robust and actionable. The involvement of employees in the performance of the bank continues to be encouraged through participation in bonus and share option plans.

Diversity policy: employees with disabilities

The group continues to be committed to providing equal opportunities to employees and to proactively encourage an inclusive workplace in line with our brand promise.

During 2006, we met the challenge of changing a number of our employment policies to meet the new age regulations that came into force on 1 October 2006.

We continue to recruit, train and develop disabled employees and make reasonable adjustments where employees become disabled during their employment.

Community involvement and donations

During the year, the bank made charitable donations totalling £6 million.

HSBC has a long record of support for the communities in which it operates. These are the communities from which we draw our employees and our customers, and we believe we can and should play a role in supporting them.

During 2006, the bank gave £6 million in charitable donations to support community activities in the UK. The donations were used to fund a wide variety of initiatives, as described below, with the main focus on education, particularly for under-privileged primary and secondary school students, and the environment. The bank also increased its focus on employee-led charitable initiatives.

Education

The HSBC Global Education Trust directly supports educational initiatives; for example it has supported two Academies. Additionally it supports the Teach First programme where top graduates teach mathematics in inner city schools. The Trust has also supported a DfeS led initiative for orphaned children and children in care with a contribution of £1 million.

Environment

The group's employees are involved in a variety of projects related to environmental sustainability. Many employees have participated in HSBC's global *Investing in Nature* programme, launched in 2002 and involving three partners: WWF, Earthwatch and Botanic Gardens Conservation International (BGCI).

Community

While some of our community activities are managed centrally, as the world's local bank we want to stay close to the communities in which we operate. In 2006 we continued our policy of allowing our employees to propose local projects for HSBC support.

Over 350 employee-led projects were initiated as a result of this policy with financial support approaching £3 million. In addition, over £1.3 million was donated to charities to match funds raised, or time given, by employees through our staff charity scheme.

2006 saw continued support for the nationwide Kielder Challenge programme. This inspirational programme operated by The Fieldfare Trust brings together young people with and without disabilities to compete in a series of outdoor challenges. Over 1,800 young people took part in this programme assisted by 60 employee volunteers.

HSBC also agreed in the year to support the Government led Russell Commission initiative to promote increased levels of youth volunteering agreeing a donation of £500,000 over 3 years.

We also expanded our innovative new service to allow customers to donate money to charity through our ATMs. HSBC customers can now donate to 7 well-known national charities directly from their account at any HSBC ATM.

In 2006 a new scheme was introduced called 'Keep the Change' which allows HSBC employees to forego the odd pennies from their monthly net salaries to 6 charities which were selected following a staff poll.

No political donations were made during the year.

At the HSBC Holdings plc Annual General Meeting in 2003 shareholders gave authority for the bank to make EU political donations and incur EU political expenditure up to a maximum aggregate sum of £50,000 over a four-year period as a precautionary measure in light of the wide definitions in the Political Parties, Elections and Referendums Act 2000. This authority has not been used. HSBC Holdings plc is intending to renew this authority at its Annual General Meeting in 2007.

Valuation of freehold and leasehold land and buildings

The group's freehold and long leasehold properties were valued in 2006. The value of these properties was £272 million in excess of their carrying amount in the consolidated balance sheet. The group no longer revalues freehold and long leasehold properties under IFRSs.

Supplier payment policy

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

Copies of, and information about, the Code are available from the Department of Trade and Industry, 1 Victoria Street, London SW1H 0ET and on the internet, www.dti.gov.uk/publications.

Report of the Directors (continued)

The amount due to the bank's trade creditors at 31 December 2006 represented 20 days' average daily purchases of goods and services received from those creditors, calculated in accordance with the Companies Act 1985, as amended by Statutory Instrument 1997/571.

Auditor

KPMG Audit Plc has expressed its willingness to continue in office and the Board recommends that it be reappointed. A resolution proposing the reappointment of KPMG Audit Plc as auditor of the bank and giving authority to the Directors to determine its remuneration will be submitted to the forthcoming Annual General Meeting.

Disclosure of information to the Auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the bank's auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

On behalf of the Board
J H McKenzie, *Secretary*

5 March 2007

Statement of Directors' Responsibilities in Relation to the Director's Report and the Financial Statements

The following statement, which should be read in conjunction with the Auditors' statement of their responsibilities set out in their report on the next page, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements.

The Directors are responsible for preparing the Annual Report, the consolidated financial statements of HSBC Bank plc and its subsidiaries (the 'group') and parent company financial statements for HSBC Bank plc (the 'bank') in accordance with applicable law and regulations.

Company law requires the Directors to prepare group and parent company financial statements for each financial year. The Directors are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the bank financial statements on the same basis.

The group and bank financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the group and the bank and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the group and bank financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether they have been prepared in accordance with IFRSs as adopted by the EU.

The Directors are required to prepare the financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the group has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on the going concern basis.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the bank and enable them to ensure that its financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The Directors have responsibility for the maintenance and integrity of the Annual Report and Accounts as they appear on the bank's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board
J H McKenzie, *Secretary* 5 March 2007

Independent Auditors' Report to the Member of HSBC Bank plc

We have audited the group and bank financial statements (the 'financial statements') of HSBC Bank plc for the year ended 31 December 2006 which comprise the group Income Statement, the group and bank Balance Sheets, the group and parent Cash Flow Statements, the group and bank Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the bank's member, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the bank's member those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the bank and the bank's member as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Directors Report and the Financial Statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 25.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report and Accounts 2006 and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the group's financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the bank's financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the bank's affairs as at 31 December 2006;
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London 5 March 2007

Financial Statements

Consolidated income statement for the year ended 31 December 2006

	Notes	2006 £m	(Restated) 2005 £m
Interest income		13,339	11,056
Interest expense		(9,143)	(7,014)
Net interest income		**4,196**	4,042
Fee income		5,018	4,249
Fee expense		(1,276)	(894)
Net fee income		**3,742**	3,355
Trading income excluding net interest income		1,699	981
Net interest income on trading activities		927	794
Net trading income		**2,626**	1,775
Net income from financial instruments designated at fair value	*4*	**59**	170
Gains less losses from financial investments		**239**	248
Dividend income		**50**	28
Net earned insurance premiums	*5*	**317**	438
Other operating income		**480**	919
Total operating income		**11,709**	10,975
Net insurance claims incurred and movement in policyholders' liabilities	*6*	**(91)**	(230)
Net operating income before loan impairment charges		**11,618**	10,745
Loan impairment charges		**(938)**	(776)
Net operating income		**10,680**	9,969
Employee compensation and benefits	*8*	**(3,929)**	(3,624)
General and administrative expenses	*9*	**(2,354)**	(2,090)
Depreciation of property, plant and equipment		**(410)**	(483)
Amortisation and impairment of intangible assets and impairment of goodwill		**(151)**	(118)
Total operating expenses		**(6,844)**	(6,315)
Operating profit		**3,836**	3,654
Share of (loss)/ profit in associates and joint ventures		**(40)**	77
Profit before tax		**3,796**	3,731
Tax expense	*11*	**(978)**	(827)
Profit for the year		**2,818**	2,904
Profit attributable to shareholders of the parent company		**2,722**	2,842
Profit attributable to minority interests		**96**	62

Financial Statements (continued)

Consolidated balance sheet at 31 December 2006

	Notes	2006 £m	(Restated) 2005 £m
ASSETS			
Cash and balances at central banks		**3,618**	1,711
Items in the course of collection from other banks		**2,937**	3,595
Trading assets	*15*	**63,779**	48,510
Trading assets which may be repledged or resold by counterparties	*15*	**22,215**	21,611
Financial assets designated at fair value	*16*	**5,985**	5,345
Derivatives	*17*	**32,090**	26,077
Loans and advances to banks	*32*	**44,428**	31,578
Loans and advances to customers	*32*	**200,416**	182,629
Financial investments	*18*	**40,104**	41,281
Financial investments which may be repledged or resold by counterparties	*18*	**2,276**	2,201
Interests in associates and joint ventures	*20*	**923**	845
Goodwill and intangible assets	*21*	**9,251**	9,618
Property, plant and equipment	*23*	**4,408**	4,319
Other assets	*25*	**4,454**	3,896
Deferred taxation	*30*	**29**	195
Prepayments and accrued income		**3,847**	3,011
Total assets		**440,760**	386,422
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	*32*	**38,513**	34,198
Customer accounts	*32*	**227,350**	205,475
Items in the course of transmission to other banks		**2,428**	2,268
Trading liabilities	*26*	**52,080**	45,133
Financial liabilities designated at fair value	*27*	**9,460**	8,185
Derivatives	*17*	**32,743**	26,636
Debt securities in issue	*32*	**38,090**	26,801
Retirement benefit liabilities	*8*	**2,252**	2,218
Other liabilities	*28*	**4,614**	4,788
Current taxation		**286**	345
Liabilities under insurance contracts issued	*29*	**1,886**	1,978
Accruals and deferred income		**4,196**	3,448
Provisions:	*30*		
– deferred taxation		**142**	139
– other provisions		**402**	384
Subordinated liabilities	*31*	**5,380**	4,792
Total liabilities		**419,822**	366,788
Equity			
Called up share capital	*36*	**797**	797
Share premium account	*37*	**14,558**	13,883
Other reserves	*37*	**78**	531
Retained earnings	*37*	**4,966**	3,880
Total equity attributable to shareholders of the parent company		**20,399**	19,091
Minority interests	*37*	**539**	543
Total equity		**20,938**	19,634
Total equity and liabilities		**440,760**	386,422

S K Green, *Chairman*
M F Geoghegan, *Deputy Chairman*
D D J John, *Chief Executive*
J H McKenzie, *Secretary*

5 March 2007

Consolidated statement of recognised income and expense for the year ended 31 December 2006

	2006 £m	(Restated) 2005 £m
Available-for-sale investments:		
– valuation gains taken to equity	**258**	49
– transferred to income statement on disposal or impairment	**(179)**	(194)
Cash flow hedges:		
– (losses)/ gains taken to equity	**(64)**	35
– transferred to income statement	**(118)**	(180)
Exchange differences arising on net investments in foreign operations	**(617)**	(28)
Other reserves:		
– gains taken to equity	**137**	42
Actuarial gains/ (losses) on post-employment benefits	**9**	(302)
	(574)	(578)
Net deferred taxation on items taken directly to equity	**29**	161
Total net expense taken directly to equity during the year	**(545)**	(417)
Profit for the year as previously stated	**–**	2,959
Restatement adjustment	**–**	(55)
Profit for the year as restated	**2,818**	2,904
Total recognised income and expense for the year	**2,273**	2,487
Effect of change in accounting policy:		
IFRSs transition adjustment at 1 January 2005	**–**	(2,620)
	2,273	(133)
Total recognised income and expense for the year attributable to:		
– shareholders of the parent company	**2,198**	2,433
– minority interests	**75**	54

Financial Statements (continued)

Consolidated cash flow statement for the year ended 31 December 2006

	Notes	2006 £m	(Restated) 2005 £m
Cash flows from operating activities			
Profit before tax		**3,796**	3,731
Adjustments for:			
– non-cash items included in profit before tax	*38*	**1,861**	1,617
– change in operating assets	*38*	**(26,052)**	(46,299)
– change in operating liabilities	*38*	**39,302**	49,503
– elimination of exchange differences [1]		**761**	(3,890)
– net gain from investing activities		**(239)**	(248)
– share of losses/ (profits) in associates and joint ventures		**40**	(77)
– distributions (to)/ from associates		**(50)**	64
– contributions paid for defined benefit pension schemes		**142**	–
– tax paid		**(766)**	(767)
Net cash from operating activities		**18,795**	3,634
Cash flows used in investing activities			
Purchase of financial investments		**(46,621)**	(58,223)
Proceeds from the sale of financial investments		**46,118**	51,820
Purchase of property, plant and equipment		**(628)**	(745)
Proceeds from the sale of property, plant and equipment		**179**	186
Purchase of goodwill and intangible assets		**(147)**	(472)
Net cash inflow/ (outflow) from acquisition of and increase in stake of subsidiaries		**7**	(25)
Net cash outflow from acquisition of and increase in stake of associates		**(259)**	(170)
Proceeds from disposal of associates		**270**	256
Net cash used in investing activities		**(1,081)**	(7,373)
Cash flows from/(used in) financing activities			
Issue of ordinary share capital		**675**	1,500
Purchases of HSBC Holdings plc shares to satisfy share based payment transactions		**142**	115
Subordinated loan capital issued		**1,207**	523
Subordinated loan capital repaid		**(411)**	(635)
Dividends paid to shareholders		**(1,591)**	(1,400)
Dividends paid to minority interests		**(9)**	(14)
Net cash (used in)/ from financing activities		**13**	89
Net increase/(decrease) in cash and cash equivalents		**17,727**	(3,650)
Cash and cash equivalents at 1 January		**30,515**	33,677
Effect of exchange rate changes on cash and cash equivalents		**(1,521)**	488
Cash and cash equivalents at 31 December	*38*	**46,721**	30,515

1 Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without reasonable expense.

HSBC Bank plc balance sheet at 31 December 2006

	Notes	2006 £m	(Restated) 2005 £m
ASSETS			
Cash and balances at central banks		**2,496**	689
Items in the course of collection from other banks		**1,367**	2,125
Trading assets	*15*	**53,918**	34,733
Trading assets which may be repledged or resold by counterparties	*15*	**8,811**	3,950
Financial assets designated at fair value	*16*	**–**	16
Derivatives	*17*	**24,361**	17,570
Loans and advances to banks	*32*	**25,121**	19,196
Loans and advances to customers	*32*	**143,964**	134,819
Financial investments	*18*	**10,964**	15,147
Financial investments which may be repledged or resold by counterparties	*18*	**1,171**	238
Interests in associates and joint ventures	*20*	**255**	230
Investments in subsidiary undertakings	*24*	**14,546**	14,493
Goodwill and intangible assets	*21*	**557**	567
Property, plant and equipment	*23*	**1,521**	1,469
Other assets	*25*	**2,014**	1,469
Deferred taxation	*30*	**873**	1,007
Prepayments and accrued income		**2,147**	1,490
Total assets		**294,086**	249,208
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	*32*	**29,182**	27,999
Customer accounts	*32*	**164,054**	141,761
Items in the course of transmission to other banks		**1,019**	805
Trading liabilities	*26*	**35,215**	21,303
Financial liabilities designated at fair value	*27*	**4,736**	4,321
Derivatives	*17*	**24,967**	17,251
Debt securities in issue	*32*	**5,408**	8,212
Retirement benefit liabilities	*8*	**2,069**	2,003
Other liabilities	*28*	**2,414**	2,846
Current taxation		**106**	95
Accruals and deferred income		**2,572**	1,851
Provisions:	*30*		
– deferred taxation		**33**	12
– other provisions		**105**	124
Subordinated liabilities	*31*	**4,999**	4,479
Total liabilities		**276,879**	233,062
Equity			
Called up share capital	*36*	**797**	797
Share premium account	*37*	**14,558**	13,883
Other reserves	*37*	**202**	82
Retained earnings	*37*	**1,650**	1,384
Total equity		**17,207**	16,146
Total equity and liabilities		**294,086**	249,208

S K Green, *Chairman*
M F Geoghegan, *Deputy Chairman*
D D J John, *Chief Executive*
J H McKenzie, *Secretary*

5 March 2007

Financial Statements (continued)

HSBC Bank plc statement of recognised income and expense for the year ended 31 December 2006

	2006 £m	(Restated) 2005 £m
Available-for-sale investments:		
– valuation gains taken to equity	**63**	–
– transferred to income statement on disposal or impairment	**2**	(1)
Cash flow hedges:		
– gains/ (losses) taken to equity	**56**	(31)
– transferred to income statement	**(35)**	–
Exchange differences arising on net investments in foreign operations	**(1)**	7
Actuarial losses on post-employment benefits	**(10)**	(240)
	75	(265)
Net deferred taxation on items taken directly to equity	**(42)**	73
Total net expense taken directly to equity during the year	**33**	(192)
Profit for the year as previously stated	**–**	1,678
Restatement adjustment	**–**	(55)
Profit for the year as restated	**1,896**	1,623
Total recognised income and expense for the year	**1,929**	1,431
Effect of change in accounting policy:		
IFRSs transition adjustment at 1 January 2005	**–**	(637)
	1,929	794
Total recognised income and expense for the year attributable to shareholders of the parent company	**1,929**	1,431

HSBC Bank plc cash flow statement for the year ended 31 December 2006

	Notes	2006 £m	(Restated) 2005 £m
Cash flows from operating activities			
Profit before tax		**2,335**	1,983
Adjustments for:			
– non-cash items included in net profit	38	**1,267**	1,124
– change in operating assets	38	**(13,812)**	(43,787)
– change in operating liabilities	38	**21,446**	38,562
– elimination of exchange differences [1]		**(160)**	(3,176)
– net gain from investing activities		**(48)**	(49)
– contribution paid for defined pension schemes		**127**	–
– tax paid		**(323)**	(394)
Net cash from/(used in) operating activities		**10,832**	(5,737)
Cash flows used in investing activities			
Purchase of financial investments		**(17,398)**	(28,886)
Proceeds from the sale of financial investments		**20,315**	26,975
Purchase of property, plant and equipment		**(373)**	(236)
Proceeds from the sale of property, plant and equipment		**148**	25
Purchase of goodwill and intangible assets		**(110)**	(410)
Net cash outflow from acquisition/increase stake in associates		**(98)**	(103)
Proceeds from disposal of associates		**46**	–
Net cash from/(used in) investing activities		**2,530**	(2,635)
Cash flows from/(used in) financing activities			
Issue of ordinary share capital		**675**	1,500
Purchases of HSBC Holdings plc shares to satisfy share based payment transactions		**84**	94
Subordinated loan capital issued		**1,110**	500
Subordinated loan capital repaid		**(400)**	(506)
Dividends paid		**(1,591)**	(1,400)
Net cash (used in)/from financing activities		**(122)**	188
Net increase/(decrease) in cash and cash equivalents		**13,240**	(8,184)
Cash and cash equivalents at 1 January		**14,053**	21,748
Effect of exchange rate changes on cash and cash equivalents		**(808)**	489
Cash and cash equivalents at 31 December	38	**26,485**	14,053

1 Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without reasonable expense.

Notes on the Financial Statements

1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The group has prepared its consolidated and parent company financial statements in accordance with International Financial Reporting Standards ('IFRSs') as endorsed by the European Union ('EU'). EU-endorsed IFRSs may differ temporarily from IFRSs as published by the International Accounting Standards Board ('IASB') if new or amended IFRSs have not been endorsed by the EU. At 31 December 2006, there were no unendorsed standards effective for 31 December 2006 affecting these consolidated and parent company financial statements, and there was no difference in application to the group between IFRSs endorsed by the EU and IFRSs issued by the IASB.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') and its predecessor body.

The significant accounting policies applied in the preparation of these financial statements are set out in Note 2 below.

On 1 January 2005, the group adopted IFRS 7 'Financial Instruments: Disclosures', ahead of its effective date, 1 January 2007.

On 1 January 2006, the group adopted the 'Amendments to IAS 39 and IFRS 4 – Financial Guarantee Contracts' and the 'Amendment to IAS 39 – Cash Flow Hedge Accounting of Forecast Intragroup Transactions'. The group retrospectively applied the amendments in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. Retrospective adoption of these amendments had no material impact on the consolidated or parent company financial statements.

On 1 January 2006, the group adopted IFRIC 7 'Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies', IFRIC 8 'Scope of IFRS 2' and IFRIC 9 'Reassessment of Embedded Derivatives' ahead of their effective dates. The application of these interpretations had no material impact on the consolidated or separate financial statements.

(b) Presentation of information

The presentation of comparative information in Note 9 has been amended following the adoption by the group of the Institute of Chartered Accountants in England and Wales Technical Release 'Tech 06/06 – Disclosure of Auditor Remuneration'.

In publishing the parent company financial statements here together with the group financial statements, the group is taking advantage of the exemption in s230 of the Companies Act 1985 not to present its individual income statement and related notes that form part of these approved financial statements.

The group has taken advantage of the exemption under Regulation 7 of the Partnerships and Unlimited Companies (Accounts) Regulations 1993 from certain partnerships that are consolidated by the group presenting their own individual financial statements under IFRSs.

The Capital management information presented on pages 15 to 17 also forms part of these financial statements.

(c) Consolidation

The consolidated financial statements of HSBC Bank plc comprise the financial statements of the bank and its subsidiaries made up to 31 December. Entities that are controlled by the group are consolidated until the date that control ceases. Newly acquired subsidiaries are consolidated from the date that control is transferred to the group.

In the context of Special Purpose Entities ('SPEs'), the following circumstances may indicate a relationship in which, in substance, the group controls, and consequently consolidates, an SPE:

- the activities of the SPE are being conducted on behalf of the group according to its specific business needs so that the group obtains benefits from the SPE's operation;
- the group has the decision-making powers to obtain the majority of the benefits of the activities of the SPE or, by setting up an 'autopilot' mechanism, the group has delegated these decision-making powers;
- the group has the rights to obtain the majority of benefits of the SPE and therefore may be exposed to risks

incident to the activities of the SPE; or

- the group retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the group. The cost of an acquisition is measured at the fair value of the consideration given at the date of exchange, together with costs directly attributable to that acquisition. The acquired identifiable assets, liabilities and contingent liabilities are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair value of the group's share of the identifiable assets, liabilities and contingent liabilities acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the group's share of the identifiable assets, liabilities and contingent liabilities of the business acquired, the difference is recognised immediately in the income statement.

All intra-group transactions are eliminated on consolidation.

The consolidated financial statements of the group also include the attributable share of the results and reserves of joint ventures and associates. These are based on financial statements made up to dates not earlier than three months prior to 31 December, adjusted for the effect of any significant transactions or events that occur between that date and the group's reporting date.

(d) Future accounting developments

At 31 December 2006, the group had adopted all IFRSs and Interpretations that had been issued by the IASB and IFRIC, and endorsed by the EU. There are currently no IFRSs or interpretations that have been issued by the IASB and endorsed by the EU which become effective after 31 December 2006 that have not already been adopted by HSBC.

Standards and interpretations issued by the IASB but not endorsed by the EU

IFRS 8 'Operating Segments', which replaces IAS 14 'Segment Reporting', was issued on 30 November 2006 and is effective for annual periods beginning on or after 1 January 2009. This standard specifies how an entity should report information about its operating segments, based on information about the components of the entity that management uses to make operating decisions. It is anticipated that this standard will be adopted with effect from 1 January 2009, and will have an impact on the group. However, IFRS 8 will only affect reporting of financial and descriptive information about its reportable segments in the financial statements at the reporting date.

IFRIC 10 'Interim Financial Reporting and Impairment' was issued on 20 July 2006 and is effective for annual periods beginning on or after 1 November 2006. IFRIC 10 states that any impairment losses recognised in an interim financial statement in respect of goodwill under IAS 36 'Impairment of Assets', or certain financial assets under IAS 39 'Financial Instruments: Recognition & Measurement' must not be reversed in subsequent interim or annual financial statements. The group will adopt IFRIC 10 from 1 January 2007. Adoption of this interpretation is not expected to have a significant impact on the group.

IFRIC 11 'Group and Treasury Share Transactions' was issued on 2 November 2006 and is effective for annual periods beginning on or after 1 March 2007. IFRIC 11 requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments required are obtained. The Interpretation also provides guidance on whether share-based payment arrangements in which suppliers of goods or services of an entity are provided with equity instruments of the entity's parent, should be accounted for as cash-settled or equity-settled in the entity's financial statements. The group applies IFRS 2 'Share-based Payment' in the same manner as set out in IFRIC 11, therefore, there will be no impact for the group.

IFRIC 12 'Service Concession Arrangements' ('IFRIC 12') was issued on 30 November 2006 and is effective for annual periods beginning on or after 1 January 2008. IFRIC 12 provides guidance on service concession arrangements by which a government or other public sector entity grants contracts for the supply of public services to the private sector operators. IFRIC 12 addresses how service concession operators should apply existing IFRSs to account for the obligations they undertake and the rights they receive in service concession arrangements. IFRIC 12 is unlikely to have a material effect on the group.

Notes on the Financial Statements (continued)

2 Summary of significant accounting policies

(a) Interest income and expense

Interest income and expense for all interest-bearing financial instruments except for those classified as held-for-trading or designated at fair value (other than debt issued by the group and related derivatives) are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method. The effective interest method is a way of calculating the amortised cost of a financial asset or a financial liability (or groups of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the group estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the group that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Interest on impaired financial assets is calculated by applying the original effective interest rate of the financial asset to the carrying amount as reduced by any allowance for impairment.

(b) Non interest income

Fee income

The group earns fee income from a diverse range of services provided to its customers. Fee income is accounted for as follows:

– income earned on the execution of a significant act is recognised as revenue when the act is completed (for example, fees arising from negotiating, or participating in the negotiation of, a transaction for a third party, such as the arrangement for the acquisition of shares or other securities);

– income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management, portfolio and other management advisory and service fees); and

– income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income' (Note 2(a)).

Dividend income

Dividend income is recognised when the right to receive payment is established. This is the ex-dividend date for equity securities.

Net income from financial instruments designated at fair value

'Net income from financial instruments designated at fair value' includes all gains and losses from changes in the fair value of financial assets and financial liabilities designated at fair value through profit or loss. Interest income and expense and dividend income arising on those financial instruments are also included, except for debt securities in issue and derivatives managed in conjunction with debt securities in issue. Interest on these instruments is shown in 'Net interest income'.

Net trading income

Net trading income comprises all gains and losses from changes in the fair value of financial assets and financial liabilities held for trading, together with related interest income, expense and dividends.

(c) Segment reporting

The group is organised into three geographical regions, the United Kingdom, Continental Europe and Rest of the World and manages its business through seven business segments: UK Personal Financial Services; UK Commercial Banking; UK Corporate, Investment Banking and Markets; International Banking; France; Private

Banking and HSBC Trinkaus & Burkhardt. Segment income and expenses include transfers between geographical regions and transfers between business segments. These transfers are conducted at arm's length.

(d) Determination of fair value

All financial instruments are recognised initially at fair value. The fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. In certain circumstances, however, the initial fair value may be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in active markets are based on bid prices for assets held and offer prices for liabilities. When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

For certain derivatives, fair values may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data.

A number of factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate, when values are calculated using valuation techniques.

If the fair value of a financial asset measured at fair value becomes negative, it is recorded as a financial liability until its fair value becomes positive, at which time it is recorded as a financial asset, or it is extinguished.

(e) Loans and advances to banks and customers

Loans and advances to banks and customers include loans and advances originated by the group which are not intended to be sold in the short term and have not been classified either as held for trading or designated at fair value through profit and loss. Loans and advances are recognised when cash is advanced to borrowers and are derecognised when either borrowers repay their obligations, or the loans are sold or written off or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses.

(f) Loan impairment

Losses for impaired loans are recognised promptly when there is objective evidence that impairment of a loan or portfolio of loans has occurred. Impairment losses are calculated on individual loans and on loans assessed collectively. Losses expected from future events, no matter how likely, are not recognised.

Individually assessed loans

At each balance sheet date, the group assesses on a case-by-case basis whether there is any objective evidence that a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining impairment losses on these loans, the following factors are considered:

– the group's aggregate exposure to the customer;

– the viability of the customer's business model and its capability to trade successfully out of financial difficulties and generate sufficient cash flow to service its debt obligations;

– the amount and timing of expected receipts and recoveries;

– the likely dividend available on liquidation or bankruptcy;

– the extent of other creditors' commitments ranking ahead of, or *pari passu* with, the group and the likelihood of other creditors continuing to support the company;

– the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

– the realisable value of security (or other credit mitigants) and likelihood of successful repossession;

Notes on the Financial Statements (continued)

– the likely deduction of any costs involved in recovery of amounts outstanding;

– the ability of the borrower to obtain, and make payments in, the currency of the loan if not local currency; and

– when available, the secondary market price of the debt.

Impairment losses are calculated by discounting the expected future cash flows of a loan at its original effective interest rate, and comparing the resultant present value with the loan's current carrying value. Any loss is charged in the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of an allowance account.

Collectively assessed loans

Impairment is assessed on a collective basis in two different scenarios:

– for loans subject to individual assessment, to cover losses which have been incurred but have not yet been identified; and

– for homogeneous groups of loans that are not considered individually significant, where there is objective evidence of impairment.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been identified are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This arises from impairment at the balance sheet date which will only be individually identified in the future.

The collective impairment allowance is determined after taking into account:

– historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, loan grade or product);

– the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and

– management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated by local management for each identified portfolio.

Homogeneous groups of loans

For homogeneous groups of loans that are not considered individually significant, two alternative methods are used to calculate allowances on a portfolio basis:

– When appropriate empirical information is available, the group utilises roll rate methodology. This methodology employs a statistical analysis of historical trends of the probability of default and the amount of consequential loss, assessed at each time period for which the customer's contractual payments are overdue. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying value of the portfolio. Other historical data and current economic conditions are also evaluated when calculating the appropriate level of allowance required to cover inherent loss. In certain highly developed markets, sophisticated models also take into account behavioural and account management trends as revealed in, for example, bankruptcy and rescheduling statistics.

– In other cases, when the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll rate methodology, the group adopts a formulaic approach which allocates progressively higher percentage loss rates in line with the period of time for which a customer's loan is overdue. Loss rates are calculated from the discounted expected future cash flows from a portfolio.

  Roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

Loan write-offs

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from realising the security have been received.

Reversals of impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance account accordingly. The reversal is recognised in the income statement.

Assets acquired in exchange for loans

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are recorded as assets held for sale and reported in 'Other assets'. The asset acquired is recorded at the lower of its fair value (less costs to sell) and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the income statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the income statement.

Renegotiated loans

Personal loans, which are generally subject to collective impairment assessment, whose terms have been renegotiated, are no longer considered to be past due or impaired but are treated as new loans only after the minimum required number of payments under the new arrangements have been received.

Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or are considered to be past due.

(g) Trading assets and trading liabilities

Treasury bills, debt securities, equity shares and short positions in securities are classified as held-for-trading if they have been acquired principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date when the group enters into contractual arrangements with counterparties to purchase or sell securities, and are normally derecognised when either sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently, their fair values are remeasured, and all gains and losses from changes therein, are recognised in the income statement in 'Net trading income' as they arise.

(h) Financial instruments designated at fair value

Financial instruments, other than those held for trading, are classified in this category if they meet one or more of the criteria set out below, and are so designated by management. The group may designate financial instruments at fair value when the designation:

– Eliminates or significantly reduces valuation or recognition inconsistencies that would otherwise arise from measuring financial assets or financial liabilities, or recognising gains and losses on them, on different bases. Under this criterion, the main classes of financial instruments designated by the group are:

  Long-term debt securities – The interest payable on certain fixed rate long-term debt securities in issue and subordinated liabilities has been matched with receive fixed/ pay variable interest rate swaps as part of a documented interest rate risk management strategy. An accounting mismatch would arise if the debt securities in issue were accounted for at amortised cost, because the related derivatives are measured at fair value with movements in the fair value taken through the income statement. By designating the long-term debt at fair value, the movement in the fair value of the long-term debt will be recorded in the income statement.

Financial assets and financial liabilities under investment contracts – These are managed on a fair value basis and management information is also prepared on this basis. Liabilities to customers under linked contracts are determined based on the fair value of the assets held in the linked funds, with changes shown in the income statement. Liabilities to customers under other types of investment contracts would be shown at amortised cost. If no designation was made for the assets relating to the customer liabilities they would be reclassified as available-for-sale and the changes in fair value would be recorded directly in equity. Designation at fair value of the financial assets and liabilities under investment contracts allows the changes in fair value to be recorded in the income statements and presented in the same line.

– Applies to groups of financial assets, financial liabilities or combinations thereof that are managed, and their performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, and where information about the groups of financial instruments is reported to management on that basis. Under this criterion, certain financial assets held to meet liabilities under insurance contracts are the main class of financial instrument so designated. The group has documented risk management and investment strategies designed to manage such assets at fair value, taking into consideration the relationship of assets to liabilities in a way that mitigates market risks. Reports are provided to management on the fair value of the assets. Fair value measurement is also consistent with the regulatory reporting requirements under the appropriate regulations for these insurance operations.

– Relates to financial instruments containing one or more embedded derivatives that significantly modify the cash flows resulting from those financial instruments, including certain debt issues and debt securities held.

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised on trade date, when the group enters into contractual arrangements with counterparties to purchase or sell securities, and are normally derecognised when sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken directly to the income statement. Subsequently, the fair values are remeasured and, except for interest payable on debt securities in issue designated at fair value, gains and losses from changes therein are recognised in ‘Net income from financial instruments designated at fair value’.

Gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are also included in ‘Net income from financial instruments designated at fair value’. Interest on these derivatives is also included in this line, except for interest on derivatives managed with debt securities in issue designated at fair value, which is included in ‘Net interest income’. The amount of change during the period, and cumulatively, in the fair value of designated financial liabilities and loans and receivables that is attributable to changes in their credit risk, is determined as the amount of change in fair value that is not attributable to changes in market conditions.

(i) Financial investments

Treasury bills, debt securities and equity shares intended to be held on a continuing basis, other than those designated at fair value (Note 2(h)), are classified as ‘available-for-sale’ or ‘held-to-maturity’. Financial investments are recognised on trade date, when the group enters into contractual arrangements with counterparties to purchase securities, and are normally derecognised when either the securities are sold or the borrowers repay their obligations.

(i) Available-for-sale securities are initially measured at fair value plus direct and incremental transaction costs. They are subsequently remeasured at fair value, and changes therein are recognised in equity in the ‘Available-for-sale reserve’ until the securities are either sold or impaired. When available-for-sale securities are sold, cumulative gains or losses previously recognised in equity are recognised in the income statement as ‘Gains less losses from financial investments’.

Interest income is recognised on available-for-sale securities using the effective interest rate method, calculated over the asset’s expected life. Premiums and/or discounts arising on the purchase of dated investment securities are included in the calculation of their effective interest rates. Dividends are recognised in the income statement when the right to receive payment has been established. Financial investments are recognised using trade date accounting.

At each balance sheet date an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset or group of financial assets. This usually arises when circumstances are such that an adverse effect on future cash flows from the asset or group of assets can be reliably estimated. If an available-for-sale security is impaired, the cumulative loss (measured as the difference between the asset's acquisition cost and its current fair value, less any impairment loss on that asset previously recognised in the income statement) is removed from equity and recognised in the income statement. Reversals of impairment losses are subject to contrasting treatments depending on the nature of the instrument concerned:

– if the fair value of a debt instrument classified as available-for-sale increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement; and

– impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(ii) Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the group positively intends, and is able, to hold until maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses.

(j) Sale and repurchase agreements (including stock lending and borrowing)

When securities are sold subject to a commitment to repurchase them at a predetermined price ('repos'), they remain on the balance sheet and a liability is recorded in respect of the consideration received. Securities purchased under commitments to sell ('reverse repos') are not recognised on the balance sheet and the consideration paid is recorded in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement.

Securities lending and borrowing transactions are generally secured, with collateral taking the form of securities or cash advanced or received. The transfer of securities to counterparties is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

Securities borrowed are not recognised on the balance sheet, unless they are sold to third parties, in which case the obligation to return the securities is recorded as a trading liability and measured at fair value, and any gains or losses are included in 'Net trading income'.

For repos and security lending, if the counterparty has the right to sell or repledge the securities transferred, the securities are presented separately on the balance sheet.

(k) Derivatives and hedge accounting

Derivatives are recognised initially, and are subsequently remeasured, at fair value. Fair values of exchange-traded derivatives are obtained from quoted market prices. Fair values of over-the-counter ('OTC') derivatives are obtained using valuation techniques, including discounted cash flow models and option pricing models.

In the normal course of business, the fair value of a derivative on initial recognition is the transaction price (i.e. the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets, such as interest rate yield curves, option volatilities and currency rates. When such evidence exists, the group recognises a trading profit or loss on inception of the derivative. When unobservable market data have a significant impact on the valuation of derivatives, the entire initial change in fair value indicated by the valuation model is not recognised immediately in the income statement. It is instead recognised over the life of the transaction on an appropriate basis, or is recognised in the income statement when the inputs become observable, or when the transaction matures or is closed out.

Derivatives may be embedded in other financial instruments, for example, a convertible bond with an embedded conversion option. Embedded derivatives are treated as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative are the same as those of a stand-alone derivative; and the combined contract is not held for trading or designated at fair value through profit and loss. These embedded derivatives are measured at fair value with changes therein recognised in the income statement.

Derivatives are classed as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.

The method of recognising fair value gains or losses depends on whether derivatives are held for trading or are designated as hedging instruments, and if the latter, the nature of the risks being hedged. All gains and losses from changes in the fair value of derivatives held for trading are recognised in the income statement. When derivatives are designated as hedges, the group classifies them as either: (i) hedges of the change in fair value of recognised assets or liabilities or firm commitments ('fair value hedges'); (ii) hedges of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ('cash flow hedges'); or (iii) hedges of net investments in a foreign operation ('net investment hedges'). Hedge accounting is applied to derivatives designated as hedging instruments in a fair value, cash flow or net investment hedge provided certain criteria are met.

Hedge accounting

At the inception of a hedging relationship, the group documents the relationship between the hedging instruments and hedged items, its risk management objective and its strategy for undertaking the hedge. The group also requires a documented assessment, both at hedge inception and on an ongoing basis, of whether or not the derivatives that are used in hedging transactions are highly effective in offsetting the changes attributable to the hedged risks in the fair values or cash flows of the hedged items. Interest on designated qualifying hedges is included in 'Net interest income'.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedging instruments are recorded in the income statement, along with changes in the fair value of the assets, liabilities or group thereof, that are attributable to the hedged risk.

If a hedging relationship no longer meets the criteria for hedge accounting, the cumulative adjustment to the carrying amount of the hedged item is amortised to the income statement based on a recalculated effective interest rate over the residual period to maturity, unless the hedged item has been derecognised whereby it is released to the income statement immediately.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity within the cash flow hedging reserve. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity until the forecast transaction is eventually recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement on the disposal of the foreign operation.

Hedge effectiveness testing

To qualify for hedge accounting, IAS 39 requires that at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness). Actual effectiveness (retrospective effectiveness) must also be demonstrated on an ongoing basis.

The documentation of each hedging relationship sets out how the effectiveness of the hedge is assessed. The method a group entity adopts for assessing hedge effectiveness will depend on its risk management strategy.

For prospective effectiveness, the hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. For actual effectiveness, the changes in fair value or cash flows must offset each other in the range of 80 per cent to 125 per cent for the hedge to be deemed effective.

Hedge ineffectiveness is recognised in the income statement in 'Net trading income'.

Derivatives that do not qualify for hedge accounting

All gains and losses from changes in the fair values of any derivatives that do not qualify for hedge accounting are recognised immediately in the income statement. These gains and losses are reported in 'Net trading income', except where derivatives are managed in conjunction with financial instruments designated at fair value (other than derivatives related to debt issued by the group), in which case gains and losses are reported in 'Net income from financial instruments designated at fair value'.

(l) Derecognition of financial assets and liabilities

Financial assets are derecognised when the right to receive cash flows from the assets has expired; or when the group has transferred its contractual right to receive the cash flows of the financial assets, and substantially all the risks and rewards of ownership; or where control is not retained. Financial liabilities are derecognised when they are extinguished, i.e. when the obligation is discharged, cancelled or expires.

(m) Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(n) Subsidiaries, associates and joint ventures

The bank's investments in subsidiaries are stated at cost less impairment losses and pre-acquisition dividends. Reversals of impairment losses are recognised in the income statement if there has been a change in the estimates used to determine the recoverable amount of the investment.

Investments in associates and interests in joint ventures are recognised using the equity method, initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in the group's share of net assets.

Adjustments to the carrying amount of investments in associates and interests in joint ventures that have not been recognised in profit or loss are recognised by the group directly in equity.

Unrealised gains on transactions between the group and its associates and joint ventures are eliminated to the extent of the group's interest in the respective associates or joint ventures. Unrealised losses are also eliminated to the extent of the group's interest in the associates or joint ventures unless the transaction provides evidence of an impairment of the asset transferred.

Notes on the Financial Statements (continued)

(o) Goodwill and intangible assets

(i) Goodwill arises on business combinations, including the acquisition of subsidiaries, joint ventures or associates, when the cost of acquisition exceeds the fair value of the group's share of the identifiable assets, liabilities and contingent liabilities acquired. By contrast, if the group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of an acquired business is greater than the cost to acquire, the excess is recognised immediately in the income statement.

Intangible assets are recognised separately from goodwill when they are separable or arise from contractual or other legal rights, and their fair value can be measured reliably.

Goodwill is allocated to cash-generating units for the purpose of impairment testing, which is undertaken at the lowest level at which goodwill is monitored for internal management purposes. Impairment testing is performed at least annually by comparing the present value of the expected future cash flows from a business with the carrying value of its net assets, including attributable goodwill. Goodwill is stated at cost less accumulated impairment losses which are charged to the income statement.

In accordance with IFRS 1, the carrying value of goodwill that existed at 31 December 2003 under UK GAAP was carried forward at 1 January 2004 adjusted for separately identifiable intangible assets and goodwill adjustments made more than 12 months from the date of acquisition.

Goodwill on acquisitions of joint ventures or associates is included in 'Interests in associates and joint ventures'.

At the date of disposal of a business, attributable goodwill is included in the group's share of net assets in the calculation of the gain or loss on disposal.

(ii) Intangible assets include the value of in-force long-term assurance business, computer software, trade names, customer lists, core deposit relationships, credit card customer relationships and merchant or other loan relationships. Intangible assets are subject to impairment review if there are events or changes in circumstances that indicate that the carrying amount may not be recoverable.

- Intangible assets that have an indefinite useful life, or are not yet ready for use, are tested for impairment at least annually. This impairment test may be performed at any time during the year, provided it is performed at the same time every year. An intangible asset recognised during the current period is tested before the end of the current year.
- Intangible assets that have a finite useful life, except for the value of in-force long-term insurance business, are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives. Estimated useful life is the lower of legal duration and expected economic life.

For the accounting policy followed in respect of the value of the in-force long-term insurance businesses see Note 2(w).

Intangible assets are amortised over their finite useful lives as follows:

Trade names	over 10 years
Purchased software	over 5 years
Internally generated software	over 5 years
Customer/merchant relationships	between 3 and 10 years
Other	over 10 years

(p) Property, plant and equipment

Land and buildings are stated at historical cost, or fair value at the date of transition to IFRSs ('deemed cost'), less any impairment losses and depreciation calculated to write off the assets over their estimated useful lives as follows:

- freehold land is not depreciated;
- freehold buildings are depreciated on cost at the greater of two per cent per annum on a straight-line basis or over their remaining useful lives; and

– leasehold buildings are depreciated on cost on a straight-line basis over the unexpired terms of the leases, or over their remaining useful lives.

Equipment, fixtures and fittings (including equipment on operating leases where the group is the lessor) are stated at cost less any impairment losses and depreciation calculated on a straight-line basis to write off the assets over their useful lives, which run to a maximum of 35 years but are generally between five years and 20 years.

The group holds certain properties as investments to earn rentals or for capital appreciation, or both. Investment properties are included in the balance sheet at fair value with changes therein recognised in the income statement in the period of change. Fair values are determined by independent professional valuers who apply recognised valuation techniques.

Property, plant and equipment is subject to an impairment review if there are events or changes in circumstances which indicate that the carrying amount may not be recoverable.

(q) Finance and operating leases

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. When the group is a lessor under finance leases the amounts due under the leases, after deduction of unearned charges, are included in 'Loans and advances to banks' or 'Loans and advances to customers' as appropriate. Finance income receivable is recognised over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

When the group is a lessee under finance leases the leased assets are capitalised and included in 'Property, plant and equipment' and the corresponding liability to the lessor is included in 'Other liabilities'. A finance lease and its corresponding liability are recognised initially at the fair value of the asset or, if lower, the present value of the minimum lease payments. Finance charges payable are recognised over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When acting as lessor, the group includes the assets subject to operating leases in 'Property, plant and equipment' and accounts for them accordingly. Impairment losses are recognised to the extent that residual values are not fully recoverable and the carrying value of the equipment is thereby impaired. When the group is the lessee, leased assets are not recognised on the balance sheet. Rentals payable and receivable under operating leases are accounted for on a straight-line basis over the periods of the leases and are included in 'General and administrative expenses' and 'Other operating income' respectively.

(r) Income tax

Income tax on the profit or loss for the year comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in shareholders' equity, in which case it is recognised in shareholders' equity.

Current tax is the tax expected to be payable on the taxable profit for the year, calculated using tax rates enacted or substantively enacted by the balance sheet date, and any adjustment to tax payable in respect of previous years. Current tax assets and liabilities are offset when the group intends to settle on a net basis and the legal right to set-off exists.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when a legal right to set off exists in the entity.

Deferred tax relating to actuarial gains and losses on post-employment benefits is recognised directly in equity. From 1 January 2005, deferred tax relating to fair value remeasurement of available-for-sale investments and

Notes on the Financial Statements (continued)

cash flow hedges which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

(s) Pension and other post-employment benefits

The group operates a number of pension and other post-employment benefit plans throughout the world. These plans include both defined benefit and defined contribution plans and various other post-employment benefits such as post-employment health care.

Payments to defined contribution plans and state-managed retirement benefit plans, when the group's obligations under the plans are equivalent to a defined contribution plan, are charged as an expense as they fall due.

The costs recognised for funding defined benefit plans are determined using the Projected Unit Credit Method, with annual actuarial valuations performed on each plan. Actuarial differences that arise are recognised in shareholders' equity and presented in the 'Statement of recognised income and expense' in the period in which they arise. All cumulative actuarial gains and losses on defined benefit plans as at 1 January 2004 were recognised in equity at the date of transition to IFRSs. Past service costs are recognised immediately to the extent that the benefits have vested, and are otherwise recognised on a straight-line basis over the average period until the benefits vest. Current service costs and any past service costs, together with the unwinding of the discount on plan liabilities less the expected return on plan assets, are charged to operating expenses.

The defined benefit liability recognised in the balance sheet represents the present value of defined benefit obligations adjusted for unrecognised past service costs and reduced by the fair value of plan assets. Any net defined benefit surplus is limited to unrecognised past service costs plus the present value of available refunds and reductions in future contributions to the plan.

The costs of providing other post-employment benefits such as post-employment health care are accounted for on the same basis as defined benefit plans.

(t) Equity compensation plans

Shares in HSBC Holdings plc awarded to an employee on joining the group that are made available immediately, with no vesting period attached to the award, are expensed immediately. When an inducement is awarded to an employee on commencement of employment with the group, and the employee must complete a specified period of service before the inducement vests, the expense is spread over the period to vesting. As these awards are made by the group a liability for the shares awarded is recognised on balance sheet over the vesting period, at fair value.

Share option awards are granted by HSBC Holdings to Group employees and are accounted for as equity-settled as they are satisfied by HSBC Holdings transferring shares to the employees.

The compensation expense of share options charged to the income statement is credited to the share-based payment reserve over the vesting period. Compensation expense is determined by reference to the fair value of the options on grant date, and the effect of any non-market vesting conditions such as option lapses. An option may lapse if, for example, an employee ceases to be employed by the group before the end of the vesting period. Estimates of future such employee departures are taken into account when accruing the cost during the service period.

The cost of bonuses awarded in respect of past service, by which an employee is required to complete a specified period of future service to be entitled to the award, is spread over the period of service rendered to the vesting date.

(u) Foreign currencies

Items included in the financial statements of each of the group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements of HSBC Bank plc are presented in sterling, which is the group's presentation currency.

Transactions in foreign currencies are recorded in the functional currency at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rate of exchange ruling at the balance sheet date. Any resulting exchange differences are included in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction, except for goodwill and fair value adjustments arising on consolidation, which are translated into the functional currency using the rate of exchange ruling at the balance sheet date. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined.

The results of branches, subsidiaries, joint ventures and associates that have a functional currency other than sterling are translated into sterling at the average rates of exchange for the reporting period. Exchange differences arising from the retranslation of opening foreign currency net investments, and exchange differences arising from retranslation of the result for the reporting period from the average rate to the exchange rate prevailing at the period end, are accounted for in a separate foreign exchange reserve. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of the separate parent and subsidiary financial statements. In consolidated financial statements these exchange differences are recognised in the foreign exchange reserve in shareholders' equity. In accordance with IFRS 1, the group has set the cumulative exchange differences for all foreign operations to zero at the date of transition to IFRSs. On disposal of a foreign operation, exchange differences relating thereto and previously recognised in reserves are recognised in the income statement.

(v) Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation as a result of past events, and a reliable estimate can be made of the amount of the obligation.

(w) Insurance contracts

Through its insurance subsidiaries, the group issues contracts to customers that contain insurance risk, financial risk or a combination thereof. A contract under which the group accepts significant insurance risk from another party by agreeing to compensate that party on the occurrence of a specified uncertain future event, is classified as an insurance contract. An insurance contract may also transfer financial risk, but is accounted for as an insurance contract if the insurance risk is significant.

Insurance contracts are accounted for as follows:

Premiums

Gross insurance premiums for non-life insurance business are reported as income over the term of the insurance contract attributable to the risks borne during the accounting period. The unearned premium or the proportion of the business underwritten in the accounting year relating to the period of risk after the balance sheet date is calculated on a daily or monthly pro rata basis.

Premiums for life assurance are accounted for when receivable, except in unit-linked business where premiums are accounted for when liabilities are established.

Reinsurance premiums are accounted for in the same accounting period as the premiums for the direct insurance to which they relate.

Claims and reinsurance recoveries

Gross insurance claims for non-life insurance business include paid claims and movements in outstanding claims reserves. The outstanding claims reserves are based on the estimated ultimate cost of all claims made but not settled at the balance sheet date, whether reported or not, together with related claim handling costs and a reduction for the expected value of salvage and other recoveries. Reserves for claims incurred but not reported are made on an estimated basis, using appropriate statistical techniques.

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration. The liabilities under non-linked life insurance contracts (long-term business provision) are calculated by each life insurance operation based on local actuarial principles. The liabilities under unit-linked life insurance

Notes on the Financial Statements (continued)

contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

Reinsurance recoveries are accounted for in the same period as the related claim.

Present value of in-force long-term insurance business

The value placed on insurance contracts that are classified as long-term insurance business and are in force at the balance sheet date is recognised as an asset.

The present value of in-force long-term insurance business is determined by discounting future cash flows expected to emerge from business currently in force using appropriate assumptions in assessing factors such as future mortality, lapse rates and levels of expenses and a risk discount rate that reflects the risk premium attributable to the respective long-term insurance business. Movements in the present value of in-force long-term insurance business are included in 'Other operating income' on a gross of tax basis.

(x) Investment contracts

Customer liabilities under non-linked and unit-linked investment contracts and the linked financial assets are measured at fair value, and the movements in fair value are recognised in the income statement in 'Net income from financial investments designated at fair value'. Premiums receivable and amounts withdrawn are accounted for as increases or decreases in the liability recorded in respect of investment contracts.

Investment management fees receivable are recognised in the income statement over the period of the provision of the investment management services.

The incremental costs directly related to the acquisition of new investment contracts or renewing existing investment contracts are deferred and amortised over the period during which the investment management services are provided.

(y) Debt securities in issue and subordinated liabilities

Debt securities in issue are initially measured at fair value, which is normally the consideration received net of directly attributable transaction costs incurred. Subsequent measurement is at amortised cost, using the effective interest rate method to amortise the difference between proceeds net of directly attributable transaction costs and the redemption amount over the expected life of the debt, unless the securities are designated at fair value (Note 2(h)).

(z) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

(aa) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and include cash and balances at central banks, treasury bills and other eligible bills, loans and advances to banks, items in the course of collection from or in transmission to other banks and certificates of deposit.

(ab) Restatement of comparatives

In 2005, HSBC Bank plc accounted for certain investments in US dollar preference shares issued by a group company as monetary items in accordance with IAS 21 'The Effects of Changes in Foreign Exchange Rates' and translated them at the closing rate at the balance sheet date. These preference shares should have been accounted for as non-monetary items, carried at historical cost using the exchange rate at the date of the transaction. A prior year adjustment has been made to correct this and previously reported figures have been restated accordingly. The amount of the restatement for each financial statement line item affected is detailed below.

The group	2005 £m	Adjustment £m	(Restated) 2005 £m
Income statement:			
- ‘Trading income excluding net interest income’	1,036	(55)	981
Equity:			
- ‘Retained earnings at 1 January 2005’	3,194	80	3,274
- ‘Foreign exchange reserve at 1 January 2005’	(41)	(80)	(121)
- ‘Profit for the year attributable to shareholders’	2,897	(55)	2,842
- ‘Exchange differences’	(75)	55	(20)
The bank			
Balance sheet:			
- ‘Investments in subsidiary undertakings’	14,468	25	14,493
Equity:			
- ‘Retained earnings at 1 January 2005’	1,494	80	1,574
- ‘Profit for the year attributable to shareholders’	1,678	(55)	1,623

3 Use of assumptions and estimates

The results of the group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its consolidated financial statements. The accounting policies used in the preparation of the consolidated financial statements are described in detail in Note 2.

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

The accounting policies that are deemed critical to the group’s results and financial position, in terms of the materiality of the items to which the policy is applied, or which involve a high degree of judgement and estimation, are:

Impairment of loans

The group’s accounting policy for losses in relation to the impairment of customer loans and advances is described in Note 2(f). Further information can be seen in Note 39 ‘Risk Management’. Impairment is calculated on the basis of discounted estimated future cash flows.

Losses in respect of impaired loans are reported in the group’s income statement under the caption ‘Loan Impairment Charges’. An increase in these losses has the effect of reducing the group’s profit for the period by a corresponding amount (while a decrease in impairment charges or reversal of impairment charges has the opposite effect).

The group’s policy requires a review of the level of impairment allowances on individual facilities above materiality thresholds at least half-yearly, or more regularly when individual circumstances require. This normally includes a review of collateral held (including re-confirmation of its enforceability) and an assessment of actual and anticipated receipts.

In the case of homogenous loans, in normal circumstances, historical experience is the most objective and relevant information from which to assess inherent loss within each portfolio. In circumstances where historical loss experience provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, where there have been changes in economic conditions or regulatory changes, management considers the most recent trends in the portfolio risk factors which may not be fully reflected in its statistical models when calculating the appropriate level of impairment allowances. Key risk factors include recent trends in charge-off and delinquency, economic conditions such as national and local trends in housing markets, changes in product mix and concentration, bankruptcy trends, other market conditions such as changes in interest rates and energy prices, changes in laws and regulations and natural disasters.

The portfolio approach is generally applied to the following types of portfolios:

- Low value, homogenous small business accounts in certain jurisdictions;
- Residential mortgages;
- Credit cards and other unsecured consumer lending products; and
- Motor vehicle financing.

These portfolio allowances are generally reassessed monthly and charges for new allowances, or reversals of existing allowances, are calculated for each separately identified portfolio.

Goodwill impairment

The group's accounting policy for goodwill is described in Note 2(o). This is discussed in further detail in Note 22 'Impairment of assets other than financial instruments'.

Goodwill is allocated to cash-generating units ('CGU') for the purpose of impairment testing. When the process of identifying and evaluating goodwill impairment demonstrates that the expected cash flows of a CGU have declined and/or that its cost of capital has increased, the effect is to reduce the CGU's estimated fair value. If this results in an estimated recoverable amount that is lower than the carrying amount of the CGU, a charge for impairment of goodwill will be recorded, thereby reducing by a corresponding amount the group's profit for the year. Goodwill is stated at cost less accumulated impairment losses.

Valuation of financial instruments

The group's accounting policy for valuation of financial instruments is included in Note 2 and is discussed further within Note 17 'Derivatives' and Note 32 'Fair value of financial instruments'.

When fair values are determined by using valuation techniques which refer to observable market data because independent prices are not available, management will consider the following when applying a model:

- The likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt; and
- An appropriate discount rate for the instrument. Management determines this rate based on its assessment of the appropriate spread of the rate for the instrument over the risk-free rate.

When valuing instruments by reference to comparable instruments, management takes into account the maturity, structure and rating of the instrument with which the position held is being compared. When valuing instruments on a model basis using the fair value of underlying components, management considers, in addition, the need for adjustments to take account of factors such as bid-offer spread, credit profile and model uncertainty. These adjustments are based on defined policies which are applied consistently across the group.

When unobservable market data have a significant impact on the valuation of derivatives, the entire initial change in fair value indicated by the valuation model is not recognised immediately in the income statement but is recognised in one of the following ways: over the life of the transaction on an appropriate basis; in the income statement when the inputs become observable; or when the transaction matures or is closed out.

Pensions

The assumptions used are disclosed in Note 8 'Employee compensation and benefits'.

Share-based payments

The assumptions used are disclosed in Note 10 'Share-based payments'.

4 Net income from financial instruments designated at fair value

Net income from financial instruments designated at fair value includes:

- all gains and losses from changes in the fair value of financial assets and liabilities designated at fair value, including liabilities under investment contracts;
- all gains and losses from changes in the fair value of derivatives that are managed in conjunction with financial assets and liabilities designated at fair value; and
- interest income, expense and dividend income of financial assets and liabilities designated at fair value, liabilities under investment contracts and derivatives managed in conjunction with them, except for interest arising on the group's debt securities in issue and subordinated liabilities, together with the interest on derivatives managed in conjunction with them, which is recognised in 'Interest expense'.

	2006 £m	2005 £m
Net income arising on:		
– financial assets held to meet liabilities under insurance and investment contracts	**395**	783
– other financial assets designated at fair value[1]	**50**	9
– derivatives managed in conjunction with financial assets designated at fair value[1]	**26**	(4)
	471	788
– financial liabilities under investment contracts	**(350)**	(500)
– own debt securities in issue and subordinated liabilities[2]	**186**	104
– derivatives managed in conjunction with own debt securities in issue and subordinated liabilities	**(186)**	(164)
– other financial liabilities designated at fair value	**(62)**	(61)
– derivatives managed in conjunction with financial liabilities designated at fair value	**–**	3
	(412)	(618)
Net income arising on financial instruments designated at fair value	**59**	170

1 *The group has designated certain loans and advances at fair value.*
2 *Gains and losses from changes in the fair value of own debt securities in issue and subordinated liabilities may arise from changes in own credit risk. In 2006, the group recognised a £6million loss (2005: £22 million loss) on changes in the fair value of these instruments arising from changes in own credit risk.*

5 Net earned insurance premiums

	2006			
	Non-life insurance £m	**Life insurance (non-linked) £m**	**Life insurance (linked) £m**	**Total £m**
Gross written premiums	**131**	**304**	**52**	**487**
Movement in unearned premiums	**22**	**5**	**–**	**27**
Gross earned premiums	**153**	**309**	**52**	**514**
Gross written premiums ceded to reinsurers	**(63)**	**(131)**	**(7)**	**(201)**
Reinsurers' share of movement in unearned premiums	**4**	**–**	**–**	**4**
Reinsurers' share of gross earned premiums	**(59)**	**(131)**	**(7)**	**(197)**
Net earned premiums	**94**	**178**	**45**	**317**

Notes on the Financial Statements (continued)

	2005			
	Non-life insurance £m	Life insurance (non-linked) £m	Life insurance (linked) £m	Total £m
Gross written premiums	200	381	92	673
Movement in unearned premiums	(12)	(14)	–	(26)
Gross earned premiums	188	367	92	647
Gross written premiums ceded to reinsurers	(56)	(145)	(7)	(208)
Reinsurers' share of movement in unearned premiums	(1)	–	–	(1)
Reinsurers' share of gross earned premiums	(57)	(145)	(7)	(209)
Net earned premiums	131	222	85	438

6 Net insurance claims incurred and movement in policyholders' liabilities

	2006			
	Non-life insurance £m	**Life insurance (non-linked) £m**	**Life insurance (linked) £m**	**Total £m**
Claims, benefits and surrenders paid	**83**	**103**	**119**	**305**
Movement in provisions	**(5)**	**(32)**	**(50)**	**(87)**
Gross claims incurred and movement in policyholder liabilities	**78**	**71**	**69**	**218**
Reinsurers' share of claims, benefits and surrenders paid	**(36)**	**(69)**	**(5)**	**(110)**
Reinsurers' share of movement in provisions	**7**	**(35)**	**11**	**(17)**
Reinsurers' share of claims incurred and movement in policyholder liabilities	**(29)**	**(104)**	**6**	**(127)**
Net insurance claims incurred and movement in policyholder liabilities	**49**	**(33)**	**75**	**91**

	2005			
	Non-life insurance £m	Life insurance (non-linked) £m	Life insurance (linked) £m	Total £m
Claims, benefits and surrenders paid	79	92	134	305
Movement in provisions	(3)	(129)	42	(90)
Gross claims incurred and movement in policyholder liabilities	76	(37)	176	215
Reinsurers' share of claims, benefits and surrenders paid	(35)	(56)	(6)	(97)
Reinsurers' share of movement in provisions	5	111	(4)	112
Reinsurers' share of claims incurred and movement in policyholder liabilities	(30)	55	(10)	15
Net insurance claims incurred and movement in policyholder liabilities	46	18	166	230

7 Net operating income

Net operating income for the year ended 31 December 2006 is stated after the following items of income, expense, gains and losses:

	2006 £m	2005 £m
Income		
Interest on financial instruments, excluding interest on financial assets held for trading or designated at fair value	**13,339**	11,056
Interest recognised on impaired financial assets	**39**	6
Fees earned on financial assets that are not held for trading or designated at fair value and that are not included in their effective interest rates	**2,316**	2,457
Fees earned relating to trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	**691**	836
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**8,936**	7,014
Fees payable on financial assets or liabilities not held for trading nor designated at fair value, other than fees included in effective interest rate calculations on these types of assets and liabilities	**478**	275
Fees payable relating to trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	**12**	80
Gains/(losses)		
Gain/(loss) on disposal or settlement of loans and advances	**–**	11
Impairment losses on:		
– loans and advances	**935**	807
– available-for-sale financial investments	**8**	8
Gains on sale of subsidiaries, associates and joint ventures	**145**	487

8 Employee compensation and benefits

	The group		The bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Wages and salaries	**3,221**	2,909	**1,951**	1,710
Social security costs	**409**	382	**187**	170
Post-employment benefits	**299**	333	**220**	261
	3,929	3,624	**2,358**	2,141

The average number of persons employed by the group during the year was as follows:

	2006	2005
UK PFS, CIBM and Commercial Banking	**49,484**	49,536
International Banking	**9,279**	7,228
France	**14,620**	14,183
Private Banking	**4,109**	3,581
HSBC Trinkaus & Burkhardt	**1,635**	1,749
Total	**79,127**	76,277

Notes on the Financial Statements (continued)

Post-employment benefit plans

Pension plans

The group's total pension cost was £291 million (2005: £325 million), of which £203 million (2005: £252 million) relates to defined benefit plans.

Progressively the group has been moving to defined contribution plans for all new employees. The pension cost of defined contribution plans was £88 million (2005: £73 million).

The extant plans are funded defined benefit plans, with assets, held in trust or similar funds separate from the group. The plans are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the defined benefit obligations and related current service cost vary according to the economic conditions of the countries in which they are situated.

Defined benefit pension arrangements for bank employees are provided by the HSBC Bank (UK) Pension Scheme (the "Scheme"), the assets of which are held in a separate trust fund. The Pension Scheme is administered by a corporate trustee, HSBC Bank Pension Trust (UK) Limited (the "Trustee"), whose Board is comprised of 19 Directors, eight of whom are elected by employees and one by pensioners. During 2007 the Trustee Board will be reconstituted and will be comprised of 13 Directors, four of whom will be elected by employees and two by pensioners. The Trustee Directors of the Pension Scheme are required to act in the best interest of the Scheme's beneficiaries.

Healthcare benefits plans

The group also provides post-employment healthcare benefits under plans in the United Kingdom and France, which are unfunded. Post-employment healthcare benefits plans are accounted for in the same manner as defined benefit pension plans. The plans are reviewed at least annually or in accordance with local practice and regulations by qualified actuaries. The actuarial assumptions used to calculate the defined benefit obligations and related current service cost vary according to the economic conditions of the countries in which they are situated. The group's total healthcare cost was £8 million (2005: £8 million).

Post-employment defined benefit plan principal actuarial assumptions

The principal actuarial financial assumptions used to calculate the defined benefit pension plans and post-employment healthcare benefits at 31 December 2006, which will form the basis for measuring the 2007 periodic costs, were:

	Discount rate %	Inflation assumption %	Rate of increase for pensions in payment and deferred pension %	Rate of pay increase %	Healthcare cost trend rates %
At 31 December 2006					
UK	**5.10**	**3.00**	**3.00**	**4.00**	**7.00**
France	**4.50**	**2.00**	**2.00**	**3.00**	**6.00**
Germany	**4.50**	**2.00**	**2.00**	**3.00**	**n/a**
Switzerland	**2.25**	**1.50**	**n/a**	**2.25**	**n/a**

The group determines discount rates in consultation with its actuary based upon the current average yield of high quality (AA rated) debt instruments, with maturities consistent with that of the pension obligation. The expected rate of return on plan assets is determined in consultation with the group's actuaries, based on historical market returns, adjusted for additional factors such as the current rate of inflation and interest rates.

The principal actuarial financial assumptions used to calculate the defined benefit pension plans and post employment healthcare benefits at 31 December 2005, which formed the basis for measuring the 2006 periodic costs, were as follows:

	Discount rate %	Inflation assumption %	Rate of increase for pensions in payment and deferred pension %	Rate of pay increase %	Healthcare cost trend rates %
At 31 December 2005					
UK	4.75	2.70	2.70	3.20	6.70
France	4.10	2.00	2.00	3.00	6.00
Germany	4.00	2.00	2.00	3.00	n/a
Switzerland	2.25	1.50	n/a	2.25	n/a

The mortality tables and average life expectancy at 65 used at 31 December 2006 were as follows:

	Mortality table	**Life expectancy at age 65 for a male member currently:**		**Life expectancy at age 65 for a female member currently:**	
		Aged 65	**Aged 45**	**Aged 65**	**Aged 45**
UK	PA92C2005	**20.30**	**21.60**	**23.30**	**24.60**
France	TG05	**22.79**	**25.59**	**26.28**	**29.14**
Switzerland	EVK2000	**17.76**	**17.76**	**21.09**	**21.09**
Germany	Heubeck 2005 G	**17.85**	**20.60**	**21.97**	**20.60**

The mortality tables and average life expectancy at 65 used at 31 December 2005 were as follows:

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
UK	PA92U2005	19.53	20.89	22.57	23.86
France	TPG93	23.02	25.32	23.02	25.32
Switzerland	EVK2000	18.30	18.30	21.21	21.21
Germany	Heubeck 2005G	18.06	20.84	22.20	24.85

Actuarial assumption sensitivities

The discount rate is sensitive to changes in market conditions arising during the reporting period. The mortality rates used are sensitive to experience from the plan member profile. The following table shows the effect of changes in these and the other key assumptions;

	HSBC Bank (UK) Pension Scheme £m
Discount rate	
Change in pension obligation at 31 December 2006 from a 25bps increase	(553)
Change in pension obligation at 31 December 2006 from a 25bps decrease	584
Change in 2007 pension cost from a 25bps increase	(10)
Change in 2007 pension cost from a 25bps decrease	11
Rate of inflation	
Change in pension obligation at 31 December 2006 from a 25bps increase	584
Change in pension obligation at 31 December 2006 from a 25bps decrease	(553)
Change in 2007 pension cost from a 25bps increase	45
Change in 2007 pension cost from a 25bps decrease	(39)
Rate of increase for pensions in payment and deferred pensions	
Change in pension obligation at 31 December 2006 from a 25bps increase	463
Change in pension obligation at 31 December 2006 from a 25bps decrease	(444)
Change in 2007 pension cost from a 25bps increase	29
Change in 2007 pension cost from a 25bps decrease	(28)
Rate of pay increase	
Change in pension obligation at 31 December 2006 from a 25bps increase	146
Change in pension obligation at 31 December 2006 from a 25bps decrease	(140)
Change in 2007 pension cost from a 25bps increase	16
Change in 2007 pension cost from a 25bps decrease	(14)

Notes on the Financial Statements (continued)

Other	HSBC Bank (UK) Pension Scheme £m	Other plans £m
Change in pension obligation from each additional year of longevity assumed	385	23

Defined benefit pension plans

Value recognised in the balance sheet

	At 31 December 2006			
	HSBC Bank (UK) Pension Scheme		**Other plans**	
	Expected rate of return %	**Value £m**	**Expected rate of return %**	**Value £m**
Equities	**8.0**	**2,570**	**5.7**	**178**
Bonds	**5.3**	**6,208**	**3.3**	**229**
Property	**7.0**	**1,047**	**–**	**5**
Other	**4.3**	**660**	**3.0**	**48**
Fair value of plan assets		**10,485**		**460**
Present value of funded obligations		**(12,392)**		**(595)**
Present value of unfunded obligations		**–**		**(32)**
Defined benefit obligation		**(12,392)**		**(627)**
Effect of limit on plan surpluses		**–**		**2**
Unrecognised past service cost		**–**		**–**
Net liability[1]		**(1,907)**		**(165)**

1 *£1,917 million of the net liability for defined benefit pension plans relates to the bank (2005: £1,862 million).*

	At 31 December 2005			
	HSBC Bank (UK) Pension Scheme		Other plans	
	Expected rate of return %	Value £m	Expected rate of return %	Value £m
Equities	8.0	4,753	6.6	119
Bonds	4.3	3,041	4.7	120
Property	6.5	895	6.0	1
Other	3.6	1,418	4.5	164
Fair value of plan assets		10,107		404
Present value of funded obligations		(11,961)		(597)
Present value of unfunded obligations		–		(4)
Defined benefit obligation		(11,961)		(601)
Unrecognised past service cost		–		1
Net liability		(1,854)		(196)

The Scheme 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 Scheme is required to produce a written statement of investment principles (SIP). The SIP sets out the principles governing how decisions about investments are made.

The Trustee has undertaken a review of the Scheme's investment strategy in the light of the latest triennial valuation (31 December 2005) and related discussions with the bank on Scheme funding. As a result of this review, the Trustee has adopted a revised investment strategy that seeks to reduce the financial risks arising from the Scheme. The impact on the asset allocation of the Scheme resulting from the implementation of this revised investment strategy has been to reduce the Scheme's equity holdings and increase holdings in debt instruments at the year end. The Scheme has entered into derivative transactions with the bank to manage the risks arising from its portfolio. These derivatives comprise interest rate, London Interbank Offered Rate ('LIBOR'), swaps and inflation, Retail Prices Index ('RPI'), swaps. Under the terms of these swaps, the Scheme is committed to making LIBOR-related interest payments in exchange for cash flows paid into the Scheme based on a projection of the future benefit payments to the Scheme members. Further information on these swaps is detailed in Note 43 'Related party transactions'.

Changes in the present value of the defined benefit obligation

	2006		2005	
	HSBC Bank (UK) Pension Scheme £m	**Other plans £m**	HSBC Bank (UK) Pension Scheme £m	Other plans £m
At 1 January	**11,961**	**601**	10,335	505
Current service cost	**242**	**24**	211	23
Interest cost	**560**	**21**	540	20
Contributions by employees	**–**	**13**	–	–
Actuarial (gains)/ losses	**(2)**	**(15)**	1,126	68
Benefits paid	**(369)**	**(32)**	(297)	(22)
Past service cost – vested immediately	**–**	**2**	–	(2)
Past service cost – unvested benefits	**–**	**–**	–	2
Acquisitions	**–**	**–**	46	10
Curtailments	**–**	**–**	–	(2)
Exchange and other movements	**–**	**13**	–	(1)
At 31 December	**12,392**	**627**	11,961	601

Changes in the fair value of plan assets

	2006		2005	
	HSBC Bank (UK) Pension Scheme £m	**Other plans £m**	HSBC Bank (UK) Pension Scheme £m	Other plans £m
At 1 January	**10,107**	**404**	7,810	240
Expected return	**620**	**22**	525	15
Contributions by the group	**127**	**15**	1,132	131
Contributions by employees	**–**	**11**	–	5
Experience gains	**–**	**7**	905	9
Benefits paid	**(369)**	**(16)**	(297)	(6)
Acquisitions	**–**	**–**	32	11
Exchange and other movements	**–**	**17**	–	(1)
At 31 December	**10,485**	**460**	10,107	404

The actual return on plan assets for the year-ended 31 December 2006 was £649 million (2005: £1,454 million). The group expects to make £546 million of contributions to defined benefit pension plans during 2007.

Total expense recognised in the income statement in 'Employee compensation and benefits'

	2006		2005		2004	
	HSBC Bank (UK) Pension Scheme £m	**Other plans £m**	HSBC Bank (UK) Pension Scheme £m	Other plans £m	HSBC Bank (UK) Pension Scheme £m	Other plans £m
Current service cost	**242**	**20**	211	23	190	17
Interest cost	**560**	**16**	540	20	503	20
Expected return on plan assets	**(620)**	**(16)**	(525)	(15)	(506)	(10)
Past service cost	**–**	**1**	-	(2)	-	(6)
(Gains)/losses on curtailments	**–**	**–**	-	-	133	(2)
Total expense	**182**	**21**	226	26	320	19

Notes on the Financial Statements (continued)

Summary

	2006		2005		2004	
	HSBC Bank (UK) Pension Scheme £m	**Other plans £m**	HSBC Bank (UK) Pension Scheme £m	Other plans £m	HSBC Bank (UK) Pension Scheme £m	Other plans £m
Defined benefit obligation	**(12,392)**	**(625)**	(11,961)	(601)	(10,335)	(505)
Fair value of plan assets	**10,485**	**460**	10,107	404	7,810	240
Net deficit	**(1,907)**	**(165)**	(1,854)	(197)	(2.525)	(265)
Experience gains on plan liabilities	**300**	**1**	40	3	219	-
Experience gains/(losses) on plan assets	**–**	**7**	905	9	276	(20)
Gains/(losses) from changes in actuarial assumptions	**(298)**	**14**	(1,166)	(71)	(741)	(9)
Total net actuarial gains/ (losses)	**2**	**22**	(221)	(59)	(246)	(29)

Total net actuarial losses recognised in equity to date are £579 million. The total effect of the limit on plan surpluses recognised in equity together with net actuarial losses in 2006 was a £3 million loss (2005: £nil).

The most recently completed triennial actuarial valuation of the Scheme performed by the Scheme Actuary on behalf of the Trustee was carried out as at 31 December 2005. The valuation identified a deficit of £1,200 million. The method adopted for this valuation was the projected unit credit method basis. The expected cash flows from the Scheme were projected by reference to the RPI swap break-even curve at 31 December 2005. Salary increases were assumed to be 1 per cent per annum above RPI and inflationary pension increases, subject to a minimum of zero per cent per annum and a maximum of five per cent per annum, were assumed to be in line with RPI. The projected cash flows were discounted at the LIBOR swap curve at 31 December 2005 plus a margin for the expected return on the investment strategy of 110 basis points per annum. The mortality experience of the Scheme's pensioners over the three year period since the previous valuation was analysed and the mortality assumption set on the basis of this with allowances for medium cohort future improvements on the PA92 series of tables from the valuation date.

As part of the 31 December 2005 valuation, calculations were also carried out as to the amount of assets that might be needed to meet the liabilities if the Scheme were 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 Scheme without the support of the bank. The amount required under this approach is estimated to be £15,500 million as at 31 December 2005. In estimating the solvency position for this purpose, a more prudent assumption about future improvements in mortality was made that for the assessment of the ongoing position and it was assumed that the Trustee would alter the investment strategy to be in line with that on an appropriately matched portfolio of cash and interest and inflation swaps. An explicit allowance for expenses was also included.

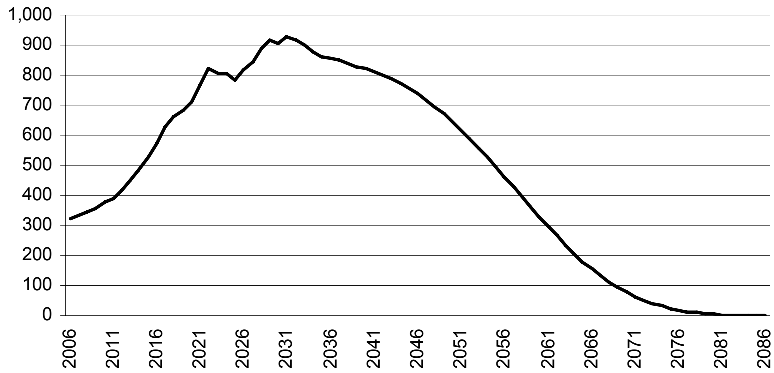
In anticipation of the valuation result, on 22 December 2005 HSBC Bank Plc made an additional contribution of £1 billion in order to reduce the deficit of the plan. Following receipt of the valuation, the Trustee and the bank have agreed a funding plan to close the deficit over a maximum period of ten years and adopt an appropriate ongoing contribution rate. As a result of these negotiations the bank has agreed to make ongoing contributions to the Scheme at a rate of 36.0 per cent of pensionable salaries from 1 January 2007, until the completion of the next actuarial valuation, due at 31 December 2008. During 2006, the bank paid contributions at the rate of 20 per cent of pensionable salaries and in order to compensate for this, a further 2 per cent of pensionable salaries is being paid over the period 1 January 2007 to 31 December 2014. In addition the bank has agreed to a series of additional contributions towards the deficit as detailed below:

	£m
2007	300
2012	465
2013	465
2014	465

The Trustee and the bank will monitor progress towards closing the deficit on an annual basis and in the light of the next triennial valuation due as at 31 December 2008.

The benefits payable from the Scheme are expected to be as shown in the chart below:

Benefit payments (£m)



Post-employment healthcare benefits plans

Value recognised in the balance sheet

	2006 £m	2005 £m
Present value of unfunded obligations	**(180)**	(168)
Net liability[1]	**(180)**	(168)

1 *£152 million of the net liability for post-employment healthcare benefits relates to the bank (2005: £141 million).*

Changes in the present value of the defined benefit obligation

	2006 £m	2005 £m
At 1 January	**168**	145
Current service cost	**1**	1
Interest cost	**7**	7
Actuarial losses	**12**	22
Past service costs	**–**	–
Benefits paid	**(6)**	(7)
Exchange and other movements	**(2)**	–
At 31 December	**180**	168

Total expense recognised in the income statement, in 'Employee compensation and benefits'

	2006 £m	2005 £m
Current service cost	**1**	1
Interest cost	**7**	7
Total expense	**8**	8

Summary

	Year ended 31 December	
	2006 £m	2005 £m
Defined benefit obligation	**(180)**	(168)
Net deficit	**(180)**	(168)
Experience losses on plan liabilities	**(5)**	–
Losses from changes in actuarial assumptions	**(7)**	(22)
Total net actuarial gains/(losses)	**(12)**	(22)

Notes on the Financial Statements (continued)

Total net actuarial losses recognised in equity to date are £36 million.

The actuarial assumptions of the healthcare cost trend rates have a significant effect on the amounts recognised. A one percentage point change in assumed healthcare cost trend rates would have the following effects on amounts recognised in 2006:

	1% increase	**1% decrease**
	£m	**£m**
Increase/ (decrease) on the aggregate of the current service cost and interest cost	**2**	**(1)**
Increase/ (decrease) on defined benefit obligation	**28**	**(22)**

The bank

Employees of the bank who are members of defined benefit pension plans are principally members of the HSBC Bank (UK) Pension Scheme, as disclosed in the note above.

Directors' emoluments

The aggregate emoluments of the Directors of the bank, computed in accordance with Part I of Schedule 6 of the Companies Act were:

	2006	2005
	£000	£000
Fees	**365**	384
Salaries and other emoluments	**1,607**	1,603
Bonuses[1]	**3,316**	2,518
	5,288	4,505
Gains on the exercise of share options	**39**	222
Vesting of Restricted Share Plan awards	**534**	410

1 *In return for the prior waiver of bonus, the employer contribution into the pension scheme of a Director has been increased by the amount of £245,458 (2005: two directors increased by the amount of £2.024 million).*

In aggregate, awards of £3,081,494 (2005: £3,650,000) will be made to four Directors under long-term incentive plans in respect of 2006.

From January to April 2006, retirement benefits accrued to four (2005: five) Directors under defined benefit schemes and to two (2005: two) Directors under money purchase schemes in respect of qualifying services. As a result of pensions tax simplification provisions introduced by the Finance Act 2004 from 6 April 2006, four Directors ceased to be members of defined benefit schemes, and, as a consequence, no additional benefits will accrue under such arrangements in respect of these Directors. As at 31 December 2006, there were no Directors accruing benefits under defined benefit arrangements and three Directors accruing benefits under money purchase arrangements in respect of qualifying services. Aggregate contributions during the year to money purchase arrangements in respect of Directors services were £718,384, including £460,458 in respect of prior waiver of bonus by two Directors.

In addition, there were payments under retirement benefit agreements with former Directors of £690,462 (2005: £677,661), including payments in respect of unfunded pension obligations to former Directors of £397,657 (2005: £394,716). The provision as at 31 December 2006 in respect of unfunded pension obligations to former Directors amounted to £5,130,000 (2005: £3,848,000). During the year, aggregate contributions to pension schemes in respect of Directors were £645,612 (2005: £2,311,172), including £245,458 (2005: £2,023,782) arising from Directors' waivers of bonuses.

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the bank's parent company, HSBC Holdings plc. The cost of the conditional awards under the HSBC Holdings Restricted Share Plan 2000 is recognised through an annual charge based on the original cost and the likely level of vesting of shares, apportioned over the period of service to which the award relates.

Of these aggregate figures, the following amounts are attributable to the highest paid Director:

	2006	2005
	£000	£000
Fees	**35**	-
Salaries and other emoluments	**422**	671
Bonuses[1]	**845**	-

1 *In return for the prior waiver of bonus, an employer contribution of £245,458 has been made into a defined contribution pension arrangement and is not shown in this figure.*

There were no awards under long-term incentive awards to the highest paid Director that vested during the year. The highest paid Director exercised share options over 13,000 HSBC Holdings Plc ordinary shares during the year with a gain on exercise of £37,700.

Contributions of £245,458, arising from the Director's prior waiver of bonus, and £204,458 into a defined contribution arrangement were made by the bank in respect of services by the highest paid Director during the year.

The Remuneration Committee of the bank's parent company, HSBC Holdings plc, is proposing that the highest paid Director should receive a conditional award of HSBC Holdings plc ordinary shares with a face value of £1,086,571 under The HSBC Share Plan in respect of services as a Director during the year. Details of The HSBC Share Plan and performance conditions are contained within the Directors' Remuneration Report of HSBC Holdings plc.

9 General and administrative expenses

Auditors' remuneration

Auditors' remuneration in relation to statutory audit amounted to £8.1 million (2005: £8.8 million).

The following fees were payable by the group to the group's principal auditor, KPMG Audit plc and its associates (together 'KPMG'):

	2006	2005
	£m	£m
Audit fees for HSBC Bank plc statutory audit:		
– fees relating to current year	**2.7**	2.6
– fees relating to prior year	**–**	–
	2.7	2.6
Fees payable to KPMG for other services provided to the group		
– audit of subsidiaries, pursuant to legislation	**5.0**	5.4
– other services pursuant to legislation	**2.3**	4.1
– tax services	**0.3**	0.5
– services relating to information technology	**0.1**	–
– internal audit services	**–**	–
– valuation and actuarial services	**0.1**	–
– services relating to litigation	**–**	–
– services relating to recruitment and remuneration	**–**	–
– services related to corporate finance transactions	**–**	–
– all other services	**1.4**	2.1
	9.2	12.1
Total fees payable	**11.9**	14.7

'Audit fees for HSBC Bank plc statutory audit' are fees payable to KPMG Audit plc for the statutory audit of the consolidated financial statements of the group and the separate financial statements of HSBC Bank plc. It excludes amounts payable for the statutory audit of HSBC Bank Plc's subsidiaries which have been included in 'Fees payable to KPMG for other services provided to the group'.

The following is a description of the type of services included in 'Fees payable to KPMG for other services provided to the group':

Audit related services:

– Audit of the group's subsidiaries pursuant to legislation, includes fees payable to KPMG for the statutory audit of HSBC Bank plc's subsidiaries and associated pension schemes.

Notes on the Financial Statements (continued)

– Other services pursuant to legislation include services for assurance and other services that are in relation to statutory and regulatory filings, including comfort letters and interim reviews.

Tax services:

– Tax services include tax compliance services and tax advisory services.

Other services:

– Services relating to information technology include advice on IT security and business continuity and performing agreed upon IT testing procedures.

– Valuation and actuarial services include internal valuation opinions on transfers within the group.

– Services related to recruitment and remuneration include advice and assistance with the recruitment of personnel on behalf of the group, except for directors, executives or managerial positions.

– Services related to corporate finance transactions include fees payable to KPMG for transaction-related work irrespective of whether the group is vendor or purchaser, such as acquisition due diligence and long-form reports.

– All other services include other assurance and advisory services such as translation services, ad-hoc accounting advice and review of financial models.

Fees payable to KPMG for non-audit services for HSBC Bank plc are not disclosed because such fees are disclosed on a consolidated basis for the group.

10 Share-based payments

Share option awards are granted by HSBC Holdings to group employees and are accounted for as equity-settled share-based payments as they are satisfied by HSBC Holdings transferring shares to the employees on exercise.

Where an award of HSBC Holdings shares is made to a group employee by a group entity, the employing entity has an obligation to transfer HSBC Holdings shares to the employee if the vesting conditions of the award are satisfied. The employing entity incurs a liability in respect of the share awards recognised at fair value, remeasured at each reporting date over the vesting period and at the date of settlement. These transactions are accounted for as cash-settled share-based payment transactions.

During 2006, £77 million was charged to the income statement in respect of equity-settled share-based payment transactions and £122 million was charged to the income statement in respect of cash-settled share-based payment transactions (2005: £59 million and £78 million respectively). The equity-settled share-based payment expense was based on the fair value of the transactions at the grant date. The cash-settled share-based payment expense was based on the fair value of the transactions at the date of settlement or at the year end. All of the expense arose under employee share awards made within the group's reward structures.

Calculation of fair values

Fair values of equity instruments at date of grant are calculated using a binomial lattice model methodology that is based on the underlying assumptions of the Black-Scholes model. When modelling options/share awards with vesting dependent on the Group's Total Shareholder Return over a period, these performance targets are incorporated into the model using Monte-Carlo simulation. The expected life of options depends on the behaviour of option holders, which is incorporated into the option model consistent with historic observable data. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used.

The significant weighted average assumptions used to estimate the fair value of the options granted in 2006 were as follows:

	1-year Savings-Related Share Option Schemes	3-year Savings-Related Share Option Schemes	5-year Savings-Related Share Option Schemes	The HSBC Share Plan
Risk-free interest rate[1] (%)	**4.7**	**4.8**	**4.7**	–
Expected life[2] (years)	**1.0**	**3.0**	**5.0**	–
Expected volatility[3] (%)	**17.0**	**17.0**	**17.0**	–

1 *The risk-free rate was determined from the UK gilts yield curve for Group Share Option Plan awards and UK Savings-Related Share Option Schemes. A similar yield curve was used for the Overseas Savings-Related Share Option Schemes.*
2 *Expected life is not a single input parameter but a function of various behavioural assumptions.*
3 *Expected volatility is estimated by considering both historic average share price volatility and implied volatility derived from traded options over HSBC shares of similar maturity to those of the employee options.*

Expected dividends have been incorporated into the valuation model for options and shares, where applicable. Expected dividend growth was determined, denominated in US Dollars, to be 9 per cent for the first year (2005: 12 per cent) and 8 per cent thereafter (2005: 8 per cent), consistent with consensus analyst forecasts.

The average share price for 2006 was £9.595 (2005: £8.89). The high mid-market price for the year was £10.28 and the low mid-market price was £9.135 (2005: £9.50 and £8.25 respectively).

The significant weighted average assumptions used to estimate the fair value of the options granted in 2005 were as follows:

	Group Share Option Plan	3-year Savings-Related Share Option Schemes	5-year Savings-Related Share Option Schemes	The HSBC Share Plan
Risk-free interest rate[1] (%)	**4.6**	**4.3**	**4.3**	**4.3**
Expected life[2] (years)	**7.8**	**3.0**	**5.0**	**5.0**
Expected volatility[3] (%)	**20.0**	**20.0**	**20.0**	**20.0**

1 *The risk-free rate was determined from the UK gilts yield curve for Group Share Option Plan awards and UK Savings-Related Share Option Schemes. A similar yield curve was used for the Overseas Savings-Related Share Option Schemes.*
2 *Expected life is not a single input parameter but a function of various behavioural assumptions.*
3 *Expected volatility is estimated by considering both historic average share price volatility and implied volatility derived from traded options over HSBC shares of similar maturity to those of the employee options.*

HSBC Share Plan

The HSBC Share Plan was adopted by the Group in 2005. This plan comprises Performance share awards, Restricted share awards and Achievement share awards. The aim of the HSBC Share Plan is to align the interests of executives to the creation of shareholder value and recognise individual performance and potential. Awards are also made under this plan for recruitment and retention purposes.

Performance share awards

Performance share awards are made to senior executives taking into account individual performance in the prior year. Performance share awards are divided into two equal parts for testing attainment against pre-determined benchmarking. One half is subject to a Total Shareholder Return measure, based on HSBC's ranking against a comparator group of 28 major banks. The other half of the award is subject to an Earnings per share target. For each element of the award, shares would be released to the employee according to a sliding scale from 30 to 100 per cent of the award, depending upon the scale of achievement against the benchmarks and providing that a threshold has been passed. If the threshold is not passed, zero per cent will vest for that part of the award. Shares will be released after three years to the extent that the performance conditions are satisfied. These awards are forfeited in total if the Group performance fails to meet the threshold criteria.

	2006 Number (000)	2005 Number (000)
Outstanding at 1 January	**492**	–
Additions during the year	**477**	492
Releases during the year	**(128)**	–
Forfeited in the year	**–**	–
Outstanding at 31 December [1]	**841**	492

1 *All the above awards relate to executives of HSBC Bank plc.*

Notes on the Financial Statements (continued)

The weighted average fair value of shares awarded by the group for Performance Share Awards in 2006 was £7.38 (2005: £4.93).

Restricted Share awards

Restricted Share awards are made to eligible employees for recruitment and retention purposes or as part of deferral of annual bonus. The awards vest between one and three years from date of award.

	2006 Number (000)	2005 Number (000)
Outstanding at 1 January	**214**	–
Additions during the year	**11,387**	226
Released during the year	**(163)**	–
Forfeited in the year	**(272)**	(12)
Outstanding at 31 December	**11,166**	214

1 *The above table includes the bank employee shares of 6,447,505 granted during the year and 6,592,157 shares outstanding at 31 December 2006.*

The weighted average fair value of shares awarded by the group for Restricted Share Awards in 2006 was £9.65 (2005: £8.68).

Share options

Share options were granted under the rules of The HSBC Share Plan to employees in France based on their performance in the previous year. The share options are subject to the corporate Performance Condition, which consists of an absolute Earnings Per Share measure and a Total Shareholder Return measure, based on the Group's ranking against a comparator group of 28 major banks. The options vest after three years. Options granted in June 2005 are exercisable up to the fourth anniversary of the date of grant, after which they will lapse. Options granted in September 2005 are exercisable up to the tenth anniversary of the grant, after which they will lapse.

	2006		2005	
	Number (000)	**Weighted average exercise price £**	Number (000)	Weighted average exercise price £
Outstanding at 1 January	**628**	**8.84**	–	–
Granted in the year	**–**	**–**	628	8.84
Forfeited in the year	**–**	**–**	–	–
Outstanding at 31 December	**628**	**8.84**	628	8.84

No share options were granted in 2006 (fair value of options granted in 2005: £1.25). The remaining contractual life of options outstanding at the balance sheet date is 3 years. (2005: 4 years). None of these options are exercisable at the balance sheet date.

No share options were exercised in the year.

Savings-related share option plans

The savings-related share option plans invite eligible employees to enter into savings contracts to save up to £250 per month, with the option to use the savings to acquire shares. The aim of the plan is to align the interests of all employees to the creation of shareholder value. The options are exercisable within six months following either the third or the fifth anniversary of the commencement of the savings contract depending on conditions set at grant. The exercise price is set at a 20 per cent (2005: 20 per cent) discount to the market value at the date of grant.

	2006 Number (000)	2006 Weighted average exercise price £	2005 Number (000)	2005 Weighted average exercise price £
Outstanding at 1 January	**37,164**	**5.98**	30,859	5.72
Granted in the year	**7,890**	**8.89**	10,228	6.67
Exercised in the year	**(6,714)**	**5.63**	(641)	5.55
Transferred in the year	**134**	**5.90**	(165)	5.38
Expired in the year	**(1,421)**	**6.41**	(3,117)	5.89
Outstanding at 31 December[1,2]	**37,053**	**6.46**	37,164	5.98

1 *The above table includes the bank employee options of 36,005,997 outstanding at 1 January 2006 (2005: 29,908,022), 7,537,041 options granted in the year (2005: 9,846,316) and 33,571,481 options outstanding at 31 December 2006 (2005: 36,005,997).*

2 *The weighted average exercise price for bank employees at 1 January 2006 was £5.97 (2005: £5.73) and at 31 December 2006 was £6.44.*

The weighted average fair value of options granted in the year as at the date of grant was £2.50 (2005: £2.06). The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the balance sheet date, analysed by exercise price range, were as follows:

The group

	2006	2005
Exercise price range (£)	**£5.35-£8.02**	£5.35-£6.75
Number (000)	**37,053**	37,164
Weighted average exercise price (£)	**6.46**	5.98
Weighted average remaining contractual life (years)	**2.08**	2.31

The bank

	2006	2005
Exercise price range (£)	**£5.35-£8.02**	£5.35-£6.75
Number (000)	**33,571**	36,006
Weighted average exercise price (£)	**6.44**	5.97
Weighted average remaining contractual life (years)	**2.24**	2.32

The weighted average share price at the dates the share options were exercised was £9.54 (2005: £9.10).

Restricted Share Plan 2000

Performance Share awards made under the HSBC Holdings Restricted Share Plan 2000

Performance Share awards under the Restricted Share Plan were granted to Senior Executives from 1996 to 2004. The aim of the plan was to align the interests of executives to the creation of shareholder value. This was achieved by setting certain Total Shareholder Return targets against a peer group of major banks which must normally be attained in order for the awards to vest. No further awards will be made under this Plan following adoption of the HSBC Share Plan in 2005.

	2006 Number (000)	2005 Number (000)
Outstanding at 1 January	**2,210**	2,157
Additions during the year	**80**	25
Released in the year	**(313)**	–
Transferred in the year	**–**	28
Outstanding at 31 December[1]	**1,977**	2,210

1 *All the above awards relate to executives of HSBC Bank plc.*

The fair value of the shares at 31 December 2006 was £9.31 (2005: £9.33).

Notes on the Financial Statements (continued)

The weighted average remaining vesting period as at 31 December 2006 was 15 months (2005: 23 months).

Restricted share awards made under the HSBC Holdings Restricted Share Plan 2000 ('Achievement Shares')

Achievement shares are utilised to promote widespread interest in HSBC Holdings shares among employees and to help foster employee engagement. They are awarded to eligible employees after taking into account the employee's performance in the prior year. Shares are awarded without corporate performance conditions and are released to employees after three years providing the employees have remained continuously employed by the Group for this period.

	2006 Number of shares (000)	2005 Number of shares (000)
Outstanding at 1 January	**298**	–
Additions during the year[1]	**652**	300
Forfeited in the year	**–**	(2)
Outstanding at 31 December[2]	**950**	298

1 *Additions during the year include reinvested scrip dividends.*
2 *594,397 of the above awards relate to executives of HSBC Bank plc.*

The weighted average fair value of shares awarded by the group for Achievement share awards in 2006 was £9.65 (2005: £8.68).

Other awards made under the Restricted Share Plan

Other awards were made under the HSBC Holdings Restricted Share Plan 2000 as part deferral of annual bonus. Awards were also made for recruitment and retention purposes. The awards generally vest from one to three years from the date of award. Awards made under this plan ceased in May 2005. Awards of restricted shares on or after 27 May 2005 were made under the Rules of the HSBC Share Plan.

	2006 Number (000)	2005 Number (000)
Outstanding at 1 January	**25,725**	34,520
Released in the year	**(13,960)**	(10,284)
Additions during the year	**487**	1,489
Forfeited in the year	**(439)**	–
Transferred in the year	**104**	–
Outstanding at 31 December[1]	**11,917**	25,725

1 *The above table includes bank employee shares of 25,333,000 outstanding at 1 January 2006 (2005: 32,207,000), 224,921 shares granted in the year (2005: 1,489,000) and 6,931,420 outstanding at 31 December 2006.*

No shares were awarded by the group for HSBC Holdings Restricted Share Plan 2000 in 2006. In 2005, the weighted average fair value of such shares awarded was £8.60.

Group Share Option Plan

The Group Share Option Plan was a long-term incentive plan available to certain group employees between 2000 and 2005. The aim of the plan was to align the interests of those higher performing employees to the creation of shareholder value. This was achieved by setting certain Total Shareholder Return targets which must normally be attained in order for the awards to vest. Options were granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions.

	2006		2005	
	Number (000)	**Weighted average exercise price £**	Number (000)	Weighted average exercise price £
Outstanding at 1 January	**67,390**	**7.74**	60,783	7.61
Granted in the year	**–**	**–**	7,991	8.39
Exercised in the year	**(22,211)**	**7.45**	(110)	7.69
Transferred in the year	**282**	**7.67**	164	7.71
Expired in the year	**(109)**	**8.02**	(1,438)	6.01
Outstanding at 31 December[1,2]	**45,352**	**7.82**	67,390	7.74

1 *The above includes the bank employee awards of 33,341,930 options outstanding at 1 January 2006 (2005: 34,661,292), NIL options granted in the year (2005: 36,265) and 21,402,302 options outstanding at 31 December 2006 (2005: 33,341,930).*

2 *The weighted average exercise price for bank employees at 1 January 2006 was £7.61 (2005: £7.62) and at 31 December 2006 was £7.80 (2005: £7.61).*

3 *A charge of £27.3 million was recognised in the income statement in 2006 arising from the waiver of the Total Shareholder Return performance condition in respect of the 2003 awards made under the Group Share Option Plan. The Group Remuneration Committee exercised its discretion, as permitted by the Plan, to waive this performance condition in light of the performance and shareholder returns over the three years covered by the 2003 awards. This was accounted for as a modification in accordance with IFRS 2, resulting in an additional charge to the income statement representing the additional fair value awarded as a result of the modification, calculated in accordance with the fair value methodology outlined above.*

No share options were awarded by the group for the Group Share Option Plan in 2006 (fair value of options granted in 2005: £1.56). The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the balance sheet date, analysed by exercise price range, were as follows:

The group

	2006		2005	
Exercise price range (£)	**£6.00-£8.00**	**£8.01-£10.00**	£6.00-£8.00	£8.01-£10.00
Number (000)	**15,807**	**29,545**	29,378	38,012
Weighted average exercise price (£)	**6.91**	**8.31**	6.91	8.31
Weighted average remaining contractual life (years)	**–**	**0.52**	0.33	1.54

The bank

	2006		2005	
Exercise price range (£)	**£6.00-£8.00**	**£8.01-£10.00**	£6.00-£8.00	£8.01-£10.00
Number (000)	**7,520**	**13,882**	16,354	16,988
Weighted average exercise price (£)	**6.91**	**8.28**	6.91	8.28
Weighted average remaining contractual life (years)	**–**	**0.22**	0.33	1.32

HSBC France and subsidiary company plans

HSBC France granted share purchase and subscription offers to certain executives of HSBC France, directors and officers, as well as to certain senior executives of subsidiaries.

Options granted between 1994 and 1999 vested upon announcement of the group's intent to acquire HSBC France and were therefore included in the valuation of HSBC France.

HSBC France granted 909,000 options in 2000 after the public announcement of the acquisition and these options did not vest as a result of the change in control. The options were subject to continued employment and vested on 1 January 2002. The HSBC France shares obtained on exercise of the options are exchangeable for HSBC's ordinary shares of US$0.50 each in the same ratio as the Exchange Offer for Crédit Commercial de France shares (13 ordinary shares of US$0.50 for each HSBC France share). Options are granted at market value and are exercisable within 10 years of the vesting date.

Notes on the Financial Statements (continued)

	2006		2005	
	Number (000)	**Weighted average exercise price €**	Number (000)	Weighted average exercise price €
Outstanding at 1 January	**766**	**142.5**	860	142.5
Exercised in the year	**(120)**	**142.5**	(94)	142.5
Outstanding at 31 December	**646**	**142.5**	766	142.5

The weighted average remaining contractual life for options outstanding at the balance sheet date was 3.3 years (2005: 4.3 years).

The weighted average share price at the dates the share options were exercised was £9.58 (2005: £8.91)

At the date of its acquisition in 2000, certain of HSBC France's subsidiary companies also operated employee share option plans under which options could be granted over their respective shares. On exercise of certain of these options, the subsidiary shares are exchanged for HSBC ordinary shares. The total number of HSBC Holdings shares exchangeable under such arrangements was 356,491 shares during the year. (2005: 821,466).

Detailed below are the share-based payment awards made before the date of application of IFRS 2 on 7 November 2002 and therefore, are not accounted for within the balance sheet or income statement.

The Group Share Option Plan

	2006		2005	
	Number (000)	**Weighted average exercise price £**	Number (000)	Weighted average exercise price £
Outstanding at 1 January	**46,654**	**8.10**	58,967	7.98
Exercised in the year	**(11,113)**	**7.90**	(11,058)	7.55
Transferred in the year	**320**	**7.83**	(283)	3.61
Expired in the year	**(63)**	**7.74**	(972)	8.29
Outstanding at 31 December[1,2]	**35,798**	**8.17**	46,654	8.10

1 *The above includes the bank employee awards of 30,424,672 options outstanding at 1 January 2006 (2005: 42,231,853), and 21,402,021 options outstanding at 31 December 2006 (2005: 30,424,672).*

2 *The weighted average exercise price for bank employees was £7.93 at 1 January 2006 (2005: £7.80) and £7.97 at 31 December 2006 (2005: £7.93).*

The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the balance sheet date, analysed by exercise price range, were as follows:

The group

	2006		2005	
Exercise price range (£)	**£6.38-£7.46**	**£7.47-£9.54**	£6.38-£7.46	£7.47-£9.64
Number (000)	**8,116**	**27,682**	12,079	34,575
Weighted average exercise price (£)	**6.84**	**8.56**	6.81	8.56
Weighted average remaining contractual life (years)	**–**	**–**	–	–
Of which exercisable:				
– number (000)	**8,116**	**27,682**	12,079	34,575
– weighted average exercise price (£)	**6.84**	**8.56**	6.81	8.56

The bank

	2006		2005	
Exercise price range (£)	**£6.38-£7.46**	**£7.47-£9.54**	£6.38-£7.46	£7.47-£9.64
Number (000)	**7,207**	**14,195**	10,929	19,496
Weighted average exercise price (£)	**6.81**	**8.56**	6.80	8.56
Weighted average remaining contractual life (years)	**–**	**–**	–	–
Of which exercisable:				
– number (000)	**7,207**	**14,195**	10,929	19,496
– weighted average exercise price (£)	**6.81**	**8.56**	6.80	8.56

Savings Related Share Option Plan

	2006		2005	
	Number (000)	**Weighted average exercise price £**	Number (000)	Weighted average exercise price £
Outstanding at 1 January	**7,347**	**6.51**	20,401	6.24
Exercised in the year	**(3,583)**	**6.70**	(12,145)	6.07
Transferred in the year	**11**	**6.36**	(54)	6.60
Expired in the year	**(125)**	**6.37**	(855)	6.34
Outstanding at 31 December[1,2]	**3,650**	**6.33**	7,347	6.51

1 *The above table includes the bank employee options of 7,246,942 outstanding at 1 January 2006 (2005:19,908,899) and 3,500,932 options outstanding at 31 December 2006 (2005: 7,246,942).*

2 *The weighted average exercise price for bank employees was £6.51 at 1 January 2006 (2005: £6.24) and £6.33 at 31 December 2006 (2005: £6.51).*

The number of options, weighted average exercise price, and the weighted average remaining contractual life for options outstanding at the balance sheet date, analysed by exercise price range, were as follows:

The group

	2006		2005	
Exercise price range (£)	**£5.40-£6.03**	**£6.04-£6.75**	£5.40-£6.03	£6.04-£6.75
Number (000)	**–**	**3,650**	175	7,172
Weighted average exercise price (£)	**–**	**6.33**	6.01	6.52
Weighted average remaining contractual life (years)	**–**	**0.33**	–	0.31
Of which exercisable:				
– number (000)	**–**	**82**	175	67
– weighted average exercise price (£)	**–**	**6.75**	6.01	6.53

The bank

	2006		2005	
Exercise price range (£)	**£5.40-£6.03**	**£6.04-£6.75**	£5.40-£6.03	£6.04-£6.75
Number (000)	**–**	**3,501**	172	7,075
Weighted average exercise price (£)	**–**	**6.33**	6.01	6.52
Weighted average remaining contractual life (years)	**–**	**0.33**	–	0.83
Of which exercisable:				
– number (000)	**–**	**75**	172	33
– weighted average exercise price (£)	**–**	**6.75**	6.01	6.32

Notes on the Financial Statements (continued)

11 Tax expense

	2006	2005
	£m	£m
Current taxation		
United Kingdom corporation tax charge – current year	**(466)**	(455)
United Kingdom corporation tax charge – adjustment in respect of prior years	**82**	53
Overseas tax – current year	**(370)**	(349)
Overseas tax – adjustment in respect of prior years	**6**	2
	(748)	(749)
Deferred taxation		
Origination and reversal of temporary differences	**(219)**	(99)
Adjustment in respect of previous periods	**(11)**	21
	(230)	(78)
Tax expense	**(978)**	(827)

The bank and its subsidiary undertakings in the United Kingdom provided for UK corporation tax at 30 per cent (2005: 30 per cent). Other overseas subsidiary undertakings and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

	2006		2005[1]	
	£m	Percentage of overall tax charge %	£m	Percentage of overall tax charge %
Analysis of overall tax charge				
Taxation at UK corporate tax rate of 30 per cent (2005: 30 per cent)	**1,139**	**30.0**	1,119	30.0
Impact of overseas profits in principal locations taxed at different rates	**(65)**	**(1.7)**	(26)	(0.7)
Tax-free gains	**(19)**	**(0.5)**	(141)	(3.8)
Impact of profits in associates and joint ventures	**11**	**0.3**	(23)	(0.6)
Adjustments in respect of prior period liabilities	**(80)**	**(2.1)**	(74)	(1.9)
Other items	**(8)**	**(0.2)**	(28)	(0.8)
Overall tax charge	**978**	**25.8**	827	22.2

1 Comparatives have changed due to 2005 being restated.

In addition to the amount charged to the income statement the aggregate amount of deferred taxation, relating to items that are charged directly to equity, was £29 million (2005: £161 million).

The group is subject to income taxes in many jurisdictions and significant judgement is required in estimating the group's provision for income taxes. There are many transactions and interpretations of tax law for which the final outcome will not be established until some time later. The group recognises liabilities for taxation based on estimates of whether additional taxes will be payable. The estimation process includes seeking expert advice where appropriate. Where the final liability for taxation is different from the amounts that were initially recorded, these differences will affect the income tax and deferred taxation provisions in the period in which the estimate is revised or the final liability is established.

12 Dividends

	2006		2005	
	£ per share	£m	£ per share	£m
Second interim dividend for previous year	**0.88**	**700**	0.88	700
First interim dividend for current year	**1.12**	**891**	0.88	700
	2.00	**1,591**	1.76	1,400

13 Segment analysis

The allocation of earnings reflects the benefit of shareholders' funds to the extent that these costs are actually allocated to businesses in the segment by way of intra-group capital and funding structures.

By geographical region

Geographical information has been classified by the location of the principal operations of the subsidiary undertaking or, in the case of the bank, by the location of the branch responsible for reporting the results or for advancing the funds.

	United Kingdom £m	Continental Europe £m	Rest of the world £m	Intra-group £m	Total £m
2006					
Total operating income					
Net interest income	**3,083**	**985**	**41**	**87**	**4,196**
Dividend income	**19**	**31**	**–**	**–**	**50**
Net fee income	**2,379**	**1,285**	**78**	**–**	**3,742**
Net trading income	**1,686**	**847**	**180**	**(87)**	**2,626**
Net income from financial instruments designated at fair value	**54**	**5**	**–**	**–**	**59**
Gains less losses from financial investments	**105**	**130**	**4**	**–**	**239**
Net earned insurance premiums	**176**	**141**	**–**	**–**	**317**
Other operating income	**382**	**66**	**32**	**–**	**480**
Total operating income	**7,884**	**3,490**	**335**	**–**	**11,709**
Share of profit in associates and joint ventures	**(53)**	**14**	**(1)**	**–**	**(40)**
Profit before tax	**2,473**	**1,133**	**190**	**–**	**3,796**
Profit attributable to shareholders	**1,819**	**737**	**166**	**–**	**2,722**
Depreciation and amortisation	**(462)**	**(98)**	**(1)**	**–**	**(561)**
Loan impairment charges	**(906)**	**(32)**	**–**	**–**	**(938)**
Cost to acquire property, plant and equipment	**(525)**	**(101)**	**(2)**	**–**	**(628)**
Cost to acquire intangibles	**(93)**	**(16)**	**–**	**–**	**(109)**
Total assets	**309,778**	**138,092**	**13,166**	**(20,276)**	**440,760**
Total liabilities	**301,147**	**125,863**	**13,088**	**(20,276)**	**419,822**

Notes on the Financial Statements (continued)

	United Kingdom £m	Continental Europe £m	Rest of the world £m	Intra-group £m	Total £m
2005 (Restated)					
Total operating income					
Net interest income	2,899	1,097	46	–	4,042
Dividend income	5	23	–	–	28
Net fee income	2,107	1,164	84	–	3,355
Net trading income	1,026	599	150	–	1,775
Net income from financial instruments designated at fair value	151	19	–	–	170
Net investment income on assets backing policyholders' liabilities	–	–	–	–	–
Gains less losses from financial investments	123	115	10	–	248
Net earned insurance premiums	269	169	–	–	438
Other operating income	723	187	9	–	919
Total operating income	7,303	3,373	299	–	10,975
Share of profit in associates and joint ventures	52	4	21	–	77
Profit before tax	2,353	1,195	183	–	3,731
Profit attributable to shareholders	1,836	843	163	–	2,842
Depreciation and amortisation	(485)	(114)	(2)	–	(601)
Loan impairment charges	(811)	30	5	–	(776)
Cost to acquire property, plant and equipment	(658)	(85)	(2)	–	(745)
Cost to acquire intangibles	(162)	(21)	(1)	–	(184)
Total assets	251,370	140,747	12,684	(18,379)	386,422
Total liabilities	243,062	129,377	12,572	(18,223)	366,788

By class of business

The group's operations include a number of support services and head office functions. The costs of these functions are allocated to business lines, where it is appropriate, on a systematic and consistent basis.

	2006 £m	(As restated) 2005 £m
Net operating income before loan impairment charges		
UK Personal Financial Services	**3,655**	3,253
UK Commercial Banking	**1,945**	1,851
UK Corporate, Investment Banking and Markets	**1,924**	1,628
International Banking	**904**	997
France	**1,709**	1,642
Private Banking	**1,153**	1,052
HSBC Trinkaus & Burkhardt	**328**	322
	11,618	10,745

	2006 £m	(As restated) 2005 £m
Profit/(loss) on ordinary activities before tax		
UK Personal Financial Services	**882**	835
UK Commercial Banking	**951**	814
UK Corporate, Investment Banking and Markets	**498**	382
International Banking	**334**	592
France	**467**	460
Private Banking	**555**	516
HSBC Trinkaus & Burkhardt	**109**	132
	3,796	3,731
Total assets		
UK Personal Financial Services	**73,723**	64,285
UK Commercial Banking	**34,105**	31,509
UK Corporate, Investment Banking and Markets	**175,182**	138,673
International Banking	**17,972**	17,943
France	**93,006**	90,707
Private Banking	**34,621**	32,651
HSBC Trinkaus & Burkhardt	**12,151**	10,654
	440,760	386,422
Cost to acquire property, plant and equipment		
UK Personal Financial Services	**222**	125
UK Commercial Banking	**92**	74
UK Corporate, Investment Banking and Markets	**210**	459
International Banking	**43**	22
France	**40**	50
Private Banking	**13**	9
HSBC Trinkaus & Burkhardt	**8**	6
	628	745
Cost to acquire other intangibles		
UK Personal Financial Services	**44**	86
UK Commercial Banking	**33**	25
UK Corporate, Investment Banking and Markets	**23**	31
International Banking	**1**	22
France	**4**	14
Private Banking	**1**	2
HSBC Trinkaus & Burkhardt	**3**	4
	109	184

14 Analysis of financial assets and liabilities by measurement basis

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The principal accounting policies in Note 2 describe how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the balance sheet by the class of financial instrument to which they are assigned, and therefore by the measurement basis:

Notes on the Financial Statements (continued)

The group

2006	Held for trading £m	Designated at fair value[1] £m	Held-to-maturity securities £m	Loans and receivables £m	Available-for-sale securities £m	Financial assets and liabilities at amortised cost £m	Derivatives designated as fair value hedging instruments £m	Derivatives designated as cash flow hedging instruments £m	Total £m
ASSETS									
Cash and balances at central banks	–	–	–	–	–	3,618	–	–	3,618
Items in the course of collection from other banks	–	–	–	–	–	2,937	–	–	2,937
Trading assets	63,779	–	–	–	–	–	–	–	63,779
Trading assets which may be repledged or resold by counterparties	22,215	–	–	–	–	–	–	–	22,215
Financial assets designated at fair value	–	5,985	–	–	–	–	–	–	5,985
Derivatives	31,336	310	–	–	–	–	41	403	32,090
Loans and advances to banks	–	–	–	44,428	–	–	–	–	44,428
Loans and advances to customers	–	–	–	200,416	–	–	–	–	200,416
Financial investments	–	–	10	–	40,094	–	–	–	40,104
Financial investments which may be repledged or resold by counterparties	–	–	66	–	2,210	–	–	–	2,276
Other assets	–	–	–	–	–	3,478	–	–	3,478
Total financial assets	117,330	6,295	76	244,844	42,304	10,033	41	403	421,326
Total non-financial assets									19,434
Total assets									440,760
LIABILITIES									
Deposits by banks	–	–	–	–	–	38,513	–	–	38,513
Customer accounts	–	–	–	–	–	227,350	–	–	227,350
Items in the course of transmission to other banks	–	–	–	–	–	2,428	–	–	2,428
Trading liabilities	52,080	–	–	–	–	–	–	–	52,080
Financial liabilities designated at fair value	–	9,460	–	–	–	–	–	–	9,460
Derivatives	32,178	69	–	–	–	–	37	459	32,743
Debt securities in issue	–	–	–	–	–	38,090	–	–	38,090
Other liabilities	–	–	–	–	–	4,141	–	–	4,141
Subordinated liabilities	–	–	–	–	–	5,380	–	–	5,380
Total financial liabilities	84,258	9,529	–	–	–	315,902	37	459	410,185
Total non-financial liabilities									9,637
Total liabilities									419,822

1 *The derivatives included under 'Designated at fair value' are trading derivatives used to economically hedge the corresponding assets and liabilities designated at fair value.*

The group

2005	Held for trading £m	Designated at fair value[1] £m	Held-to-maturity securities £m	Loans and receivables £m	Available-for-sale securities £m	Financial assets and liabilities at amortised cost £m	Derivatives designated as fair value hedging instruments £m	Derivatives designated as cash flow hedging instruments £m	Total £m
ASSETS									
Cash and balances at central banks	–	–	–	–	–	1,711	–	–	1,711
Items in the course of collection from other banks	–	–	–	–	–	3,595	–	–	3,595
Trading assets	48,510	–	–	–	–	–	–	–	48,510
Trading assets which may be repledged or resold by counterparties	21,611	–	–	–	–	–	–	–	21,611
Financial assets designated at fair value	–	5,345	–	–	–	–	–	–	5,345
Derivatives	24,836	379	–	–	–	–	64	798	26,077
Loans and advances to banks	–	–	–	31,578	–	–	–	–	31,578
Loans and advances to customers	–	–	–	182,629	–	–	–	–	182,629
Financial investments	–	–	137	–	41,144	–	–	–	41,281
Financial investments which may be repledged or resold by counterparties	–	–	–	–	–	2,201	–	–	2,201
Other assets	–	–	–	–	–	4,091	–	–	4,091
Total financial assets	94,957	5,724	137	214,207	41,144	11,598	64	798	368,629
Total non-financial assets									17,793
Total assets									386,422
LIABILITIES									
Deposits by banks	–	–	–	–	–	34,198	–	–	34,198
Customer accounts	–	–	–	–	–	205,475	–	–	205,475
Items in the course of transmission to other banks	–	–	–	–	–	2,268	–	–	2,268
Trading liabilities	45,133	–	–	–	–	–	–	–	45,133
Financial liabilities designated at fair value	–	8,185	–	–	–	–	–	–	8,185
Derivatives	25,453	567	–	–	–	–	96	520	26,636
Debt securities in issue	–	–	–	–	–	26,801	–	–	26,801
Other liabilities	–	–	–	–	–	4,788	–	–	4,788
Subordinated liabilities	–	–	–	–	–	4,792	–	–	4,792
Total financial liabilities	70,586	8,752	–	–	–	278,322	96	520	358,276
Total non-financial liabilities									8,512
Total liabilities									366,788

1 *The derivatives included under 'Designated at fair value' are trading derivatives used to economically hedge the corresponding assets and liabilities designated at fair value.*

Notes on the Financial Statements (continued)

The bank

2006	Held for trading £m	Designated at fair value[1] £m	Held-to-maturity securities £m	Loans and receivables £m	Available-for-sale securities £m	Financial assets and liabilities at amortised cost £m	Derivatives designated as fair value hedging instruments £m	Derivatives designated as cash flow hedging instruments £m	Total £m
ASSETS									
Cash and balances at central banks	–	–	–	–	–	2,496	–	–	2,496
Items in the course of collection from other banks	–	–	–	–	–	1,367	–	–	1,367
Trading assets	53,918	–	–	–	–	–	–	–	53,918
Trading assets which may be repledged or resold by counterparties	8,811	–	–	–	–	–	–	–	8,811
Financial assets designated at fair value	–	–	–	–	–	–	–	–	–
Derivatives	24,061	209	–	–	–	–	–	91	24,361
Loans and advances to banks	–	–	–	25,121	–	–	–	–	25,121
Loans and advances to customers	–	–	–	143,964	–	–	–	–	143,964
Financial investments	–	–	–	–	10,964	–	–	–	10,964
Financial investments which may be repledged or resold by counterparties	–	–	–	–	1,171	–	–	–	1,171
Other assets	–	–	–	–	–	1,818	–	–	1,818
Total financial assets	86,790	209	–	169,085	12,135	5,681	–	91	273,991
Total non-financial assets									20,095
Total assets									294,086
LIABILITIES									
Deposits by banks	–	–	–	–	–	29,182	–	–	29,182
Customer accounts	–	–	–	–	–	164,054	–	–	164,054
Items in the course of transmission to other banks	–	–	–	–	–	1,019	–	–	1,019
Trading liabilities	35,215	–	–	–	–	–	–	–	35,215
Financial liabilities designated at fair value	–	4,736	–	–	–	–	–	–	4,736
Derivatives	24,811	67	–	–	–	–	–	89	24,967
Debt securities in issue	–	–	–	–	–	5,408	–	–	5,408
Other liabilities	–	–	–	–	–	2,320	–	–	2,320
Subordinated liabilities	–	–	–	–	–	4,999	–	–	4,999
Total financial liabilities	60,026	4,803	–	–	–	206,982	–	89	271,900
Total non-financial liabilities									4,979
Total liabilities									276,879

1 *The derivatives included under 'Designated at fair value' are trading derivatives used to economically hedge the corresponding assets and liabilities designated at fair value.*

The bank

2005	Held for trading £m	Designated at fair value[1] £m	Held-to-maturity securities £m	Loans and receivables £m	Available-for-sale securities £m	Financial assets and liabilities at amortised cost £m	Derivatives designated as fair value hedging instruments £m	Derivatives designated as cash flow hedging instruments £m	Total £m
ASSETS									
Cash and balances at central banks	–	–	–	–	–	689	–	–	689
Items in the course of collection from other banks	–	–	–	–	–	2,125	–	–	2,125
Trading assets	34,733	–	–	–	–	–	–	–	34,733
Trading assets which may be repledged or resold by counterparties	3,950	–	–	–	–	–	–	–	3,950
Financial assets designated at fair value	–	16	–	–	–	–	–	–	16
Derivatives	17,361	155	–	–	–	–	–	54	17,570
Loans and advances to banks	–	–	–	19,196	–	–	–	–	19,196
Loans and advances to customers	–	–	–	134,819	–	–	–	–	134,819
Financial investments	–	–	–	–	15,147	–	–	–	15,147
Financial investments which may be repledged or resold by counterparties	–	–	–	–	–	238	–	–	238
Other assets	–	–	–	–	–	2,476	–	–	2,476
Total financial assets	56,044	171	–	154,015	15,147	5,528	–	54	230,959
Total non-financial assets									18,249
Total assets									249,208
LIABILITIES									
Deposits by banks	–	–	–	–	–	27,999	–	–	27,999
Customer accounts	–	–	–	–	–	141,761	–	–	141,761
Items in the course of transmission to other banks	–	–	–	–	–	805	–	–	805
Trading liabilities	21,303	–	–	–	–	–	–	–	21,303
Financial liabilities designated at fair value	–	4,321	–	–	–	–	–	–	4,321
Derivatives	16,662	564	–	–	–	–	1	24	17,251
Debt securities in issue	–	–	–	–	–	8,212	–	–	8,212
Other liabilities	–	–	–	–	–	2,846	–	–	2,846
Subordinated liabilities	–	–	–	–	–	4,479	–	–	4,479
Total financial liabilities	37,965	4,885	–	–	–	186,102	1	24	228,977
Total non-financial liabilities									4,085
Total liabilities									233,062

1 *The derivatives included under 'Designated at fair value' are trading derivatives used to economically hedge the corresponding assets and liabilities designated at fair value.*

Notes on the Financial Statements (continued)

15 Trading assets

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Trading assets:				
– which may be repledged or resold by counterparties	**22,215**	21,611	**8,811**	3,950
– not subject to repledge or resale by counterparties	**63,779**	48,510	**53,918**	34,733
	85,994	70,121	**62,729**	38,683
Treasury and other eligible bills	**197**	268	**165**	181
Debt securities	**47,101**	40,550	**25,260**	17,127
Equity securities	**10,836**	8,881	**7,279**	5,592
Loans and advances to banks	**10,233**	7,993	**13,560**	4,940
Loans and advances to customers	**17,627**	12,429	**16,465**	10,843
	85,994	70,121	**62,729**	38,683

16 Financial assets designated at fair value

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Financial assets designated at fair value:				
– not subject to repledge or resale by counterparties	**5,985**	5,345	**–**	16

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Treasury and other eligible bills	**28**	10	**–**	–
Debt securities	**2,361**	1,614	**–**	–
Equity securities	**3,476**	3,624	**–**	–
Loans and advances to banks	**120**	70	**–**	–
Loans and advances to customers	**–**	27	**–**	16
	5,985	5,345	**–**	16

17 Derivatives

Fair values of derivatives open positions by product contract type held by the group

	At 31 December 2006					
	Assets			Liabilities		
	Trading	**Hedging**	**Total**	**Trading**	**Hedging**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Exchange rate	**10,298**	**87**	**10,385**	**(10,572)**	**(89)**	**(10,661)**
Interest rate	**18,141**	**357**	**18,498**	**(17,985)**	**(404)**	**(18,389)**
Equities	**3,728**	**–**	**3,728**	**(4,063)**	**(3)**	**(4,066)**
Credit derivatives	**1,442**	**–**	**1,442**	**(1,585)**	**–**	**(1,585)**
Commodity and other	**7**	**–**	**7**	**(12)**	**–**	**(12)**
Gross total fair values	**33,616**	**444**	**34,060**	**(34,217)**	**(496)**	**(34,713)**
Netting			**(1,970)**			**1,970**
Total			**32,090**			**(32,743)**

	At 31 December 2005					
	Assets			Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total
	£m	£m	£m	£m	£m	£m
Exchange rate	6,807	34	6,841	(7,529)	(1)	(7,530)
Interest rate	18,165	828	18,993	(18,329)	(615)	(18,944)
Equities	2,254	–	2,254	(2,181)	–	(2,181)
Credit derivatives	687	–	687	(677)	–	(677)
Commodity and other	3	–	3	(5)	–	(5)
Gross total fair values	27,916	862	28,778	(28,721)	(616)	(29,337)
Netting			(2,701)			2,701
Total			26,077			(26,636)

Fair values of derivatives open positions by product contract type held by the bank

	At 31 December 2006					
	Assets			**Liabilities**		
	Trading	**Hedging**	**Total**	**Trading**	**Hedging**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Exchange rate	**10,864**	**–**	**10,864**	**(10,910)**	**–**	**(10,910)**
Interest rate	**11,031**	**91**	**11,122**	**(11,021)**	**(89)**	**(11,110)**
Equities	**965**	**–**	**965**	**(1,390)**	**–**	**(1,390)**
Credit derivatives	**1,407**	**–**	**1,407**	**(1,549)**	**–**	**(1,549)**
Commodity and other	**3**	**–**	**3**	**(8)**	**–**	**(8)**
Gross total fair values	**24,270**	**91**	**24,361**	**(24,878)**	**(89)**	**(24,967)**
Netting			**–**			**–**
Total			**24,361**			**(24,967)**

	At 31 December 2005					
	Assets			Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total
	£m	£m	£m	£m	£m	£m
Exchange rate	6,602	-	6,602	(7,246)	-	(7,246)
Interest rate	9,169	54	9,223	(8,394)	(25)	(8,419)
Equities	1,062	-	1,062	(913)	-	(913)
Credit derivatives	683	-	683	(673)	-	(673)
Commodity and other	-	-	-	-	-	-
Gross total fair values	17,516	54	17,570	(17,226)	(25)	(17,251)
Netting			-			-
Total			17,570			(17,251)

Derivatives are financial instruments that derive their value from the price of an underlying item such as equities, bonds, interest rates, foreign exchange, credit spreads, commodities and equity or other indices. Derivatives enable users to increase, reduce or alter exposure to credit or market risks. The group makes markets in derivatives for its customers and uses derivatives to manage its exposure to credit and market risks.

Derivatives are carried at fair value and shown in the balance sheet as separate totals of assets and liabilities. Asset values represent the cost to the group of replacing all transactions with a fair value in the group's favour assuming that all the group's relevant counterparties default at the same time, and that transactions can be replaced instantaneously. Liability values represent the cost to the group counterparties of replacing all their transactions with the group with a fair value in their favour if the group were to default. Derivative assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis.

Notes on the Financial Statements (continued)

Use of derivatives

The group transacts derivatives for three primary purposes: to create risk management solutions for clients, for proprietary trading purposes, and to manage and hedge the group's own risks. For accounting purposes, derivative instruments are classified as held either for trading or hedging. Derivatives that are held as hedging instruments are formally designated as hedges as defined in IAS 39. All other derivative instruments are classified as held-for-trading. The held-for-trading classification includes two types of derivative instruments: those used in sales and trading activities, and those instruments that are used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second type of held-for-trading category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

The group's derivative activities give rise to significant open positions in portfolios of derivatives. These positions are managed constantly to ensure that they remain within acceptable risk levels, with offsetting deals being utilised to achieve this where necessary. Whilst the group employs the same credit risk management procedures to approve potential credit exposures for derivatives as are used for traditional lending, the calculations and procedures used to assess credit risk for derivatives are more complex.

Trading derivatives

Most of the group's derivative transactions relate to sales and trading activities. Sales activities include the structuring and marketing of derivative products to customers to enable them to take, transfer, modify or reduce current or expected risks. Trading activities in derivatives are entered into principally for the purpose of generating profits from short-term fluctuations in price or margin. Positions may be traded actively or be held over a period of time to benefit from expected changes in currency rates, interest rates, equity prices or other market parameters. Trading includes market-making, positioning and arbitrage activities. Market-making entails quoting bid and offer prices to other market participants for the purpose of generating revenues based on spread and volume; positioning means managing market risk positions in the expectation of benefiting from favourable movements in prices, rates or indices; arbitrage involves identifying and profiting from price differentials between markets and products.

As mentioned above, other derivatives classified as held-for-trading include non-qualifying hedging derivatives, ineffective hedging derivatives and the components of hedging derivatives that are excluded from assessing hedge effectiveness. Non-qualifying hedging derivatives are entered into for risk management purposes but do not meet the criteria for hedge accounting. These include derivatives managed in conjunction with financial instruments designated at fair value. Ineffective hedging derivatives were previously designated as hedges, but no longer meet the criteria for hedge accounting.

Contract amounts of derivatives held-for-trading purposes by product type

	Year ended 31 December			
	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Exchange rate	**1,073,641**	918,878	**962,351**	804,652
Interest rate	**5,294,152**	4,019,310	**2,811,680**	2,048,901
Equities	**105,785**	56,698	**27,630**	20,289
Credit derivatives	**303,693**	161,095	**299,731**	160,312
Commodity	**1,076**	351	**668**	60
Total derivatives	**6,778,347**	5,156,332	**4,102,060**	3,034,214

The notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Derivatives valued using models with unobservable inputs

The amount that has yet to be recognised in the income statement relating to the difference between the fair value at initial recognition (the transaction price) and the amount that would have arisen had the market data available at inception been considered observable, less subsequent releases, is as follows:

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Unamortised balance at 1 January	**63**	16	**37**	10
Deferral on new transactions	**118**	86	**87**	54
Recognised in the income statement during the period:				
– amortisation	**(15)**	(5)	**(5)**	(1)
– subsequent to observability	**(60)**	(19)	**(39)**	(19)
– maturity or termination	**(21)**	(10)	**(14)**	(7)
– FX movements and other	**(1)**	(5)	**–**	-
Unamortised balance at 31 December	**84**	63	**66**	37

Hedging instruments

The group uses derivatives (principally interest rate swaps) for hedging purposes in the management of its own asset and liability portfolios and structural positions. This enables the group to optimise the overall cost to the group of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from structural imbalances in the maturity and other profiles of its assets and liabilities.

The accounting treatment of hedge transactions varies according to the nature of the instrument hedged and the type of hedge transactions. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges, or cash flow hedges. These are described under the relevant headings below.

Contract amounts of derivatives held for hedging purposes by product type

	The group			
	At 31 December 2006		At 31 December 2005	
	Cash flow hedge £m	**Fair value hedge £m**	Cash flow hedge £m	Fair value hedge £m
Exchange rate contracts	**847**	**547**	37	232
Interest rate contracts	**147,110**	**11,359**	168,501	8,338

	The bank			
	At 31 December 2006		At 31 December 2005	
	Cash flow hedge £m	**Fair value hedge £m**	Cash flow hedge £m	Fair value hedge £m
Exchange rate contracts	**–**	**–**	–	–
Interest rate contracts	**18,083**	**60**	32	131

The notional or contractual amounts of these instruments indicate the nominal value of transactions outstanding at the balance sheet date; they do not represent amounts at risk.

Fair value hedges

The group's fair value hedges principally consist of interest rate swaps that are used to protect against changes in the fair value of fixed-rate long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative and in the fair value of the item in relation to the risk being hedged are recognised in income. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to income as a yield adjustment over the remainder of the hedging period.

The fair values of outstanding derivatives designated as fair value hedges at 31 December 2006, were assets of £41 million and liabilities of £37 million (2005: assets of £64 million and liabilities of £96 million).

Notes on the Financial Statements (continued)

Gains or losses arising from the change in fair value of fair value hedges

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Gains/(losses) arising from the change in fair value of fair value hedges:				
– on hedged instruments	**54**	(9)	**–**	3
– on hedged items attributable to the hedged risk	**(54)**	9	**–**	–

The amount reported in the income statement in respect of the ineffectiveness of fair value hedges was insignificant in the year ended 31 December 2006.

Cash flow hedges

The group is exposed to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. These are initially recognised directly in equity as gains or losses not recognised in the income statement and are transferred to current period earnings when the forecast cash flows affect net profit or loss.

At 31 December 2006, the fair values of outstanding derivatives designated as cash flow hedges of forecast transactions were assets of £403 million (2005: £798 million) and liabilities of £459 million (2005: £520 million).

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December 2006 is as follows:

	At 31 December 2006			
	3 months or less	**More than 3 months but less than 1 year**	**5 years or less but more than 1 year**	**More than 5 years**
	£m	**£m**	**£m**	**£m**
Cash inflows from assets	**15,940**	**14,032**	**9,362**	**197**
Cash outflows from liabilities	**(11,617)**	**(9,674)**	**(6,797)**	**-**
Net cash inflows	**4,323**	**4,358**	**2,565**	**197**

	At 31 December 2005			
	3 months or less	More than 3 months but less than 1 year	5 years or less but more than 1 year	More than 5 years
	£m	£m	£m	£m
Cash inflows from assets	19,326	15,049	15,845	826
Cash outflows from liabilities	(7,781)	(4,285)	(4,285)	(152)
Net cash inflows	11,545	10,764	11,560	674

The gains and losses on ineffective portions of such derivatives are recognised immediately in the income statement. During the year to 31 December 2006, a loss of £2 million (2005: £2 million) was recognised due to hedge ineffectiveness.

Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives

Fair values of certain derivatives recognised in the financial statements may be determined in whole or in part using valuation techniques based on assumptions that are not supported by prices from current market transactions or observable market data. In these instances, the net fair value recorded in the financial statements is the sum of three components:

– the value given by application of a valuation model, based upon the group's best estimate of the most appropriate model inputs;

– any fair value adjustments to account for market features not included within the valuation model (for example, bid-mid spreads, counterparty credit spreads and/or market data uncertainty); and

– inception profit, or an unamortised element thereof, not recognised immediately in the income statement in accordance with Note 2(k).

As the valuation models are based upon assumptions, changing the assumptions changes the resultant estimate of fair value. The group performs various sensitivity analyses on its valuation assumptions. The potential effect of using reasonably possible alternative assumptions in valuation models has been quantified as a reduction in assets of approximately £29 million using less favourable assumptions, and an increase in assets of approximately £29 million (using more favourable assumptions). The ranges of reasonably possible alternative assumptions are established by application of professional judgement to an analysis of the data available to support each assumption.

The total amount of the change in fair value estimated using a valuation technique, based on assumptions that are not supported by prices from current market transactions or observable market data that was recognised in the year ended 31 December 2006 was a loss of £32 million (2005: £31 million).

Fair value profits on derivatives and complex structured products indicated by a valuation model for which observable market data are not available for key components are not recognised immediately in the income statement. These profits are recognised in the income statement when the model valuation inputs become observable in external markets or when the transaction matures or is closed out. The table below summarises the group's portfolios held at fair value by valuation methodology at 31 December:

	Assets		Liabilities	
	Trading securities purchased %	**Derivatives %**	**Trading securities sold %**	**Derivatives %**
At 31 December 2006 Fair value based on:				
Quoted market prices	**87.0**	**0.3**	**96.9**	**1.1**
Internal models with significant observable market parameters	**13.0**	**96.8**	**3.1**	**97.6**
Internal models with significant unobservable market parameters	**0.0**	**2.9**	**0.0**	**1.3**
	100.0	**100.0**	**100.0**	**100.0**

	Assets		Liabilities	
	Trading Securities Purchased %	**Derivatives %**	**Trading securities sold %**	**Derivatives %**
At 31 December 2005 Fair value based on:				
Quoted market prices	92.4	1.5	99.9	1.2
Internal models with significant observable market parameters	7.6	96.7	0.1	98.0
Internal models with significant unobservable market parameters	–	1.8	–	0.8
	100.0	100.0	100.0	100.0

18 Financial investments

	The group		The bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Financial investments:				
– which may be pledged or resold by counterparties	**2,276**	2,201	**1,171**	238
– not subject to repledge or resale by counterparties	**40,104**	41,281	**10,964**	15,147
	42,380	43,482	**12,135**	15,385

Notes on the Financial Statements (continued)

The group

	2006		2005	
	Carrying value	**Fair value**	Carrying value	Fair value
	£m	**£m**	£m	£m
Treasury and other eligible bills	**3,199**	**3,199**	3,950	3,950
– available-for-sale	**3,199**	**3,199**	3,950	3,950
– held-to-maturity	**-**	**-**	–	–
Debt securities	**37,286**	**37,286**	37,371	37,371
– available-for-sale	**37,210**	**37,210**	37,234	37,234
– held-to-maturity	**76**	**76**	137	137
Equity securities	**1,895**	**1,895**	2,161	2,161
– available-for-sale	**1,895**	**1,895**	2,161	2,161
Total financial investments	**42,380**	**42,380**	43,482	43,482

The bank

	2006		2005	
	Carrying value	**Fair value**	Carrying value	Fair value
	£m	**£m**	£m	£m
Treasury and other eligible bills	**2,826**	**2,826**	3,554	3,554
– available-for-sale	**2,826**	**2,826**	3,554	3,554
– held-to-maturity	**-**	**-**	–	–
Debt securities	**8,923**	**8,923**	11,505	11,505
– available-for-sale	**8,923**	**8,923**	11,505	11,505
– held-to-maturity	**-**	**-**	–	–
Equity securities	**386**	**386**	326	326
– available-for-sale	**386**	**386**	326	326
Total financial investments	**12,135**	**12,135**	15,385	15,385

19 Securitisations and other structured transactions

The group enters into transactions in the normal course of business by which it transfers recognised financial assets directly to third parties or to special purpose entities. These transfers may give rise to the full or partial derecognition of the financial assets concerned.

(i) Full derecognition occurs when the group transfers its contractual right to receive cash flows from the financial assets and substantially all the risks and rewards of ownership. The risks include credit, interest rate, currency, prepayment and other price risks. In addition, full derecognition occurs where the contractual rights to receive the cash flows of the financial assets are retained but a contractual obligation to pay the cash flows to one or more recipients is assumed.

(ii) Partial derecognition occurs when the group sells or otherwise transfers financial assets in such a way that some but not substantially all of the risks and rewards of ownership are transferred but control is retained. These financial assets are recognised on the balance sheet to the extent of the group's continuing involvement.

The majority of transferred financial assets that do not qualify for derecognition are (i) debt securities held by counterparties as collateral under repurchase agreements or (ii) equity securities lent under securities lending agreements. The following table analyses the carrying amount of financial assets as at 31 December that did not qualify for derecognition during the year and their associated financial liabilities:

	2006		2005	
	Carrying amount of assets £m	**Carrying amount of associated liabilities £m**	Carrying amount of assets £m	Carrying amount of associated liabilities £m
Nature of transaction				
Repurchase agreements	**18,313**	**18,168**	21,484	21,994
Securities lending agreements	**6,178**	**5,952**	2,328	2,416
Total	**24,491**	**24,120**	23,812	24,410

A small proportion of financial assets that do not qualify for derecognition relate to loans, credit cards, debt securities and trade receivables that have been securitised under arrangements by which the group retains a continuing involvement in such transferred assets. Continuing involvement may entail retaining the rights to future cash flows arising from the assets after investors have received their contractual terms (for example, interest rate strips); providing subordinated interest; continuing to service the underlying asset; or entering into derivative transactions with the securitisation vehicles. As such, the group continues to be exposed to risks associated with these transactions.

The rights and obligations that the group retains from its continuing involvement in securitisations are initially recorded as an allocation of the fair value of the financial asset between the part that is derecognised and the part that continues to be recognised on the date of transfer. The following is an analysis of the carrying amount of financial assets to the extent of the group's continuing involvement, that qualified for partial derecognition during the year, and their associated liabilities:

	Carrying amount of assets (original) £m	**Carrying amount of assets (currently recognised) £m**	**Carrying amount of associated liabilities £m**
Nature of transaction			
At 31 December 2006			
Securitisations	**2,035**	**42**	**24**
At 31 December 2005			
Securitisations	2,565	18	18

20 Interests in associates and joint ventures

Principal associates of the group

	At 31 December 2006		
	Country of incorporation	**The group's interest in equity capital**	**Issued equity capital**
Erisa S.A	France	49.99%	€115m
AEA Investors (Cayman) I LP[1]	–[2]	–[2]	–[2]
HSBC PE European No. 2 LP[1]	–[3]	–[3]	–[3]
Private Equity Portfolio (Investment) LP Inc[1]	–[4]	–[4]	–[4]
Montagu III LP	–[5]	–[5]	–[5]

1 *Limited partnership where the group owns more than 50% but does not have control due to the limitations within these types of entities.*
2 *Venture Capital Limited partnership. Address of principal place of business is c/o Walkers SPV Limited, Walker House, 87 Mary Street, PO Box 908GT, George Town, Grand Cayman, Cayman Islands.*
3 *Limited partnership. Address of principal place of business is 68 Upper Thames Street, London EC4V 3PE.*
4 *Limited partnership. Address of principal place of business is 68 Upper Thames Street, London EC4V 3PE.*
5 *Limited partnership. Address of principal place of business is 68 Upper Thames Street, London EC4V 3PE.*

All the above investments in associates are owned by subsidiaries of HSBC Bank plc.

Notes on the Financial Statements (continued)

Summarised aggregate financial information on associates

	2006 £m	2005 £m
Assets	**10,539**	8,777
Liabilities	**10,210**	8,518
Net income	**30**	30

Interests in joint ventures

	At 31 December 2006		
	Principal activity	**HSBC's interest in equity capital**	**Issued equity capital**
International Transaction Services GMBH	Outsourcing support	51%	€5m

Although the group owns more than 50 per cent of the equity capital of International Transaction Services GMBH, the agreement with the other shareholder means joint control is exercised over the entity with strategic, financial and operating decisions requiring joint consent.

Summarised aggregate financial information on joint ventures

	2006 £m	2005 £m
Assets	**52**	90
Liabilities	**54**	90
Net income	**2**	93

21 Goodwill and intangible assets

'Goodwill and intangible assets' includes goodwill arising on business combinations, the present value of in-force long-term assurance business, and other intangible assets.

Goodwill

The group

	2006 £m	2005 £m
Cost		
At 1 January	**8,664**	8,438
Additions[1,2]	**38**	288
Disposals	**–**	(41)
Exchange translation differences	**(312)**	(61)
Other changes[3]	**5**	40
At 31 December	**8,395**	8,664
Accumulated impairment losses		
At 1 January	**–**	–
At 31 December	**–**	–
Net book value at 31 December	**8,395**	8,664

1 *2006 Additions include goodwill arising on the acquisition of the Czech, Slovak, and Hungary Consumer Finance Businesses of £15 million and the Alternative Fund Services Business also of £15 million.*
2 *2005 Additions include goodwill arising on the acquisition of the HFC Cards Business of £248 million.*
3 *2005 Other changes include an increase in goodwill of £44 million arising from the increase in stake of HSBC Trinkaus & Burkhardt AG.*

The bank

	2006 £m	2005 £m
Cost		
At 1 January	**321**	56
Additions[1,2]	**15**	262
Exchange translation differences	**(6)**	3
Other changes	**1**	–
At 31 December	**331**	321
Accumulated impairment losses		
At 1 January	**–**	–
At 31 December	**–**	–
Net book value at 31 December	**331**	321

1 *2006 Additions include goodwill arising on the acquisition of the Alternative Fund Services Business of £15 million.*
2 *2005 Additions include goodwill arising on the acquisition of the HFC Cards Business of £248 million.*

The present value of in-force long-term assurance business ('PVIF')

PVIF-specific assumptions

The key assumptions used in the computation of PVIF for the group's main insurance company are:

	2006 UK Life	2005 UK Life
Risk free rate	**4.30%**	3.90%
Risk discount rate	**8.00%**	8.00%
Expenses inflation	**3.40%**	3.20%

Movement on the PVIF

	2006 £m	2005 £m
At 1 January	**463**	–
IFRS transition adjustment at 1 January 2005	**–**	527
Addition from current year new business	**25**	45
Movement from in-force business	**(81)**	(74)
Exchange and other adjustments	**–**	(35)
At 31 December	**407**	463

The calculation of the PVIF is based upon assumptions that take into account risk and uncertainty. To project these cash flows, a variety of assumptions regarding future experience is made by each insurance operation which reflect local market conditions and management's judgement of local future trends. The calculations are consistent in their objective of achieving a valuation that reflects the shareholder's interest in the in-force business of the life insurance operations. Some of the group's insurance operations incorporate risk margins separately into the projection assumptions for each product, while others incorporate risk margins into the overall discount rate. This is reflected in the wide range of risk discount rates applied. The use of different methodology is, *inter alia*, attributable to the differing nature of the products being valued and the constitution and structure of the local funds, but it represents a consistent application of the policy.

Other intangible assets

The analysis of the movement of intangible assets, excluding the present value of in-force long-term assurance business, for the year ended 31 December 2006 is as follows:

Notes on the Financial Statements (continued)

The group

	Trade names £m	Internally generated software £m	Purchased software £m	Customer/ merchant relation-ships £m	Other £m	Total[3] £m
Cost						
At 1 January 2006	**16**	**578**	**56**	**246**	**16**	**912**
Additions[1]	**–**	**101**	**7**	**–**	**1**	**109**
Disposals	**–**	**–**	**(6)**	**(3)**	**–**	**(9)**
Exchange translation differences	**(3)**	**(1)**	**–**	**(1)**	**–**	**(5)**
Other changes	**–**	**(3)**	**1**	**2**	**–**	**–**
At 31 December 2006	**13**	**675**	**58**	**244**	**17**	**1,007**
Accumulated amortisation and impairment						
At 1 January 2006	**(5)**	**(366)**	**(30)**	**(19)**	**(1)**	**(421)**
Amortisation charge for the year[2]	**(1)**	**(78)**	**(11)**	**(20)**	**–**	**(110)**
Impairment charge for the year[2]	**–**	**(3)**	**(1)**	**(37)**	**–**	**(41)**
Disposals	**–**	**–**	**6**	**3**	**–**	**9**
Exchange translation differences	**1**	**1**	**–**	**–**	**–**	**2**
Other changes	**–**	**5**	**(2)**	**–**	**–**	**3**
At 31 December 2006	**(5)**	**(441)**	**(38)**	**(73)**	**(1)**	**(558)**
Net book value at 31 December 2006	**8**	**234**	**20**	**171**	**16**	**449**
Cost						
At 1 January 2005	14	475	7	192	10	698
Additions[1]	–	110	13	57	4	184
Disposals	–	–	(34)	–	–	(34)
Exchange translation differences	2	(5)	–	–	–	(3)
Other changes	–	(2)	70	(3)	2	67
At 31 December 2005	16	578	56	246	16	912
Accumulated amortisation and impairment						
At 1 January 2005	(3)	(296)	(6)	(9)	(1)	(315)
Charge for the year[2]	(2)	(78)	(24)	(14)	–	(118)
Disposals	–	–	15	–	–	15
Exchange translation differences	(1)	4	–	–	–	3
Other changes	1	4	(15)	4	–	(6)
At 31 December 2005	(5)	(366)	(30)	(19)	(1)	(421)
Net book value at 31 December 2005	11	212	26	227	15	491

1 *The group has £nil (2005: £32 million) of contractual commitments on the acquisition of intangible assets in the year.*

2 *The amortisation and impairment charges for the year are recognised within the income statement under 'Amortisation and impairment of intangible assets and impairment of goodwill'. The impairment has arisen due to customer delinquency on the HFC Cards Business which has caused the recoverable amount of the intangible asset to be revised.*

3 *Included in the above are intangible assets relating to Marks and Spencer Retail Financial Services Holdings Limited with a net book value of £158 million (2005: £174 million), on which the amortisation charges for the year to 31 December 2006 was £16 million (2005: £9 million). The remaining amortisation period is 8 years.*

The bank

	Internally generated software £m	Customer/ merchant relationships[2] £m	Other £m	Total £m
Cost				
At 1 January 2006	**479**	**41**	**2**	**522**
Additions[1]	**94**	**–**	**1**	**95**
Other changes	**(1)**	**–**	**–**	**(1)**
At 31 December 2006	**572**	**41**	**3**	**616**
Accumulated amortisation				
At 1 January 2006	**(273)**	**(3)**	**–**	**(276)**
Amortisation charge for the year[2]	**(73)**	**(2)**	**(1)**	**(76)**
Impairment charge for the year[2]	**(3)**	**(36)**	**–**	**(39)**
Other changes	**1**	**–**	**–**	**1**
At 31 December 2006	**(348)**	**(41)**	**(1)**	**(390)**
Net book value at 31 December 2006	**224**	**–**	**2**	**226**
Cost				
At 1 January 2005	373	–	–	373
Additions[1]	105	41	2	148
Other changes	1	–	–	1
At 31 December 2005	479	41	2	522
Accumulated amortisation				
At 1 January 2005	(200)	–	–	(200)
Amortisation charge for the year[2]	(72)	(3)	–	(75)
Other changes	(1)	–	–	(1)
At 31 December 2005	(273)	(3)	–	(276)
Net book value at 31 December 2005	206	38	2	246

1 The bank has £nil (2005: £32 million) of contractual commitments on the acquisition of intangible assets in the year.

2 The amortisation and impairment charges for the year are recognised within the income statement under 'Amortisation and impairment of intangible assets and impairment of goodwill'. The impairment has arisen due to customer delinquency on the HFC Cards Business which has caused the recoverable amount of the intangible asset to be revised.

22 Impairment of assets other than financial instruments

During 2006 there was no impairment of goodwill (2005: Nil). Impairment testing in respect of goodwill is performed annually by comparing the recoverable amount of cash generating units ('CGUs') determined at 1 July 2006 based on a value in use calculation. That calculation uses cash flow estimates based on management's cash flow projections, extrapolated in perpetuity using a nominal long-term growth rate based on current GDP and inflation for the countries within which the CGU operates. Cash flows are extrapolated on perpetuity due to the long-term perspective within the group of the business units making up the CGUs. The discount rate used is based on the cost of capital the group allocates to investments in the countries within which the CGU operates.

The cost of capital assigned to an individual cash-generating unit and used to discount its future cash flows can have a significant effect on its valuation. The cost of capital percentage is generally derived from an appropriate Capital Asset Pricing Model, which itself depends on inputs reflecting a number of financial and economic variables including the risk-free rate in the country concerned and a premium or discount to reflect the inherent risk of the business being evaluated. These variables are established on the basis of management judgement.

Management judgement is required in estimating the future cash flows of the cash-generating units. These values are sensitive to the cash flows projected for the periods for which detailed forecasts are available, and to assumptions regarding the long-term sustainable pattern of cash flows thereafter. While the acceptable range within which underlying assumptions can be applied is governed by the requirement for resulting forecasts to be compared with actual performance and verifiable economic data in future years, the cash flow forecasts necessarily and appropriately reflect management's view of future business prospects.

Notes on the Financial Statements (continued)

The following CGUs include in their carrying value goodwill that is a significant proportion of total goodwill reported by the group. These CGUs do not carry on their balance sheet any intangible assets with indefinite useful lives, other than goodwill.

Cash Generating Unit ('CGU')	Goodwill at 1 July 2006 £m	Discount rate %	Nominal growth rate beyond initial cash flow projections %
Private Banking	2,496	10.0	4.4
France	5,082	8.5	4.5
Total goodwill in the CGUs listed above	7,578		

During 2006 there was no impairment of the carrying amount of investments in subsidiaries in the bank's financial statements. A review of the net asset value of the subsidiaries against carrying value is performed on an annual basis to determine whether an impairment is required.

23 Property, plant and equipment

The group

	Freehold land and Buildings £m	Long leasehold land and buildings £m	Short leasehold land and buildings £m	Equipment, fixtures and fittings[1] £m	Equipment on operating leases £m	Total[2] £m
Cost or fair value						
At 1 January 2006	1,045	370	235	2,472	2,746	6,868
Additions at cost[5]	42	2	57	378	149	628
Fair value adjustments	6	–	–	–	–	6
Disposals	(110)	(1)	(17)	(164)	(15)	(307)
Transfers	–	–	–	7	–	7
Exchange translation differences	(16)	–	(2)	(39)	–	(57)
Other changes	(1)	(9)	2	3	124	119
At 31 December 2006	966	362	275	2,657	3,004	7,264
Accumulated depreciation						
At 1 January 2006	(90)	(28)	(153)	(1,556)	(722)	(2,549)
Depreciation charge for the year	(24)	(9)	(15)	(268)	(94)	(410)
Disposals	14	–	18	149	14	195
Transfers	–	–	–	(7)	–	(7)
Exchange translation differences	2	–	–	27	–	29
Other changes	1	10	–	(1)	(124)	(114)
At 31 December 2006	(97)	(27)	(150)	(1,656)	(926)	(2,856)
Net book value at 31 December 2006	869	335	125	1,001	2,078	4,408

1 *Includes assets held on finance leases with a net book value of £169 million (2005: £147 million), on which the accumulated depreciation as at 31 December 2006 was £20 million (2005: £2 million).*

2 *Includes assets with a net book value of £172 million (2005: £147 million) pledged as security for liabilities, on which the accumulated depreciation as at 31 December 2006 was £24 million (2005: £2 million).*

3 *HSBC Bank plc incurred £329 million of contractual commitments on the acquisition of property, plant and equipment in 2006 (2005: £490 million).*

	Freehold land and buildings £m	Long leasehold land and buildings £m	Short leasehold land and buildings £m	Equipment, fixtures and fittings £m	Equipment on operating leases £m	Total £m
Cost or fair value						
At 1 January 2005	1,076	362	261	2,527	3,149	7,375
Additions at cost	23	–	15	303	404	745
Acquisition of subsidiaries	1	–	–	–	–	1
Fair value adjustments	10	–	–	–	–	10
Disposals	(61)	–	(21)	(163)	(195)	(440)
Transfers	–	–	(1)	3	–	2
Exchange translation differences	(14)	–	(2)	14	–	(2)
Other changes	10	8	(17)	(212)	(612)	(823)
At 31 December 2005	1,045	370	235	2,472	2,746	6,868
Accumulated depreciation						
At 1 January 2005	(65)	(12)	(160)	(1,537)	(906)	(2,680)
Depreciation charge for the year	(24)	(9)	(12)	(274)	(164)	(483)
Disposals	1	–	19	112	132	264
Transfers	–	–	1	(2)	–	(1)
Exchange translation differences	1	–	–	(13)	–	(12)
Other changes	(3)	(7)	(1)	158	216	363
At 31 December 2005	(90)	(28)	(153)	(1,556)	(722)	(2,549)
Net book value at 31 December 2005	955	342	82	916	2,024	4,319

The bank

	Freehold land and buildings £m	Long leasehold land and buildings £m	Short leasehold land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Cost or fair value					
At 1 January 2006	**454**	**376**	**208**	**1,922**	**2,960**
Additions at cost[1]	**37**	**2**	**54**	**280**	**373**
Disposals	**(89)**	**(1)**	**(22)**	**(105)**	**(217)**
Transfers	**–**	**–**	**–**	**9**	**9**
Other changes	**(5)**	**(9)**	**–**	**(1)**	**(15)**
At 31 December 2006	**397**	**368**	**240**	**2,105**	**3,110**
Accumulated depreciation					
At 1 January 2006	**(62)**	**(28)**	**(147)**	**(1,254)**	**(1,491)**
Depreciation charge for the year	**(13)**	**(9)**	**(12)**	**(199)**	**(233)**
Disposals	**11**	**–**	**23**	**95**	**129**
Transfers	**–**	**–**	**–**	**(9)**	**(9)**
Other changes	**5**	**10**	**–**	**–**	**15**
At 31 December 2006	**(59)**	**(27)**	**(136)**	**(1,367)**	**(1,589)**
Net book value at 31 December 2006	**338**	**341**	**104**	**738**	**1,521**

1 *HSBC Bank plc incurred £111 million of contractual commitments on the acquisition of property, plant and equipment in 2006 (2005: £176 million).*

Notes on the Financial Statements (continued)

	Freehold land and buildings £m	Long leasehold land and buildings £m	Short leasehold land and buildings £m	Equipment, fixtures and fittings £m	Total £m
Cost or fair value					
At 1 January 2005	441	366	216	1,763	2,786
Additions at cost	11	–	13	212	236
Disposals	–	–	(21)	(55)	(76)
Transfers	–	–	–	2	2
Other changes	2	10	–	–	12
At 31 December 2005	454	376	208	1,922	2,960
Accumulated depreciation					
At 1 January 2005	(42)	(12)	(155)	(1,095)	(1,304)
Depreciation charge for the year	(13)	(9)	(8)	(197)	(227)
Disposals	–	–	18	39	57
Transfers	–	–	–	(1)	(1)
Other changes	(7)	(7)	(2)	–	(16)
At 31 December 2005	(62)	(28)	(147)	(1,254)	(1,491)
Net book value at 31 December 2005	392	348	61	668	1,469

Included within 'Short leasehold land and buildings' are the following amounts in respect of assets classed as improvements to buildings, which are carried at depreciated historical cost:

The group

	2006		2005	
	Cost £m	**Accumulated depreciation £m**	Cost £m	Accumulated depreciation £m
At 1 January	**231**	**(150)**	228	(162)
Additions	**56**	**–**	15	–
Disposals	**(22)**	**24**	(21)	18
Transfers	**–**	**–**	–	–
Depreciation charge for the year	**–**	**(13)**	–	(8)
Exchange translation differences	**(2)**	**–**	–	–
Other changes	**1**	**(6)**	9	2
At 31 December	**264**	**(145)**	231	(150)
Net book value at 31 December	**119**		81	

The bank

	2006		2005	
	Cost £m	**Accumulated depreciation £m**	Cost £m	Accumulated depreciation £m
At 1 January	**207**	**(150)**	215	(158)
Additions	**54**	**–**	13	–
Disposals	**(22)**	**24**	(21)	18
Depreciation charge for the year	**–**	**(11)**	–	(8)
Other changes	**–**	**–**	–	(2)
At 31 December	**239**	**(137)**	207	(150)
Net book value at 31 December	**102**		57	

Investment properties

The composition of the investment properties at fair value in the year was as follows:

	Freehold land and buildings[1] £m
Fair value	
At 1 January 2006	**27**
Additions at cost	**–**
Disposals	**(1)**
Fair value adjustments	**6**
Other changes	**(1)**
At 31 December 2006	**31**
Fair value	
At 1 January 2005	19
Additions at cost	11
Disposals	(22)
Fair value adjustments	10
Other changes	9
At 31 December 2005	27

1 *Included in Property, plant and equipment on page 90.*

Investment properties are valued on an open market value basis as at 31 December each year by independent professional valuers who have recent experience in the location and type of properties. A surplus of £6 million (2005: surplus of £10 million) was credited to the income statement for the year ended 31 December 2006.

Included within 'Other operating income' was rental income of £2 million (2005: £2 million) earned by the group on its investment properties. Direct operating expenses of £nil (2005: £nil) incurred in respect of the investment properties during the year were recognised in 'General and administrative expenses'.

Group properties leased to customers

The group properties leased to customers, none of which was held by the group, included £25 million at 31 December 2006 (2005: £25 million) let under operating leases, net of accumulated depreciation of £20 million (2005: £18 million).

Notes on the Financial Statements (continued)

24 Investments

Principal subsidiary undertakings of HSBC Bank plc

	Country of incorporation or registration	HSBC Bank plc's interest in equity capital %
HSBC France	France	99.99
HSBC Asset Finance (UK) Limited	England	100
HSBC Bank A.S.	Turkey	100
HSBC Bank International Limited	Jersey	99.34
HSBC Bank Malta p.l.c.	Malta	68.19
HSBC Guyerzeller Bank AG	Switzerland	99.43
HSBC Invoice Finance (UK) Limited	England	100
HSBC Life (UK) Limited	England	100
HSBC Rail (UK) Limited	England	100
HSBC Private Bank (Guernsey) Limited	Guernsey	99.43
HSBC Private Bank (Suisse) S.A.	Switzerland	94.02
HSBC Private Bank (UK) Limited	England	99.43
HSBC Trinkaus & Burkhardt AG	Germany	78.60
HSBC Trust Company (UK) Limited	England	100
Marks and Spencer Retail Financial Services Holdings Limited	England	100

All the above make their financial statements up to 31 December.

Acquisitions

HSBC Bank plc made the following acquisitions of subsidiary undertakings or business operations in 2006, which were accounted for by applying the purchase method:

- On 2 March 2006, the group increased its stake in HSBC Trinkaus & Burkhardt AG by 0.709 per cent for a cash consideration of £10.85 million. Goodwill of £6.88 million arose on the increase in stake.
- On 9 November 2006, the group, through its Dutch holding company HSBC Europe (Netherlands) BV, acquired two consumer finance subsidiaries Beneficial Zrt in Hungary and Beneficial Finance a.s. in the Czech Republic and Slovakia. Both companies were wholly owned subsidiaries of Household International Europe Limited, owned by HSBC Finance Corporation for consideration of £24.4 million. Goodwill of £14.5 million arose on the acquisition.

HSBC Bank plc made the following acquisitions of subsidiary undertakings or business operations in 2005, which were accounted for by applying the purchase method:

- On 31 December 2005, the group increased its stake in HSBC Trinkaus & Burkhardt AG by 4.42 per cent for a cash consideration of £69 million. Goodwill of £44 million arose on the acquisition.
- During 2005, as part of the reorganisation of The Bank of Bermuda Limited, the group purchased subsidiary undertakings and business operations for a total cash consideration of £122 million. Goodwill of £34 million was transferred into the group on these acquisitions.

25 Other assets

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Bullion	**233**	114	**180**	66
Assets held for sale	**22**	25	**16**	16
Reinsurance assets	**633**	594	**–**	–
Current taxation recoverable	**33**	20	**–**	–
Endorsements and acceptances	**353**	539	**238**	476
Other accounts	**3,180**	2,604	**1,580**	911
	4,454	3,896	**2,014**	1,469

Assets held for sale

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Disposal groups				
Property, plant and equipment	**16**	25	**16**	16
Receivables	**6**	–	**–**	–
Non-current assets held for sale	**22**	25	**16**	16
Total assets classified as held for sale	**22**	25	**16**	16

The property, plant and equipment classified as held for sale is a result of repossession of property that had been pledged as collateral by the customers.

26 Trading liabilities

	Carrying amount			
	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Deposits by banks	**8,672**	3,945	**10,497**	3,289
Customer accounts	**9,791**	6,110	**8,610**	4,831
Other debt securities in issue	**9,863**	7,187	**5,972**	4,132
Other liabilities – net short positions	**23,754**	27,891	**10,136**	9,051
	52,080	45,133	**35,215**	21,303

27 Financial liabilities designated at fair value

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Deposits by banks	**108**	1	**72**	–
Liabilities to customers under investment contracts	**4,553**	3,649	**–**	–
Debt securities in issue	**1,141**	205	**1,003**	–
Subordinated liabilities	**3,353**	4,006	**3,661**	4,321
Preference shares	**305**	324	**–**	–
	9,460	8,185	**4,736**	4,321

The difference between the carrying amount of financial liabilities designated at fair value and the contractual amount at maturity at 31 December 2006 for the group was a gain of £111 million (2005: £255 million) (the bank: 2006: £113 million; 2005: £272 million).

At 31 December 2006, the accumulated amount of the change in fair value attributable to changes in credit risk for the group was £48 million (2005: £13 million) (the bank: 2006: £47 million; 2005: £14 million).

28 Other liabilities

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Amounts due to investors in funds consolidated by the group	**396**	396	**–**	–
Share-based payments	**140**	89	**89**	56
Obligations under finance leases	**327**	324	**–**	–
Endorsements and acceptances	**353**	539	**238**	476
Other liabilities	**3,398**	3,440	**2,087**	2,314
	4,614	4,788	**2,414**	2,846
Obligations under finance leases falling due:				
– less than 1 year	**1**	–	**–**	–
– between 1 and 5 years	**3**	7	**–**	–
– over 5 years	**323**	317	**–**	–
	327	324	**–**	–

Notes on the Financial Statements (continued)

29 Liabilities under insurance contracts issued

	2006 Gross £m	2006 Reinsurance £m	2006 Net £m
Non-life insurance provisions			
Unearned premiums	**286**	**(27)**	**259**
Notified claims	**75**	**(32)**	**43**
Claims incurred but not reported	**41**	**(20)**	**21**
	402	**(79)**	**323**
Policyholder liabilities			
Life (non-linked)	**837**	**(525)**	**312**
Life (linked)	**647**	**(29)**	**618**
	1,484	**(554)**	**930**
Total liabilities under insurance contracts[1]	**1,886**	**(633)**	**1,253**

1 *Though investment contracts with discretionary participation features are financial instruments, the group continued to treat them as insurance contracts as permitted by IFRS 4.*

	2005 Gross £m	2005 Reinsurance £m	2005 Net £m
Non-life insurance provisions			
Unearned premiums	313	(23)	290
Notified claims	89	(39)	50
Claims incurred but not reported	32	(18)	14
	434	(80)	354
Policyholder liabilities			
Life (non-linked)	847	(474)	373
Life (linked)	697	(40)	657
	1,544	(514)	1,030
Total liabilities under insurance contracts[1]	1,978	(594)	1,384

1 *Though investment contracts with discretionary participation features are financial instruments, the group continued to treat them as insurance contracts as permitted by IFRS 4.*

The movement of liabilities under insurance contracts was as follows:

Non-life insurance

	Year ended 31 December 2006 Gross £m	Reinsurance £m	Net £m
Unearned premium provision			
At 1 January	**313**	**(23)**	**290**
Gross written premiums	**(131)**	**63**	**(68)**
Gross earned premiums	**153**	**(59)**	**94**
Foreign exchange and other movements	**(49)**	**(8)**	**(57)**
At 31 December	**286**	**(27)**	**259**
Notified and incurred but not reported			
At 1 January	**121**	**(57)**	**64**
– notified claims	**89**	**(39)**	**50**
– claims incurred but not reported	**32**	**(18)**	**14**
Claims paid in respect of current year	**(83)**	**36**	**(47)**
Current year notifications	**78**	**(29)**	**49**
Foreign exchange and other movements	**–**	**(2)**	**(2)**
At 31 December			
– notified claims	**75**	**(32)**	**43**
– claims incurred but not reported	**41**	**(20)**	**21**
At 31 December	**116**	**(52)**	**64**

	Year ended 31 December 2005		
	Gross £m	Reinsurance £m	Net £m
Unearned premium provision			
At 1 January	288	–	288
Gross written premiums	(200)	56	(144)
Gross earned premiums	188	(57)	131
Foreign exchange and other movements	37	(22)	15
At 31 December	313	(23)	290
Notified and incurred but not reported			
At 1 January	124	(64)	60
– notified claims	86	(41)	45
– claims incurred but not reported	38	(23)	15
Claims paid in respect of current year	(79)	35	(44)
Current year notifications	76	(29)	47
Foreign exchange and other movements	–	1	1
At 31 December			
– notified claims	89	(39)	50
– claims incurred but not reported	32	(18)	14
At 31 December	121	(57)	64

The above tables each include an insignificant amount in respect of the development of prior year claims. For this reason, no detailed table of claims development has been provided. This is because a significant amount of the non-life insurance business claims are settled within a short period of time.

Life insurance policyholder liabilities

	Year ended 31 December 2006		
	Gross £m	**Reinsurance £m**	**Net £m**
Life non-linked			
At 1 January	**847**	**(474)**	**373**
Benefits paid	**(103)**	**69**	**(34)**
Current year notifications	**71**	**(104)**	**(33)**
Foreign exchange and other movements	**22**	**(16)**	**6**
At 31 December	**837**	**(525)**	**312**
Life (linked)			
At 1 January	**697**	**(40)**	**657**
Benefits paid	**(119)**	**5**	**(114)**
Current year notifications	**69**	**6**	**75**
At 31 December	**647**	**(29)**	**618**
Total policyholder liabilities	**1,484**	**(554)**	**930**

Notes on the Financial Statements (continued)

	Year ended 31 December 2005		
	Gross	Reinsurance	Net
	£m	£m	£m
Life non-linked			
At 1 January	944	(505)	439
Benefits paid	(92)	56	(36)
Current year notifications	100	(39)	61
Foreign exchange and other movements	(105)	14	(91)
At 31 December	847	(474)	373
Life (linked)			
At 1 January	660	(89)	571
Benefits paid	(124)	6	(118)
Current year notifications	85	–	85
Foreign exchange and other movements	76	43	119
At 31 December	697	(40)	657
Total policyholder liabilities	1,544	(514)	1,030

The current year notifications represent the aggregate of all events giving rise to additional policyholder liabilities in the year. These include death claims, surrenders, lapses, the setting up of liability to policyholders at the initial inception of the policy, the declaration of bonuses and other amounts attributable to policyholder.

30 Provisions

Deferred taxation

The group

	2006			2005		
	Deferred tax asset	**Deferred tax liability**	**Total**	Deferred tax asset	Deferred tax liability	Total
	£m	**£m**	**£m**	£m	£m	£m
Temporary differences:						
– retirement benefits	**31**	**749**	**780**	821	58	879
– provision for loan impairment charges	**2**	**68**	**70**	88	41	129
– assets leased to customers	**(21)**	**(790)**	**(811)**	(696)	(24)	(720)
– revaluation of property	**(46)**	**(47)**	**(93)**	(36)	(67)	(103)
– accelerated capital allowances	**–**	**(60)**	**(60)**	(49)	(1)	(50)
– other short term timing differences	**63**	**(110)**	**(47)**	50	(147)	(97)
Unused tax losses	**–**	**48**	**48**	17	1	18
	29	**(142)**	**(113)**	195	(139)	56

The amount of deferred tax assets for which no deferred tax is recognised in the balance sheet is £115 million (2005: £113 million). This amount is in respect of capital losses that have no expiry date where the recoverability of the potential benefits is not considered likely.

The bank

	2006			2005		
	Deferred tax asset	**Deferred tax liability**	**Total**	Deferred tax asset	Deferred tax liability	Total
	£m	**£m**	**£m**	£m	£m	£m
Temporary differences:						
– retirement benefits	**730**	**–**	**730**	821	–	821
– provision for loan impairment charges	**73**	**–**	**73**	85	–	85
– revaluation of property	**(29)**	**–**	**(29)**	(36)	–	(36)
– accelerated capital allowances	**(63)**	**–**	**(63)**	(45)	–	(45)
– other short term timing differences	**130**	**(49)**	**81**	165	(12)	153
Unused tax losses	**32**	**16**	**48**	17	–	17
	873	**(33)**	**840**	1,007	(12)	995

The amount of temporary differences for which no deferred tax is recognised in the balance sheet is £107 million (2005: £104 million). This amount is in respect of capital losses that have no expiry date where the recoverability of the potential benefits is not considered likely.

Deferred tax is not recognised on temporary differences with investments in subsidiaries and branches because earnings are intended to be indefinitely reinvested in the case of subsidiaries and no further tax is expected to arise in the foreseeable future in respect of branches. The total amount of such relevant temporary differences amounted to £2,977 million (2005: £2,239 million).

Other provisions

The group

	Provisions	
	2006	2005
	£m	£m
At 1 January	**384**	434
Additional provisions/increase in provisions[1]	**206**	217
Provisions utilised	**(124)**	(101)
Amounts reversed	**(72)**	(159)
Exchange and other movements	**8**	(7)
At 31 December	**402**	384

1 *Includes unwinding of discounts of £5 million (2005: £6 million) in relation to vacant space provisions.*

Included above is a provision of £58 million (2005: £73 million) for the possible cost of redress relating to the sale of certain personal pension plans and mortgage endowment policies and a provision for indemnity clawbacks. The provision is based on an actuarial calculation extrapolated from a sample of cases. The timing of the expenditure depends on settlement of individual claims.

The bank

	Provisions	
	2006	2005
	£m	£m
At 1 January	**124**	176
Additional provisions/increase in provisions[1]	**46**	49
Provisions utilised	**(43)**	(16)
Amounts reversed	**(23)**	(84)
Exchange and other movements	**1**	(1)
At 31 December	**105**	124

1 *Includes unwinding of discounts of £5 million (2005: £6 million) in relation to vacant space provisions.*

The above includes provisions for onerous property contracts of £54 million (2005: £87 million), of which £13 million (2005: £19 million) relates to discounted future costs associated with leasehold properties that became vacant as a consequence of the bank's move to Canary Wharf in 2002. The provisions cover rent voids while finding new tenants, shortfalls in expected rent receivable compared with rent payable, and the cost of refurbishing the buildings to attract tenants. Uncertainties arise from movements in market rents, delays in finding new tenants and the timing of rental reviews.

Notes on the Financial Statements (continued)

31 Subordinated liabilities

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Subordinated liabilities:				
– At amortised cost	**5,380**	4,792	**4,999**	4,479
Subordinated liabilities	**2,960**	2,297	**4,553**	3,987
Preference shares	**2,420**	2,495	**446**	492
– Designated at fair value	**3,658**	4,330	**3,661**	4,321
Subordinated liabilities	**3,353**	4,006	**3,661**	4,321
Preference shares	**305**	324	**–**	–
	9,038	9,122	**8,660**	8,800

Subordinated borrowings of the group

		Book value	
		2006	2005
		£m	£m
US$500m	7.625% Subordinated Notes 2006	**–**	296
US$300m	6.95% Subordinated Notes 2011	**166**	193
€1,000m	Floating Rate Subordinated Loan 2012	**671**	686
€250m	Floating Rate Subordinated Loan 2015	**168**	172
€600m	4.25% Callable Subordinated Notes 2016[1]	**408**	440
€800m	Callable Subordinated Floating Rate Notes 2016	**536**	–
£350m	Callable Subordinated Variable Coupon Notes 2017[2]	**344**	378
£400m	Floating Rate Subordinated Loan 2020	**–**	400
£500m	4.75% Callable Subordinated Notes 2020[3]	**480**	506
€500m	Callable Subordinated Floating Rate Notes 2020	**335**	341
£350m	5% Callable Subordinated Notes 2023[4]	**350**	370
£300m	6.5% Subordinated Notes 2023	**298**	295
US$300m	7.65% Subordinated Notes 2025[5]	**190**	214
£350m	5.375% Callable Subordinated Step-up Notes 2030[6]	**357**	378
£500m	5.375% Subordinated Notes 2033	**531**	555
€900m	7.75% Non-cumulative Subordinated Notes 2040	**604**	617
£225m	6.25% Subordinated Notes 2041	**223**	223
£600m	4.75% Subordinated Notes 2046	**591**	–
£700m	5.844% Non-cumulative Step-up Perpetual Preferred Securities[7]	**700**	700
£300m	5.862% Non-cumulative Step-up Perpetual Preferred Securities[8]	**305**	324
US$750m	Undated Floating Rate Primary Capital Notes	**382**	437
US$500m	Undated Floating Rate Primary Capital Notes	**255**	291
US$300m	Undated Floating Rate Primary Capital Notes (Series 3)	**153**	174
£150m	9.25% Undated Subordinated Step-up Notes	**–**	157
£150m	8.625% Undated Subordinated Step-up Notes[9]	**155**	161
US$875m	Non-cumulative Third US$ Preference Shares	**446**	492
	Other subordinated liabilities less than £50m	**390**	322
		9,038	9,122

1 *The interest rate on the 4.25% Callable Subordinated Notes 2016 changes in March 2011 to three month EURIBOR plus 1.05%.*
2 *The interest rate on the Callable Subordinated Variable Coupon Notes 2017 is fixed at 5.75% until June 2012. Thereafter, the rate per annum is the sum of the gross redemption yield of the then prevailing five year UK gilt plus 1.70%.*
3 *The interest rate on the 4.75% Callable Subordinated Notes 2020 changes in September 2015 to three month sterling LIBOR plus 0.82%.*
4 *The interest rate on the 5% Callable Subordinated Notes 2023 changes in March 2018 to become the rate per annum which is the sum of the gross redemption yield of the then prevailing five year UK gilt plus 1.80%.*
5 *The 7.65% Subordinated Notes 2025 are repayable at the option of each of the holders in May 2007.*
6 *The interest rate on the 5.375% Callable Subordinated Step-up Notes 2030 changes in November 2025 to three month sterling LIBOR plus 1.50%.*
7 *The interest rate on the 5.844% Non-cumulative Step-up Perpetual Preferred Securities changes in November 2031 to six month sterling LIBOR plus 1.76%.*
8 *The interest rate on the 5.862% Non-cumulative Step-up Perpetual Preferred Securities changes in April 2020 to six month sterling LIBOR plus 1.85%.*
9 *The interest rate on the 8.625% Undated Subordinated Step-up Notes changes in December 2007 to become, for each successive five year period, the rate per annum which is the sum of the yield on the then five year benchmark UK gilt plus 1.87%.*

Footnotes 1 to 4 and 6 to 9 all relate to notes that are repayable at the option of the borrower on the date of the change of the interest rate, and at subsequent interest rate reset dates and interest payment dates in some cases, subject to the prior consent of the Financial Services Authority.

32 Fair value of financial instruments

The following table provides an analysis of the fair value of financial instruments not measured at fair value in the balance sheet. For all other instruments the fair value is equal to the carrying value:

The group

	2006		2005	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair Value £m
Assets				
Loans and advances to banks	**44,428**	**44,428**	31,578	31,615
Loans and advances to customers	**200,416**	**200,416**	182,629	182,840
Financial investments: Debt securities	**76**	**76**	137	137
Liabilities				
Deposits by banks	**38,513**	**38,510**	34,198	34,197
Customer accounts	**227,350**	**227,358**	205,475	205,498
Debt securities in issue	**38,090**	**38,178**	26,801	28,146
Subordinated liabilities	**5,380**	**5,338**	4,792	4,798

The bank

	2006		2005	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair Value £m
Assets				
Loans and advances to banks	**25,121**	**25,121**	19,196	19,196
Loans and advances to customers	**143,964**	**143,964**	134,819	134,835
Liabilities				
Deposits by banks	**29,182**	**29,182**	27,999	27,997
Customer accounts	**164,054**	**164,185**	141,761	141,753
Debt securities in issue	**5,408**	**5,421**	8,212	8,212
Subordinated liabilities	**4,999**	**4,959**	4,479	4,474

The methods used to determine fair values for financial instruments for the purpose of measurement and disclosure are set out in Note 2. The majority of the group's financial instruments measured at fair value are valued using quoted market prices or valuation techniques based on observable market data. Observable market prices are not, however, available for many of the group's financial assets and liabilities not measured at fair value. The determination of the fair values of the assets and liabilities in the table above are as follows:

(i) Loans and advances to banks and customers

The fair values of personal and commercial loans and advances are estimated by discounting anticipated cash flows (including interest at contractual rates).

Performing loans are grouped, as far as possible, into homogeneous pools segregated by maturity and the coupon rates of the loans within each pool. In general, cash flows are discounted using current market rates for instruments with similar maturity, repricing and credit risk characteristics. For fixed rate loans, assumptions are made on the expected prepayment rates appropriate to the type of loan.

For non-performing uncollateralised commercial loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered. For non-performing commercial loans where collateral exists, fair value is the lower of the carrying values of the loans net of impairment allowances, and the fair value of the collateral, discounted as appropriate.

(ii) Financial investments

The only financial investments not measured at fair value in the balance sheet are held-to-maturity debt securities. Held-to-maturity debt securities are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses.

Notes on the Financial Statements (continued)

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration future earnings streams and valuations of equivalent quoted securities.

(iii) Deposits by banks and customer accounts

Deposits by banks and customer accounts are grouped by residual maturity. Fair values are estimated using discounted cash flows, applying either market rates, where applicable, or current rates offered for deposits of similar remaining maturities.

(iv) Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where applicable, or by reference to quoted market prices for similar instruments.

The fair values presented in the table above are stated at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values. Accordingly these fair values do not represent the value of these financial instruments to the group as a going concern.

The fair values of intangible assets, such as values placed on portfolios of core deposits, credit card relationships and customer goodwill, are not included above, because they are not financial instruments.

As other financial institutions use different valuation methodologies and assumptions in determining fair values, comparisons of fair values between financial institutions may not be meaningful and users are advised to exercise caution when using this data.

In addition, the following table lists those financial instruments where the carrying amount is a reasonable approximation of fair value, for example, because they are either short term in nature or reprice to current market rates frequently.

Assets
Cash and balances at central banks
Items in the course of collection
Endorsements and acceptances
Short term receivables within 'Other Assets'

Liabilities
Items in the course of transmission
Endorsements and acceptances
Short-term payables within 'Other Liabilities'

33 Maturity analysis of assets and liabilities

The following is an analysis of undiscounted cash flows payable under financial liabilities by remaining contractual maturities at the balance sheet date:

The group	On demand £m	Due within 3 months £m	Due between 3 and 12 months £m	Due between 1 and 5 years £m	Due after 5 years £m	Total £m
Deposits by banks	8,562	25,134	2,706	2,546	2,089	41,037
Customer accounts	159,604	68,152	5,606	2,486	1,753	237,601
Financial liabilities designated at fair value	4,540	72	193	2,600	4,460	11,865
Debt securities in issue	275	26,392	2,165	9,539	2,272	40,643
Subordinated liabilities	–	62	181	1,430	7,068	8,741
Other financial liabilities	649	3,852	95	381	409	5,386
Total at 31 December 2006	173,630	123,664	10,946	18,982	18,051	345,273

	On demand £m	Due within 3 months £m	Due between 3 and 12 months £m	Due between 1 and 5 years £m	Due after 5 years £m	Total £m
Deposits by banks	7,324	18,557	4,752	3,168	1,636	35,437
Customer accounts	138,061	58,061	6,320	3,809	2,533	208,784
Financial liabilities designated at fair value	3,636	55	478	921	5,141	10,231
Debt securities in issue	831	19,470	2,861	4,984	–	28,146
Subordinated liabilities	–	49	153	868	6,620	7,690
Other financial liabilities	1	2,739	16	12	369	3,137
Total at 31 December 2005	149,853	98,931	14,580	13,762	16,299	293,425

The bank	**On demand £m**	**Due within 3 months £m**	**Due between 3 and 12 months £m**	**Due between 1 and 5 years £m**	**Due after 5 years £m**	**Total £m**
Deposits by banks	**7,002**	**20,590**	**1,432**	**175**	**106**	**29,305**
Customer accounts	**128,767**	**26,196**	**1,856**	**4,226**	**3,769**	**164,814**
Financial liabilities designated at fair value	**–**	**43**	**174**	**2,435**	**4,197**	**6,849**
Debt securities in issue	**275**	**3,175**	**427**	**1,195**	**1,052**	**6,124**
Subordinated liabilities	**–**	**41**	**795**	**1,785**	**4,631**	**7,252**
Other financial liabilities	**202**	**2,450**	**43**	**64**	**52**	**2,811**
Total at 31 December 2006	**136,246**	**52,495**	**4,727**	**9,880**	**13,807**	**217,155**

	On demand £m	Due within 3 months £m	Due between 3 and 12 months £m	Due between 1 and 5 years £m	Due after 5 years £m	Total £m
Deposits by banks	18,945	5,526	3,174	476	329	28,450
Customer accounts	116,815	19,659	2,676	2,775	2,068	143,993
Financial liabilities designated at fair value	–	35	420	750	4,954	6,159
Debt securities in issue	805	4,002	2,086	1,741	–	8,634
Subordinated liabilities	–	43	129	4,159	1,404	5,735
Other financial liabilities	–	1,265	–	–	16	1,281
Total at 31 December 2005	136,565	30,530	8,485	9,901	8,771	194,252

The following is an analysis, by remaining contractual maturities at the balance sheet date, of assets and liability line items that combine amounts expected to be recovered or settled in under one year, and after one year.

Contractual maturity is considered to be a reasonable approximation of expected maturity for the assets and liabilities analysed below. However, for items such as demand deposits and overdrafts, the contractual maturities could differ from expected maturities.

Trading assets, trading liabilities and derivatives are expected to be recovered or settled no more than twelve months after the balance sheet date, and therefore are excluded from this analysis.

Notes on the Financial Statements (continued)

The group

	At 31 December 2006		
	Due within one year £m	**Due after more than one year £m**	**Total £m**
Assets			
Financial assets designated at fair value	**794**	**5,191**	**5,985**
Loans and advances to banks	**43,176**	**1,252**	**44,428**
Loans and advances to customers	**100,933**	**99,483**	**200,416**
Financial investments	**18,631**	**23,749**	**42,380**
Other financial assets	**3,119**	**719**	**3,838**
	166,653	**130,394**	**297,047**
Liabilities			
Deposits by banks	**34,175**	**4,338**	**38,513**
Customer accounts	**223,932**	**3,418**	**227,350**
Financial liabilities designated at fair value	**342**	**9,118**	**9,460**
Debt securities in issue	**28,053**	**10,037**	**38,090**
Other financial liabilities	**922**	**860**	**1,782**
Subordinated liabilities	**123**	**5,257**	**5,380**
	287,547	**33,028**	**320,575**

	At 31 December 2005		
	Due within one year £m	Due after more than one year £m	Total £m
Assets			
Financial assets designated at fair value	316	5,029	5,345
Loans and advances to banks	30,932	646	31,578
Loans and advances to customers	91,564	91,065	182,629
Financial investments	16,409	27,073	43,482
Other financial assets	1,338	63	1,401
	140,559	123,876	264,435
Liabilities			
Deposits by banks	30,180	4,018	34,198
Customer accounts	201,076	4,399	205,475
Financial liabilities designated at fair value	3,976	4,209	8,185
Debt securities in issue	22,579	4,222	26,801
Other financial liabilities	1,061	381	1,442
Subordinated liabilities	6	4,786	4,792
	258,878	22,015	280,893

The bank

	At 31 December 2006		
	Due within one year £m	**Due after more than one year £m**	**Total £m**
Assets			
Financial assets designated at fair value	–	–	–
Loans and advances to banks	**24,528**	**593**	**25,121**
Loans and advances to customers	**68,943**	**75,021**	**143,964**
Financial investments	**9,665**	**2,470**	**12,135**
Other financial assets	**1,734**	**206**	**1,940**
	104,870	**78,290**	**183,160**
Liabilities			
Deposits by banks	**28,929**	**253**	**29,182**
Customer accounts	**156,578**	**7,476**	**164,054**
Financial liabilities designated at fair value	**190**	**4,546**	**4,736**
Debt securities in issue	**3,756**	**1,652**	**5,408**
Other financial liabilities	**317**	**155**	**472**
Subordinated liabilities	**671**	**4,328**	**4,999**
	190,441	**18,410**	**208,851**

	At 31 December 2005		
	Due within one year £m	Due after more than one year £m	Total £m
Assets			
Financial assets designated at fair value	–	16	16
Loans and advances to banks	18,740	456	19,196
Loans and advances to customers	58,106	76,713	134,819
Financial investments	10,203	5,180	15,383
Other financial assets	502	28	530
	87,551	82,393	169,944
Liabilities			
Deposits by banks	27,371	628	27,999
Customer accounts	138,505	3,256	141,761
Financial liabilities designated at fair value	295	4,026	4,321
Debt securities in issue	6,680	1,532	8,212
Other financial liabilities	485	16	501
Subordinated liabilities	(1)	4,480	4,479
	173,335	13,938	187,273

Further discussion of the group's liquidity and funding management can be found in Note 39 'Risk management'.

34 Foreign currency exposures

Structural currency exposures

The group's structural foreign currency exposure is represented by the net asset value of its foreign currency equity and subordinated debt investments in subsidiary undertakings, branches, joint ventures and associates. Gains or losses on structural foreign currency exposures are taken to reserves.

The group's management of structural foreign currency exposures is discussed in Note 39.

Net structural currency exposures

Currency of structural exposure	**2006 £m**	2005 £m
Euros	**9,433**	9,453
US dollars	**818**	882
Swiss francs	**1,271**	1,137
Turkish lira	**494**	534
Maltese lira	**137**	145
Others, less than £100 million	**145**	118
Total	**12,298**	12,269

35 Assets charged as security for liabilities and collateral accepted as security for assets

Financial assets pledged to secure liabilities are as follows:

	Group assets pledged at		Bank assets pledged at	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Treasury bills and other eligible securities	**213**	323	**213**	323
Loans and advances to banks	**347**	714	**347**	714
Loans and advances to customers	**11,213**	5,958	**11,213**	5,958
Debt securities	**47,188**	40,337	**32,446**	21,192
Equity shares	**5,887**	2,892	**5,767**	2,007
	64,848	50,224	**49,986**	30,194

These transactions are conducted under terms that are usual and customary to standard lending, and stock borrowing and lending activities.

Notes on the Financial Statements (continued)

Collateral accepted as security for assets

The fair value of financial assets accepted as collateral that the group is permitted to sell or repledge in the absence of default is £46,794 million (2005: £33,836 million).

The fair value of financial assets accepted as collateral that have been sold or repledged is £24,729 million (2005: £15,600 million). The group is obliged to return these assets.

These transactions are conducted under terms that are usual and customary to standard stock borrowing and lending activities.

36 Called up share capital

Authorised

The authorised ordinary share capital of HSBC Bank plc at 31 December 2006 and 2005 was £1,000 million divided into 1,000 million ordinary shares of £1 each.

At 31 December 2006 and 2005, the authorised preference share capital of HSBC Bank plc was £150 million non-cumulative preference shares of £1 each, £1 million non-cumulative preference shares of £0.01 each.

Issued

	Number of HSBC Bank plc ordinary shares	£m
At 1 January 2006	**796,969,099**	**797**
Shares issued	**2**	**–**
At 31 December 2006	**796,969,101**	**797**
At 1 January 2005	796,969,096	797
Shares issued	3	–
At 31 December 2005	796,969,099	797

37 Equity

The group

	2006										
				Other reserves							
	Called up share capital £m	Share premium £m	Retained earnings £m	Available-for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Share-based payment reserve £m	Associates and joint ventures £m	Total share-holders' equity £m	Minority interests £m	Total equity £m
At 1 January	797	13,883	3,880	433	86	(141)	111	42	19,091	543	19,634
New share capital subscribed, net of costs	–	675	–	–	–	–	–	–	675	–	675
Profit for the year attributable to shareholders	–	–	2,722	–	–	–	–	–	2,722	–	2,722
Dividends to shareholders of the parent company	–	–	(1,591)	–	–	–	–	–	(1,591)	–	(1,591)
Actuarial gains/(losses) on defined benefit plans	–	–	8	–	–	–	–	–	8	1	9
Fair value gains/(losses) taken to equity	–	–	–	258	(64)	–	–	137	331	–	331
Amounts transferred to the income statement	–	–	–	(179)	(118)	–	–	(54)	(351)	–	(351)
Charge to the income statement in respect of equity settled share-based payment transactions	–	–	–	–	–	–	77	–	77	–	77
Tax on items taken directly to or transferred from equity	–	–	(31)	(4)	64	–	–	–	29	–	29
Transfer to minority interest	–	–	–	15	–	–	–	–	15	(15)	–
Profit attributable to minority interests	–	–	–	–	–	–	–	–	–	96	96
Dividends to minority interests	–	–	(9)	–	–	–	–	–	(9)	(65)	(74)
Exchange differences	–	–	–	–	–	(596)	–	–	(596)	(21)	(617)
Other	–	–	(13)	–	–	–	11	–	(2)	–	(2)
At 31 December	797	14,558	4,966	523	(32)	(737)	199	125	20,399	539	20,938

Notes on the Financial Statements (continued)

	2005										
				Other reserves							
	Called up share capital £m	Share premium £m	Retained earnings £m	Available-for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Share-based payment reserve £m	Associates and joint ventures £m	Total share-holders' equity £m	Minority interests £m	Total equity £m
At 1 January as reported	797	12,820	3,194	–	–	(41)	58	–	16,828	2,687	19,515
Adjustment for restatement	–	–	80	–	–	(80)	–	–	–	–	–
At 1 January as restated	797	12,820	3,274	–	–	(121)	58	–	16,828	2,687	19,515
IFRSs transition adjustment at 1 January 2005	–	(437)	(606)	553	177	–	–	–	(313)	(2,307)	(2,620)
New share capital subscribed, net of costs	–	1,500	–	–	–	–	–	–	1,500	–	1,500
Profit for the year attributable to shareholders (restated)	–	–	2,842	–	–	–	–	–	2,842	–	2,842
Dividends to shareholders of the parent company	–	–	(1,400)	–	–	–	–	–	(1,400)	–	(1,400)
Actuarial gains/(losses) on defined benefit plans	–	–	(302)	–	–	–	–	–	(302)	–	(302)
Fair value gains/(losses) taken to equity	–	–	–	49	35	–	–	42	126	–	126
Amounts transferred to the income statement	–	–	–	(194)	(180)	–	–	–	(374)	–	(374)
Charge to the income statement in respect of equity settled share-based payment transactions	–	–	–	–	–	–	53	–	53	–	53
Tax on items taken directly to or transferred from equity	–	–	72	35	54	–	–	–	161	–	161
Transfer to minority interest	–	–	–	(10)	–	–	–	–	(10)	10	–
Profit attributable to minority interests	–	–	–	–	–	–	–	–	–	62	62
Dividends to minority interests	–	–	–	–	–	–	–	–	–	(25)	(25)
Exchange differences (restated)	–	–	–	–	–	(20)	–	–	(20)	(8)	(28)
Increase in minority interest stake and other	–	–	–	–	–	–	–	–	–	124	124
At 31 December	797	13,883	3,880	433	86	(141)	111	42	19,091	543	19,634

The bank

	2006								
				Other reserves					
	Called up share capital £m	Share premium £m	Retained earnings £m	Available-for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Share-based payment reserve £m	Associates and Joint Ventures £m	Total equity £m
At 1 January	797	13,883	1,384	36	(22)	(1)	69	–	16,146
New share capital subscribed, net of costs	–	675	–	–	–	–	–	–	675
Profit for the year attributable to shareholders	–	–	1,896	–	–	–	–	–	1,896
Dividends to shareholders of the parent company	–	–	(1,591)	–	–	–	–	–	(1,591)
Actuarial gains/(losses) on defined benefit plans	–	–	(10)	–	–	–	–	–	(10)
Fair value gains/(losses) taken to equity	–	–	–	63	56	–	–	–	119
Amounts transferred to the income statement	–	–	–	2	(35)	–	–	–	(33)
Charge to the income statement in respect of equity settled share-based payment transactions	–	–	–	–	–	–	52	–	52
Tax on items taken directly to or transferred from equity	–	–	(25)	(10)	(7)	–	–	–	(42)
Exchange differences	–	–	–	–	–	(1)	–	–	(1)
Other	–	–	(4)	–	–	–	–	–	(4)
At 31 December	797	14,558	1,650	91	(8)	(2)	121	–	17,207

Notes on the Financial Statements (continued)

	2005								
				Other reserves					
	Called up share capital £m	Share premium £m	Retained earnings £m	Available-for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Share-based payment reserve £m	Associates and Joint Ventures £m	Total equity £m
At 1 January as reported	797	12,820	1,494	–	–	(8)	37	–	15,140
Adjustment for restatement	–	–	80	–	–	–	–	–	80
At 1 January as restated	797	12,820	1,574	–	–	–	37	–	15,220
IFRSs transition adjustment at 1 January 2005	–	(437)	(234)	34	–	–	–	–	(637)
New share capital subscribed, net of costs	–	1,500	–	–	–	–	–	–	1,500
Profit for the year attributable to shareholders (restated)	–	–	1,623	–	–	–	–	–	1,623
Dividends to shareholders of the parent company	–	–	(1,400)	–	–	–	–	–	(1,400)
Actuarial gains/(losses) on defined benefit plans	–	–	(240)	–	–	–	–	–	(240)
Fair value gains/(losses) taken to equity	–	–	–	–	(31)	–	–	–	(31)
Amounts transferred to the income statement	–	–	–	(1)	–	–	–	–	(1)
Exchange differences	–	–	–	–	–	7	–	–	7
Charge to the income statement in respect of equity settled share-based payment transactions	–	–	–	–	–	–	32	–	32
Tax on items taken directly to or transferred from equity	–	–	61	3	9	–		–	73
At 31 December	797	13,883	1,384	36	(22)	(1)	69	–	16,146

38 Notes on the cash flow statement

Non-cash items included in profit before tax

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Depreciation and amortisation	**561**	601	**348**	302
Loan impairment losses gross of recoveries	**938**	776	**798**	702
Provisions raised	**140**	90	**22**	(28)
Impairment of financial investments	**(4)**	–	**–**	–
Charge for defined benefit pension schemes	**203**	252	**182**	226
Accretion of discounts and amortisation of premiums	**23**	(102)	**(83)**	(78)
	1,861	1,617	**1,267**	1,124

Change in operating assets

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Change in prepayments and accrued income	**(836)**	430	**(657)**	295
Change in net trading securities and net derivatives	**(6,018)**	421	**(5,775)**	(5,693)
Change in loans and advances to banks	**(547)**	(119)	**2,238**	(3,291)
Change in loans and advances to customers	**(17,669)**	(41,936)	**(9,126)**	(34,353)
Change in financial assets designated at fair value	**(640)**	(5,345)	**16**	(16)
Change in other assets	**(342)**	250	**(508)**	(729)
	(26,052)	(46,299)	**(13,812)**	(43,787)

Change in operating liabilities

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Change in accruals and deferred income	**748**	(368)	**721**	(236)
Change in deposits by banks	**4,315**	1,603	**1,183**	1,017
Change in customer accounts	**21,875**	44,406	**22,293**	37,578
Change in debt securities in issue	**11,289**	16	**(2,804)**	(5,434)
Change in financial liabilities designated at fair value	**1,275**	8,185	**415**	4,321
Change in other liabilities	**(200)**	(4,339)	**(362)**	1,316
	39,302	49,503	**21,446**	38,562

Cash and cash equivalents comprise

	The group		The bank	
	2006	2005	**2006**	2005
	£m	£m	**£m**	£m
Cash and balances at central banks	**3,618**	1,711	**2,496**	689
Items in the course of collection from other banks	**2,937**	3,595	**1,367**	2,125
Loans and advances to banks of one month or less	**31,838**	19,535	**13,669**	5,506
Treasury bills, other bills and certificates of deposit less than three months	**10,756**	7,942	**9,972**	6,538
Less: items in the course of transmission to other banks	**(2,428)**	(2,268)	**(1,019)**	(805)
Total cash and cash equivalents [1]	**46,721**	30,515	**26,485**	14,053

1 Total cash and cash equivalents include the following amounts that are not available for use by the group: £65.6 million held by foreign subsidiaries and subject to foreign exchange control restrictions (2005: £68.7 million); and £942 million subject to other restrictions (2005: £862.6 million).

Total interest paid by the group during the year was £11,176 million (2005: £8,159 million). Total interest received by the group during the year was £16,312 million (2005: £12,946 million). Total dividends received by the group during the year was £635 million (2005: £364 million).

Notes on the Financial Statements (continued)

39 Risk management

All the group's activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The most important types of risk arising from financial instruments are credit risk (which includes country and cross-border risk), liquidity risk, market risk, and insurance risk. Market risk includes foreign exchange, interest rate and equity price risk.

The management of all risks which are significant to the group is discussed below.

Credit risk management

Credit risk is the risk that financial loss arises from the failure of a customer or counterparty to meet its obligations under a contract. It arises principally from lending, trade finance, treasury and leasing activities. The group has standards, policies and procedures dedicated to controlling and monitoring risk from all such activities.

HSBC Holdings plc is responsible for the formulation of high-level credit policies. It also reviews the application of HSBC's universal facility grading system. Historically, the group's risk rating framework has consisted of a minimum of seven grades, taking into account the risk of default and the availability of security or other credit risk mitigation, the first three of which are applied to differing levels of satisfactory risk. Accounts in grades 4 and 5 require different degrees of special attention and grades 6 and 7 indicate non-performing status. A more sophisticated risk rating framework for banks and other customers, based on default probability and loss estimates and comprising up to 22 categories, is being progressively implemented and is operative in most major business units. This new approach will increasingly allow a more granular analysis of risk and trends. Rating methodology is based upon a wide range of financial analytics together with market data-based tools which are core inputs to the assessment of counterparty risk. Although automated risk rating processes are increasingly in use, for the larger facilities ultimate responsibility for setting risk grades rests with the final approving executive in each case. It is policy to review grades frequently and implement amendments promptly when required.

The group's credit risk limits to counterparties in the financial and government sectors are managed centrally to optimise the use of credit availability and to avoid excessive risk concentration. Cross-border risk is controlled through the imposition of country limits, which are determined by taking into account economic and political factors, and local business knowledge, with sub-limits by maturity and type of business. Transactions with counterparties in higher risk countries are considered on a case-by-case basis.

Within the overall framework of the HSBC policy, the group has an established risk management process encompassing credit approvals, the control of exposures (including those to borrowers in financial difficulty), credit policy direction to business units and the monitoring and reporting of exposures both on an individual and a portfolio basis which includes the management of adverse trends. Local management is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to build and maintain risk assets of high quality. Regular reviews are undertaken to assess and evaluate levels of risk concentration, including those to individual industry sectors and products, or to individual geographic areas.

Special attention is paid to the management of problem loans. Where deemed appropriate, specialist units are established to provide intensive management and control to maximise recoveries of doubtful debts.

Maximum exposure to credit risk

Maximum exposure to credit risk, collateral held or other credit enhancements:

The group

	Maximum exposure 2006 £m	Maximum exposure 2005 £m
Items in course of collection from other banks	**2,937**	3,595
Trading assets	**75,158**	61,240
– treasury and other similar bills	**197**	268
– debt securities	**47,101**	40,550
– loans and advances	**27,860**	20,422
Financial assets designated at fair value	**2,509**	1,721
– treasury and other similar bills	**28**	10
– debt securities	**2,361**	1,614
– loans and advances	**120**	97
Derivatives	**32,090**	26,077
Loans and advances to banks	**44,428**	31,578
Loans and advances to customers	**200,416**	182,629
Financial investments	**40,485**	41,321
– treasury and other similar bills	**3,199**	3,950
– debt securities	**37,286**	37,371
Other assets:		
– endorsements and acceptances	**353**	539
– other	**2,762**	2,247
Off-balance sheet:		
– financial guarantees and other credit related contingent liabilities	**22,938**	17,557
– loan commitments and other credit related commitments	**131,352**	127,159
At 31 December	**555,428**	495,663

The bank

	Maximum exposure 2006 £m	Maximum exposure 2005 £m
Items in course of collection from other banks	**1,367**	2,125
Trading assets	**55,450**	33,091
– treasury and other similar bills	**165**	181
– debt securities	**25,260**	17,127
– loans and advances	**30,025**	15,783
Financial assets designated at fair value	**–**	16
– treasury and other similar bills	**–**	–
– debt securities	**–**	–
– loans and advances	**–**	16
Derivatives	**24,361**	17,570
Loans and advances to banks	**25,121**	19,196
Loans and advances to customers	**143,964**	134,819
Financial investments	**11,749**	15,059
– treasury and other similar bills	**2,826**	3,554
– debt securities	**8,923**	11,505
Other assets:		
– endorsements and acceptances	**238**	476
– other	**1,482**	828
Off-balance sheet:		
– financial guarantees and other credit related contingent liabilities	**16,129**	9,840
– loan commitments and other credit related commitments	**94,336**	90,811
At 31 December	**374,197**	323,831

Notes on the Financial Statements (continued)

Collateral and other credit enhancements

Loans and advances

Where appropriate, operating companies are required to implement guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determine valuation parameters. Such parameters are expected to be conservative, reviewed regularly and be supported by empirical evidence. Security structures and legal covenants are required to be subjected to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice. While collateral is an important mitigant to credit risk, it is the group's policy to establish that loans are within the customer's capacity to repay rather than to over rely on security. In certain cases, depending on the customer's standing and the type of product, facilities may be unsecured. The principal collateral types are as follows:

- in the personal sector, mortgages over residential properties;
- in the commercial and industrial sector, charges over business assets such as premises, stock and debtors;
- in the commercial real estate sector, charges over the properties being financed; and
- in the financial sector, charges over financial instruments such as debt securities and equities in support of trading facilities.

Other securities

Collateral held as security for financial assets other than loans and advances is determined by the structure of the instrument. Debt securities, treasury and other eligible bills are generally unsecured with the exception of asset backed securities and similar instruments, which are secured by pools of financial assets.

Concentrations of exposure

The group

	2006	2005
	%	%
United Kingdom	**47**	47
France	**12**	11
Germany	**8**	8
Rest of Continental Europe	**21**	20
Continental Europe	**41**	39
United States	**5**	7
Rest of world	**7**	7
	100	100

The bank

	2006	2005
	%	%
United Kingdom	**66**	68
France	**4**	5
Germany	**4**	3
Rest of Continental Europe	**18**	14
Continental Europe	**26**	22
United States	**3**	5
Rest of world	**5**	5
	100	100

The group provides a diverse range of financial services both in the United Kingdom and internationally. As a result, its portfolio of financial instruments with credit risk is highly diversified with no exposures to individual industries or economic groupings totalling more than 10 per cent of consolidated total assets, except as follows:

– the bank's position as one of the principal UK clearing banks means that the majority of the group's exposure to credit risk is concentrated in the United Kingdom. Within the United Kingdom, the group's credit risk is diversified over a wide range of industrial and economic groupings; and

– the group's position as part of a major international banking group means, that it has a significant concentration of exposure to banking counterparties. The majority of credit risk to the banking industry at 31 December 2006 and 31 December 2005 was concentrated in Europe (including the United Kingdom).

There are no special collateral requirements relating to industrial concentrations, with the exception of exposures to the property sector. The majority of exposures to the property and construction industry and the residential mortgage market are secured on the underlying property.

Credit quality

Loans and advances

The group

	At 31 December 2006		At 31 December 2005	
	Loans and advances to customers £m	**Loans and advances to banks £m**	Loans and advances to customers £m	Loans and advances to banks £m
Gross loans and advances:				
– neither past due nor impaired	**197,999**	**44,426**	180,497	31,575
– past due but not impaired	**1,412**	**–**	1,298	–
– impaired	**2,767**	**6**	2,714	8
	202,178	**44,432**	184,509	31,583

The bank

	At 31 December 2006		At 31 December 2005	
	Loans and advances to customers £m	**Loans and advances to banks £m**	Loans and advances to customers £m	Loans and advances to banks £m
Gross loans and advances:				
– neither past due nor impaired	**142,156**	**25,118**	133,113	19,195
– past due but not impaired	**1,198**	**–**	1,274	–
– impaired	**1,513**	**6**	1,354	5
	144,867	**25,124**	135,741	19,200

Distribution of loans and advances neither past due nor impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired at 31 December 2006 can be assessed by reference to HSBC's standard credit grading system. The following information is based on that system:

The group

	At 31 December 2006		At 31 December 2005	
	Loans and advances to customers £m	**Loans and advances to banks £m**	Loans and advances to customers £m	Loans and advances to banks £m
Grade 1-3 – satisfactory risk	**191,896**	**44,011**	173,736	31,454
Grade 4 – watch list	**4,088**	**415**	5,247	108
Grade 5 – sub-standard but not impaired	**2,015**	**–**	1,514	13
	197,999	**44,426**	180,497	31,575

Notes on the Financial Statements (continued)

The bank

	At 31 December 2006		At 31 December 2005	
	Loans and advances to customers £m	**Loans and advances to banks £m**	Loans and advances to customers £m	Loans and advances to banks £m
Grade 1-3 – satisfactory risk	**137,569**	**25,089**	128,303	19,140
Grade 4 – watch list	**3,042**	**29**	4,153	43
Grade 5 – sub-standard but not impaired	**1,545**	**–**	657	12
	142,156	**25,118**	133,113	19,195

Grades 1 and 2 represent corporate facilities demonstrating financial condition, risk factors and capacity to repay that are good to excellent, residential mortgages with low to moderate loan to values ratios, and other retail accounts which are not impaired and are maintained within product guidelines.

Grade 3 represents satisfactory risk and includes corporate facilities that require closer monitoring, mortgages with higher loan to value ratios than grades 1 and 2, all non-impaired credit card exposures, and other retail exposures which operate outside product guidelines without being impaired.

Grades 4 and 5 represent corporate facilities that require various degrees of special attention and all retail exposures that are progressively between 30 and 90 days past due.

Loans and advances which were past due but not impaired

Loans and advances that were past due at 31 December 2006 but not impaired were as follows:

The group

	Loans and advances to customers	
	2006 £m	2005 £m
Past due up to 29 days	**776**	608
Past due 30 – 59 days	**310**	211
Past due 60 – 89 days	**205**	135
	1,291	954
Past due 90 – 179 days	**105**	204
Past due over 180 days but less than 1 year	**14**	110
Past due more than 1 year	**2**	30
	1,412	1,298

The bank

	Loans and advances to customers	
	2006 £m	2005 £m
Past due up to 29 days	**635**	594
Past due 30 – 59 days	**276**	207
Past due 60 – 89 days	**183**	132
	1,094	933
Past due 90 – 179 days	**102**	202
Past due over 180 days but less than 1 year	**1**	110
Past due more than 1 year	**1**	29
	1,198	1,274

The past due ageing analysis includes loans and advances less than 90 days past due that have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears.

There are a variety of reasons why certain loans designated as 'past due' are not regarded as impaired. Unless other information is available to indicate to the contrary, all loans less than 90 days past due are not considered impaired. It is also not unusual for short-term trade finance facilities to extend beyond 90 days past due for reasons that do not reflect any concern on the creditworthiness of the counterparty, such as delays in documentation. In addition, past due loans secured in full by cash collateral are not considered impaired and, where appropriate, neither are residential mortgages in arrears by more than 90 days where the value of collateral is sufficient to repay both the debt and all potential interest for at least one year.

Loans and advances to customers and to banks – net total credit risk

Loans and advances against which the group had legally enforceable rights to offset with financial liabilities were as follows:

The group

	At 31 December 2006		
	Book value £m	**Amount for which the group has a legally enforceable right to off-set[1] £m**	**Net total credit risk[2] £m**
Loans and advances to customers	**200,416**	**(33,254)**	**167,162**
Loans and advances to banks	**44,428**	**(229)**	**44,199**
	244,844	**(33,483)**	**211,361**

	At 31 December 2005		
	Book value £m	Amount for which the group has a legally enforceable right to off-set[1] £m	Net total credit risk[2] £m
Loans and advances to customers	182,629	(734)	181,895
Loans and advances to banks	31,578	–	31,578
	214,207	(734)	213,473

The bank

	At 31 December 2006		
	Book value £m	**Amount for which the group has a legally enforceable right to off-set[1] £m**	**Net total credit risk[2] £m**
Loans and advances to customers	**143,964**	**(31,138)**	**112,826**
Loans and advances to banks	**25,121**	**–**	**25,121**
	169,085	**(31,138)**	**137,947**

1 *Against financial liabilities with the same counterparty.*
2 *Excluding the value of any collateral or security held.*

Notes on the Financial Statements (continued)

	At 31 December 2005		
	Book value £m	Amount for which the group has a legally enforceable right to off-set[1] £m	Net total credit risk[2] £m
Loans and advances to customers	134,819	–	134,819
Loans and advances to banks	19,196	–	19,196
	154,015	–	154,015

1 *Against financial liabilities with the same counterparty.*
2 *Excluding the value of any collateral or security held.*

Other securities

Debt securities and other bills by rating agency designation

The following table presents an analysis of debt and similar securities, other than loans, by rating agency designation, based on Standard and Poor's ('S&P') ratings or their equivalent:

The group

	At 31 December 2006			
	Treasury bills £m	**Other eligible bills £m**	**Debt securities £m**	**Total £m**
AAA	**2,800**	**144**	**41,447**	**44,391**
AA – to AA +	**54**	**111**	**16,930**	**17,095**
A – to A +	**41**	**–**	**12,797**	**12,838**
Lower than A –	**246**	**–**	**3,254**	**3,500**
Unrated	**–**	**–**	**10,727**	**10,727**
Supporting linked insurance and investment contracts	**28**	**–**	**1,593**	**1,621**
Total	**3,169**	**255**	**86,748**	**90,172**
Of which issued by:				
– governments	**2,935**	**–**	**28,793**	**31,728**
– local authorities	**41**	**–**	**341**	**382**
– corporates	**–**	**–**	**21,990**	**21,990**
– other	**193**	**255**	**35,624**	**36,072**
Total	**3,169**	**255**	**86,748**	**90,172**
Of which classified as:				
– financial instruments designated at fair value	**28**	**–**	**2,361**	**2,389**
– available-for-sale securities	**2,944**	**255**	**37,210**	**40,409**
– held-to-maturity investments	**–**	**–**	**76**	**76**
– held for trading	**197**	**–**	**47,101**	**47,298**
Total	**3,169**	**255**	**86,748**	**90,172**

	At 31 December 2005			
	Treasury bills £m	Other eligible bills £m	Debt securities £m	Total £m
AAA	3,450	221	41,279	44,950
AA – to AA +	18	151	17,160	17,329
A – to A +	146	–	8,881	9,027
Lower than A –	18	–	1,946	1,964
Unrated	224	–	10,269	10,493
Total	3,856	372	79,535	83,763
Of which issued by:				
– governments	2,197	–	31,753	33,950
– local authorities	1,521	–	637	2,158
– corporates	–	–	21,108	21,108
– other	138	372	26,037	26,547
Total	3,856	372	79,535	83,763
Of which classified as:				
– financial instruments designated at fair value	10	–	1,614	1,624
– available-for-sale securities	3,623	327	37,234	41,184
– held-to-maturity investments	–	–	137	137
– held for trading	223	45	40,550	40,818
Total	3,856	372	79,535	83,763

Debt securities with short-term ratings are reported against the long-term rating of the issuer of the short-term debt securities. If major rating agencies have different ratings for the same debt securities, the securities are reported against the lower rating.

The bank

	At 31 December 2006			
	Treasury bills £m	**Other eligible bills £m**	**Debt securities £m**	**Total £m**
AAA	**2,756**	–	**13,738**	**16,494**
AA – to AA +	**41**	–	**7,467**	**7,508**
A – to A +	–	–	**9,128**	**9,128**
Lower than A –	**194**	–	**2,782**	**2,976**
Unrated	–	–	**1,068**	**1,068**
Supporting linked insurance and investment contracts	–	–	–	–
Total	**2,991**	–	**34,183**	**37,174**
Of which issued by:				
– governments	**2,757**	–	**8,299**	**11,056**
– local authorities	**41**	–	**65**	**106**
– corporates	–	–	**10,823**	**10,823**
– other	**193**	–	**14,996**	**15,189**
Total	**2,991**	–	**34,183**	**37,174**
Of which classified as:				
– financial instruments designated at fair value	–	–	–	–
– available-for-sale securities	**2,826**	–	**8,923**	**11,749**
– held-to-maturity investments	–	–	–	–
– held for trading	**165**	–	**25,260**	**25,425**
Total	**2,991**	–	**34,183**	**37,174**

Notes on the Financial Statements (continued)

	At 31 December 2005			
	Treasury bills £m	Other eligible bills £m	Debt securities £m	Total £m
AAA	3,414	28	13,216	16,658
AA – to AA +	–	17	6,029	6,046
A – to A +	146	–	5,530	5,676
Lower than A –	–	–	1,396	1,396
Unrated	130	–	2,461	2,591
Total	3,690	45	28,632	32,367
Of which issued by:				
– governments	2,171	–	8,561	10,732
– local authorities	1,382	–	143	1,525
– corporates	–	–	8,191	8,191
– other	137	45	11,737	11,919
Total	3,690	45	28,632	32,367
Of which classified as:				
– financial instruments designated at fair value	–	–	–	–
– available-for-sale securities	3,554	–	11,505	15,059
– held-to-maturity investments	–	–	–	–
– held for trading	136	45	17,127	17,308
Total	3,690	45	28,632	32,367

Debt securities and other bills – net total credit risk

Debt securities and other bills against which the group had legally enforceable rights to offset with financial liabilities were as follows:

The group

	At 31 December 2006		
	Book value £m	**Amount for which the group has a legally enforceable right to off set[1] £m**	**Net total credit risk[2] £m**
Trading assets:			
– treasury and other similar bills	**197**	–	**197**
– debt securities	**47,101**	–	**47,101**
– loans and advances to banks	**10,233**	–	**10,233**
– loans and advances to customers	**17,627**	–	**17,627**
	75,158	–	**75,158**
Financial assets designated at fair value:			
– treasury and other similar bills	**28**	–	**28**
– debt securities	**2,361**	–	**2,361**
– loans and advances to banks	**120**	–	**120**
– loans and advances to customers	**–**	–	**–**
	2,509	–	**2,509**
Derivatives	**32,090**	**(14,335)**	**17,755**
Financial investments:			
– treasury and other similar bills	**3,199**	**–**	**3,199**
– debt securities	**37,286**	**(1)**	**37,285**
	40,485	**(1)**	**40,484**
Other assets			
Acceptances and endorsements	**353**	**(95)**	**258**
	150,595	**(14,431)**	**136,164**

1 Against financial liabilities with the same counterparty.
2 Excluding the value of any collateral or security held.

	At 31 December 2005		
	Book value £m	Amount for which the group has a legally enforceable right to off set[1] £m	Net total credit risk[2] £m
Trading assets:			
– treasury and other similar bills	268	–	268
– debt securities	40,550	–	40,550
– loans and advances to banks	7,993	–	7,993
– loans and advances to customers	12,429	–	12,429
	61,240	–	61,240
Financial assets designated at fair value:			
– treasury and other similar bills	10	–	10
– debt securities	1,614	–	1,614
– loans and advances to banks	70	–	70
– loans and advances to customers	27	–	27
	1,721	–	1,721
Derivatives	26,077	(14,011)	12,066
Financial investments:		–	
– treasury and other similar bills	3,950	–	3,950
– debt securities	37,371	–	37,371
	41,321	–	41,321
Other assets			
Acceptances and endorsements	539	–	539
	130,898	(14,011)	116,887

1 *Against financial liabilities with the same counterparty.*
2 *Excluding the value of any collateral or security held.*

The bank

	At 31 December 2006		
	Book value £m	**Amount for which the group has a legally enforceable right to off-set[1] £m**	**Net total credit risk[2] £m**
Trading assets:			
– treasury and other similar bills	**165**	–	**165**
– debt securities	**25,260**	–	**25,260**
– loans and advances to banks	**13,560**	–	**13,560**
– loans and advances to customers	**16,465**	–	**16,465**
	55,450	**–**	**55,450**
Derivatives	**24,361**	**(8,893)**	**15,468**
Financial investments:			
– treasury and other similar bills	**2,826**	**–**	**2,826**
– debt securities	**8,923**	**(1)**	**8,922**
	11,749	**(1)**	**11,748**
Other assets			
Acceptances and endorsements	**238**	**–**	**238**
	91,798	**(8,894)**	**82,904**

1 *Against financial liabilities with the same counterparty.*
2 *Excluding the value of any collateral or security held.*

Notes on the Financial Statements (continued)

	At 31 December 2005		
	Book value £m	Amount for which the group has a legally enforceable right to off-set[1] £m	Net total credit risk[2] £m
Trading assets:			
– treasury and other similar bills	181	–	181
– debt securities	17,127	–	17,127
– loans and advances to banks	4,940	–	4,940
– loans and advances to customers	10,843	–	10,843
	33,091	–	33,091
Financial assets designated at fair value:			
– loans and advances to customers	16	–	16
	16	–	16
Derivatives	17,570	(6,215)	11,355
Financial investments:			
– treasury and other similar bills	3,554	–	3,554
– debt securities	11,505	–	11,505
	15,059	–	15,059
Other assets			
Acceptances and endorsements	476	–	476
	66,212	(6,215)	59,997

1 *Against financial liabilities with the same counterparty.*
2 *Excluding the value of any collateral or security held.*

Impairment assessment

It is the group's policy that each operating company makes allowance for impaired loans promptly when required and on a consistent basis in accordance with established group guidelines.

The group's rating process for credit facilities extended by members of the group is designed to highlight exposures requiring greater management attention based on a higher probability of default and potential loss. Management are required to particularly focus on facilities to those borrowers and portfolio segments classified below satisfactory grades. Amendments to risk grades, where necessary, are required to be undertaken promptly. Management are also required to regularly evaluate the adequacy of the established allowances for impaired loans by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics with historical trends and assessing the impact of current economic conditions.

Two types of impairment allowance are in place: individually assessed and collectively assessed. These are discussed in Note 2.

The group's policy requires a review of the level of impairment allowances on individual facilities that are above materiality thresholds at least half-yearly, and more regularly where individual circumstances require. The policy requires that this will normally include a review of collateral held (including re-confirmation of its enforceability) and an assessment of actual and anticipated receipts. For significant commercial and corporate debts, specialised loan 'work-out' teams with experience in insolvency and specific market sectors are used to determine likely losses. Reversals on individually calculated impairment allowances are recognised whenever the group has reasonable objective evidence that the established estimate of loss has been reduced.

Portfolio allowances are generally reassessed monthly and charges for new allowances, or releases of existing allowances, are calculated for each separately identified portfolio.

In relevant cases, impairment allowances will include an element in respect of cross-border exposures to countries assessed by management to be vulnerable to foreign currency payment restrictions. This assessment includes analysis of both economic and political factors existing at the time. Economic factors include the level of external indebtedness, the debt service burden and access to external sources of funds to meet the debtor country's financing requirements. Political factors taken into account include the stability of the country and its government, threats to security and the quality and independence of the legal system.

Non-performing loans

For individually assessed accounts, loans are required to be designated as non-performing as soon as there is objective evidence that an impairment loss has been incurred. Objective evidence of impairment includes observable data such as when contractual payments of principal or interest are 90 days overdue. Portfolios of homogeneous loans are designated as non-performing if facilities are 90 days or more overdue.

Charge-offs

Loans (and the related impairment allowances) are normally charged-off, either partially or in full, when there is no realistic prospect of recovery of these amounts and when the proceeds from the realisation of security have been received. Unsecured personal facilities are normally charged-off between 150 and 210 days overdue. There are no cases where the charge-off period exceeds 360 days except where certain personal accounts are still deemed collectible beyond this point. In the case of bankruptcy, charge-off occurs at the time of notification.

Impaired loans

Individually impaired loans by industry sector and by geographical region

The group

	Year to 31 December 2006				
	United Kingdom £m	**Continental Europe £m**	**Rest of the world £m**	**Gross loans and advances to customers £m**	**Gross loans by industry sector as a % of total gross loans %**
Personal	**295**	**200**	**–**	**495**	**24**
Commercial and corporate	**822**	**734**	**1**	**1,557**	**76**
Total impaired loans and advances to customers	**1,117**	**934**	**1**	**2,052**	**100**

	Year to 31 December 2005				
	United Kingdom £m	Continental Europe £m	Rest of the world £m	Gross loans and advances to customers £m	Gross loans by industry sector as a % of total gross loans %
Personal	248	127	–	375	20
Commercial and corporate	847	639	9	1,495	80
Total impaired loans and advances to customers	1,095	766	9	1,870	100

The bank

	Year to 31 December 2006				
	United Kingdom £m	**Continental Europe £m**	**Rest of the world £m**	**Gross loans and advances to customers £m**	**Gross loans by industry sector as a % of total gross loans %**
Personal	**272**	**–**	**–**	**272**	**25**
Commercial and corporate	**790**	**31**	**1**	**822**	**75**
Total impaired loans and advances to customers	**1,062**	**31**	**1**	**1,094**	**100**

Notes on the Financial Statements (continued)

	Year to 31 December 2005				
	United Kingdom £m	Continental Europe £m	Rest of the world £m	Gross loans and advances to customers £m	Gross loans by industry sector as a % of total gross loans %
Personal	234	–	–	234	22
Commercial and corporate	796	28	3	827	78
Total impaired loans and advances to customers	1,030	28	3	1,061	100

Impairment allowances

When impairment losses occur, the group reduces the carrying amount of loans and advances and held-to-maturity financial investments through the use of an allowance account. When impairment of available-for-sale financial assets occurs, the carrying amount of the asset is reduced directly.

Movement in allowance accounts for total loans and advances

The group

	Year ended 31 December 2006		
	Individually assessed £m	**Collectively assessed £m**	**Total £m**
At 1 January	**910**	**975**	**1,885**
Amounts written off	**(294)**	**(944)**	**(1,238)**
Recoveries of loans and advances written off in previous years	**(240)**	**(109)**	**(349)**
Charge to income statement	**388**	**1,123**	**1,511**
Transfers	**149**	**(149)**	**–**
Exchange and other movements	**(31)**	**(12)**	**(43)**
At 31 December	**882**	**884**	**1,766**

	Year ended 31 December 2005		
	Individually assessed £m	Collectively assessed £m	Total £m
At 1 January	1,342	1,031	2,373
Amounts written off	(269)	(1,082)	(1,351)
Recoveries of loans and advances written off in previous years	(354)	(182)	(536)
Charge to income statement	564	824	1,388
Transfers	(328)	328	–
Exchange and other movements	(45)	56	11
At 31 December	910	975	1,885

The bank

	Year ended 31 December 2006		
	Individually assessed £m	**Collectively assessed £m**	**Total £m**
At 1 January	**408**	**518**	**926**
Amounts written off	**(169)**	**(839)**	**(1,008)**
Recoveries of loans and advances written off in previous years	**(100)**	**(47)**	**(147)**
Charge to income statement	**208**	**943**	**1,151**
Exchange and other movements	**(13)**	**(3)**	**(16)**
At 31 December	**334**	**572**	**906**

	Year ended 31 December 2005		
	Individually assessed £m	Collectively assessed £m	Total £m
At 1 January	383	914	1,297
Amounts written off	(169)	(1,011)	(1,180)
Recoveries of loans and advances written off in previous years	(146)	(115)	(261)
Charge to income statement	340	670	1,010
Exchange and other movements	–	60	60
At 31 December	408	518	926

Impairment allowances against loans and advances to customers

The group

	2006 %	2005 %
Total impairment allowances to gross lending[1]		
Individually assessed impairment allowances	**0.45**	0.51
Collectively assessed impairment allowances	**0.45**	0.55
Total	**0.90**	1.06

The bank

	2006 %	2005 %
Total impairment allowances to gross lending[1]		
Individually assessed impairment allowances	**0.23**	0.33
Collectively assessed impairment allowances	**0.40**	0.42
Total	**0.63**	0.75

1 *Net of reverse repo transactions and settlement accounts.*

Net impairment charge to income statement by geographical region

The group

	Year ended 31 December 2006			
	United Kingdom £m	**Continental Europe £m**	**Rest of the world £m**	**Total £m**
Individually assessed impairment allowances				
New allowances	**230**	**158**	**–**	**388**
Release of allowances no longer required	**(111)**	**(129)**	**–**	**(240)**
Recoveries of amounts previously written off	**(8)**	**(11)**	**–**	**(19)**
	111	**18**	**–**	**129**
Collectively assessed impairment allowances				
New allowances	**1,042**	**81**	**–**	**1,123**
Release of allowances no longer required	**(46)**	**(63)**	**–**	**(109)**
Recoveries of amounts previously written off	**(208)**	**–**	**–**	**(208)**
	788	**18**	**–**	**806**
Total charge for impairment losses	**899**	**36**	**–**	**935**
Bank	**–**	**–**	**–**	**–**
Customer	**899**	**36**	**–**	**935**
Other credit risk provisions	**5**	**(2)**	**–**	**3**
Loan impairment charges and other credit risk provisions	**904**	**34**	**–**	**938**
Customer charge for impairment losses as a percentage of closing gross loans and advances	**0.58**	**0.08**	**–**	**0.46**
31 December 2006	**£m**	**£m**	**£m**	**£m**
Balances outstanding				
Non-performing loans	**1,779**	**992**	**2**	**2,773**
Impairment allowances	**1,120**	**645**	**1**	**1,766**
Gross loans and advances	**175,120**	**66,181**	**5,309**	**246,610**
Total allowances cover as a percentage of non-performing loans and advances	**62.96**	**65.02**	**50.00**	**63.69**

Notes on the Financial Statements (continued)

	Year ended 31 December 2005			
	United Kingdom £m	Continental Europe £m	Rest of the world £m	Total £m
Individually assessed impairment allowances				
New allowances	363	201	–	564
Release of allowances no longer required	(141)	(213)	–	(354)
Recoveries of amounts previously written off	(9)	(1)	(2)	(12)
	213	(13)	(2)	198
Collectively assessed impairment allowances				
New allowances	745	79	–	824
Release of allowances no longer required	(116)	(63)	(3)	(182)
Recoveries of amounts previously written off	(33)	–	–	(33)
	596	16	(3)	609
Total charge for impairment losses	809	3	(5)	807
Bank	(1)	(2)	–	(3)
Customer	810	5	(5)	810
Other credit risk provisions	1	(32)	–	(31)
Loan impairment charges and other credit risk provisions	810	(29)	(5)	776
Customer charge for impairment losses as a percentage of closing gross loans and advances	0.58	0.01	(0.14)	0.44

31 December 2005	£m	£m	£m	£m
Balances outstanding				
Non-performing loans	1,584	1,129	9	2,722
Impairment allowances	1,123	759	3	1,885
Gross loans and advances	154,021	57,109	4,962	216,092
Total allowances cover as a percentage of non-performing loans and advances	70.90	67.23	33.33	69.25

The bank

	Year ended 31 December 2006			
	United Kingdom £m	**Continental Europe £m**	**Rest of the world £m**	**Total £m**
Individually assessed impairment allowances				
New allowances	**204**	**4**	**–**	**208**
Release of allowances no longer required	**(99)**	**(1)**	**–**	**(100)**
Recoveries of amounts previously written off	**(7)**	**–**	**–**	**(7)**
	98	**3**	**–**	**101**
Collectively assessed impairment allowances				
New allowances	**941**	**2**	**–**	**943**
Release of allowances no longer required	**(46)**	**(1)**	**–**	**(47)**
Recoveries of amounts previously written off	**(198)**	**–**	**–**	**(198)**
	697	**1**	**–**	**698**
Total charge for impairment losses	**795**	**4**	**–**	**799**
Bank	**–**	**–**	**–**	**–**
Customer	**795**	**4**	**–**	**799**
Other credit risk provisions	**5**	**1**	**–**	**6**
Loan impairment charges and other credit risk provisions	**800**	**5**	**–**	**805**
Customer charge for impairment losses as a percentage of closing gross loans and advances	**0.57**	**0.09**	**–**	**0.55**

31 December 2006	**£m**	**£m**	**£m**	**£m**
Balances outstanding				
Non-performing loans	**1,486**	**32**	**1**	**1,519**
Impairment allowances	**893**	**12**	**1**	**906**
Gross loans and advances	**163,771**	**5,269**	**951**	**169,991**
Total allowances cover as a percentage of non-performing loans and advances	**60.09**	**37.50**	**100.00**	**59.64**

	Year ended 31 December 2005			
	United Kingdom £m	Continental Europe £m	Rest of the world £m	Total £m
Individually assessed impairment allowances				
New allowances	335	5	–	340
Release of allowances no longer required	(137)	(9)	–	(146)
Recoveries of amounts previously written off	(10)	–	–	(10)
	188	(4)	–	184
Collectively assessed impairment allowances				
New allowances	669	1	–	670
Release of allowances no longer required	(115)	–	–	(115)
Recoveries of amounts previously written off	(32)	–	–	(32)
	522	1	–	523
Total charge for impairment losses	710	(3)	–	707
Bank	(1)	–	–	(1)
Customer	711	(3)	–	708
Other credit risk provisions	–	(5)	–	(5)
Loan impairment charges and other credit risk provisions	710	(8)	–	702
Customer charge for impairment losses as a percentage of closing gross loans and advances	0.58	(0.02)	–	0.56

31 December 2005	£m	£m	£m	£m
Balances outstanding				
Non-performing loans	1,327	29	3	1,359
Impairment allowances	909	16	1	926
Gross loans and advances	149,783	4,461	697	154,941
Total allowances cover as a percentage of non-performing loans and advances	68.50	55.17	33.33	68.14

Collateral and other credit enhancements obtained

During 2006, the group obtained assets by taking control of collateral accepted as security, or through other credit enhancements, as follows:

	Carrying value obtained in 2006		Carrying value obtained in 2005	
	The group £m	**The bank £m**	The group £m	The bank £m
Type of asset				
Residential property	**20**	**19**	6	6
Commercial and industrial property	**1**	**–**	–	–
Other assets	**3**	**3**	8	–
	24	**22**	14	6

Procedures for the disposal of assets not readily convertible into cash are established at operating company level, and depend on the nature of the asset concerned.

Renegotiated loans

Restructuring activity is designed to manage customer relationships, maximise collection opportunities and avoid foreclosure or repossession, if possible. Following restructuring, an overdue personal account will normally be reset from delinquent to current status. Restructuring policies and practices are based on indicators or criteria which, in the judgement of local management, evidence the probability that payment will continue. These policies are reviewed and their application varies depending upon the nature of the market, the product and the availability of empirically based data. Where empirical evidence indicates an increased propensity to default on restructured accounts, the use of roll rate methodologies for the calculation of impairment allowances results in the increased default propensity being reflected in impairment allowances.

Notes on the Financial Statements (continued)

Renegotiated loans that would otherwise be past due or impaired

The group

	2006 £m	2005 £m
Loans and advances to customers	**813**	977
Loans and advances to banks	**–**	–
	813	977

The bank

	2006 £m	2005 £m
Loans and advances to customers	**705**	890
Loans and advances to banks	**–**	–
	705	890

Liquidity and funding management

The objective of the group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due, and that wholesale market access is co-ordinated and disciplined. To this end, the group maintains a diversified and stable funding base comprising core retail and corporate customer deposits and institutional balances, augmented by wholesale funding and portfolios of highly liquid assets which are diversified by currency and maturity, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

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

The group's policy is to require operating entities to maintain a strong liquidity position and to manage the liquidity profile of their assets, liabilities and commitments so that cash flows are appropriately balanced and all funding obligations are met when due.

The group's liquidity and funding management policy requires:

- projecting cash flows by major currency and considering the level of liquid assets necessary in relation thereto;
- monitoring balance sheet liquidity ratios against internal and regulatory requirements;
- maintaining a diverse range of funding sources with adequate back-up facilities;
- managing the concentration and profile of debt maturities;
- maintaining debt financing plans;
- monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and
- maintaining liquidity and funding contingency plans. These plans must identify early indicators of stress conditions and describe actions to be taken in the event of difficulties arising from systemic or other crises while minimising adverse long-term implications for the business.

Primary sources of funding

Current accounts and savings deposits payable on demand or at short notice form a significant part of the group's funding. The group places considerable importance on the stability of these deposits.

The group accesses professional markets in order to provide funding for non-banking subsidiaries that do not accept deposits, to maintain a presence in local money markets and to optimise the funding of asset maturities not naturally matched by core deposit funding.

Of total liabilities of £420 billion at 31 December 2006, funding from customers amounted to £227 billion, of which £224 billion was contractually repayable within one year. However, although the contractual repayments of many customer accounts are on demand or at short notice, in practice short-term deposit balances remain stable as inflows and outflows broadly match.

An analysis of cash flows payable by the group and bank under financial liabilities by remaining contractual maturities at the balance sheet date is included in Note 33.

Liabilities in trading portfolios have not been analysed by contractual maturity because trading assets and liabilities are typically held for short periods of time.

Assets available to meet these liabilities, and to cover outstanding commitments to lend (£441 billion), included cash, central bank balances, items in the course of collection and treasury and other bills (£10 billion); loans to banks (£44 billion, including £43 billion repayable within one year); and loans to customers (£200 billion, including £101 billion repayable within one year). In the normal course of business, a proportion of customer loans contractually repayable within one year will be extended. In addition, the group held debt securities marketable at a value of £87 billion. Of these assets, some £47 billion of debt securities and treasury and other bills have been pledged to secure liabilities.

The group would meet unexpected net cash outflows by selling securities and accessing additional funding sources such as interbank or asset-backed markets.

A key measure used by the group for managing liquidity risk is the ratio of net liquid assets to customer liabilities. Generally, liquid assets comprise cash balances, short-term interbank deposits and highly rated debt securities available for immediate sale and for which a deep and liquid market exists. Net liquid assets are liquid assets less all wholesale market funds, and all funds provided by customers deemed to be professional, maturing in the next 30 days. The definition of a professional customer takes account of the size of the customer's total deposits.

Minimum liquidity ratio limits are set for each bank operating entity. Limits reflect the local marketplace, the diversity of funding sources available, and the concentration risk from large depositors.

Although consolidated data is not utilised in the management of the group's liquidity, the consolidated liquidity ratio figures of net liquid assets to customer-liabilities shown in the following table provide a useful insight into the overall liquidity position of the group's banking entities.

Ratio of net liquid assets to customer liabilities

	At 31 December		Average during	Maximum	Minimum
	2006	2005	**2006**	**in 2006**	**in 2006**
The bank:	**16.3%**	11.0%	**15.1%**	**19.1%**	**12.8%**
The group:	**20.4%**	15.6%	**19.3%**	**21.8%**	**17.5%**

Market risk management

The objective of the group's market risk management is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the group's status as a premier provider of financial products and services.

Market risk is the risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and equity and commodity prices will reduce the group's income or the value of its portfolios.

Each operating entity is required to assess the market risks which arise on each product in its business and to transfer these risks to either its local Global Markets unit for management, or to separate books managed under the auspices of the local Asset and Liability Management Committee ('ALCO'). The aim is to ensure that all market risks are consolidated within operations which have the necessary skills, tools, management and governance to professionally manage such risks.

Notes on the Financial Statements (continued)

Value at risk ('VAR')

One of the principal tools used by the group to monitor and limit market risk exposure is VAR. 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 (for the group, 99 per cent). The group calculates VAR daily. The VAR model used by the group is predominantly based on historical simulation. The historical simulation model derives plausible future scenarios from historical market rates time series, taking account of inter-relationships between different markets and rates, for example between interest rates and foreign exchange rates. Potential movements in market prices are calculated with reference to market data from the last two years. The VAR model has been extended to cover Specific Interest Rate risk ("credit VAR") and has received regulatory approval to use this model to calculate capital on issuer risk, with effect from 1 December 2006. The total VAR disclosed below as at 31 December 2006 includes credit VAR. The average, minimum and maximum VAR figures disclosed, exclude credit VAR in view of the short period of time the credit VAR element of the model has been in use by the group. Similarly, the disclosures under total trading VAR by risk type include credit VAR, which has also been reported separately, as at 31 December 2006. However, for the same reasons as mentioned above, this is not included in the average, minimum and maximum disclosures in this section.

Although a useful 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 1-day holding period assumes that all positions can be liquidated or hedged in one day. This may not fully reflect the market risk arising at times of severe illiquidity, when a 1-day holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence; and
- VAR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

The group recognises these limitations by augmenting its VAR limits with other position and sensitivity limit structures. Additionally, the group applies a wide range of stress testing, both on individual portfolios and on the group's consolidated positions. The group's stress-testing regime provides senior management with an assessment of the financial impact of identified extreme events on the market risk exposures of the group.

The VAR, both trading and non-trading, for Global Markets was as follows:

	£m[1]
Total	
At 31 December 2006	**17.9**
At 31 December 2005	39.8

	Average[2] £m	Minimum[2] £m	Maximum[2] £m
2006	**17.8**	**9.2**	**37.7**
2005	36.7	23.3	97.3

1 *This includes credit VAR in 2006.*
2 *These exclude credit VAR in both 2005 and in 2006.*

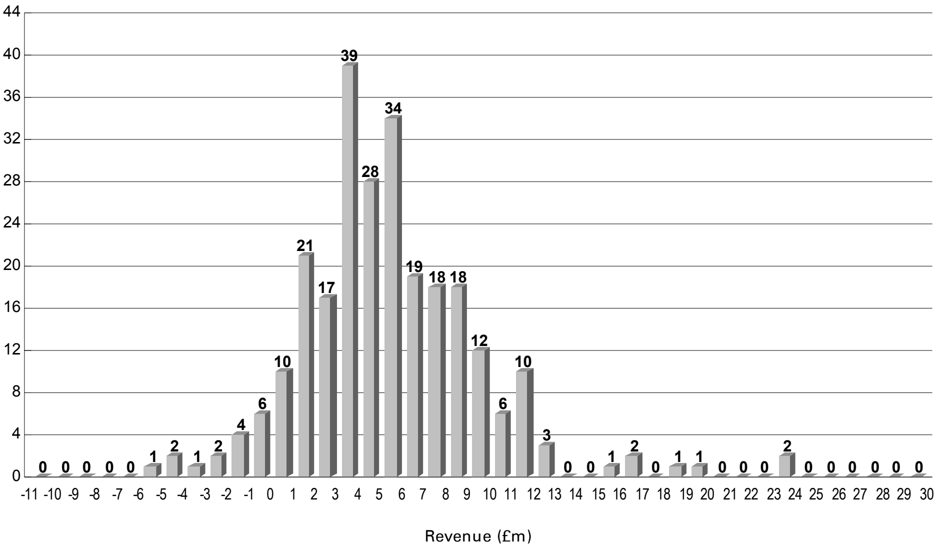
The daily revenue earned from market risk-related treasury activities includes net interest income and funding related to dealing positions. The histogram below illustrates the frequency of daily revenue arising from all Global Markets' business and other trading activities.

The average daily revenue earned from Global Markets' business and other trading activities in 2006 was £5.3 million, compared with £4.3 million in 2005. The standard deviation of these daily revenues was £4.1 million compared with £4.2 million for 2005. The standard deviation measures the variation of daily revenues about the mean value of those revenues.

An analysis of the frequency distribution of daily revenue shows that there were 16 days with negative revenue during 2006 compared with 30 days in 2005. Of these 16 days, 6 days were losses of less than £1.0 million. The most frequent result was a daily revenue of between £3 million and £4 million with 39 occurrences.

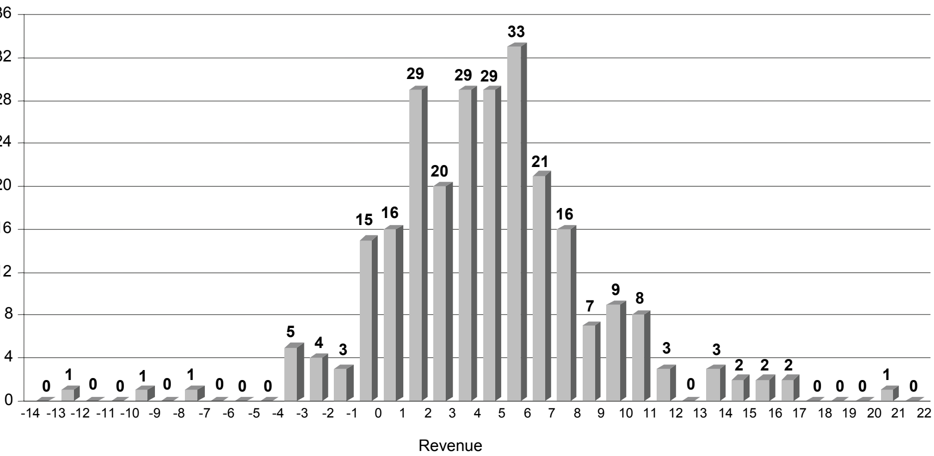
Daily distribution of Global Markets' trading, Balance Sheet Management and other trading revenues in 2006

Number of days



Daily distribution of Global Markets' trading, Balance Sheet Management and other trading revenues in 2005

Number of days



Fair value and price verification control

Where certain financial instruments are carried on the group's balance sheet at fair values, it is the group policy that the valuation and the related price verification processes are subject to independent testing across the group. Financial instruments which are accounted for on a fair value basis include assets held in the trading portfolio, financial instruments designated at fair value, obligations related to securities sold short, all derivative financial instruments and available for sale securities.

The determination of fair values is therefore a significant element in the reporting of the group's Global Markets activities.

All significant valuation policies, and any changes thereto, must be approved by senior finance management. The group's governance of financial reporting requires that Financial Control departments across the group are independent of the risk-taking businesses, with the Finance functions having ultimate responsibility for the determination of fair values included in the financial statements, and for ensuring that the group's policies and relevant accounting standards are adhered to. Senior management are required to assess the resourcing and expertise of Finance functions within the group on a regular basis to ensure that the group's financial control and price verification processes are properly staffed to support the required control infrastructure.

Notes on the Financial Statements (continued)

Trading

Market risk in trading portfolios is monitored and controlled at both portfolio and position levels using a complementary set of techniques, such as VAR and present value of a basis point, together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of defined market movements.

Other controls include restricting individual operations to trading within a list of permissible instruments authorised for each site by Traded Credit and Market Risk, and enforcing rigorous new product approval procedures. In particular, trading in the more complex derivative products is concentrated in offices with appropriate levels of product expertise and robust control systems.

HSBC's policy on hedging is to manage economic risk in the most appropriate way without regard as to whether hedge accounting is available, within limits regarding the potential volatility of reported earnings. Trading VAR is further analysed below by risk type, by positions taken with trading intent and by positions taken without trading intent:

Total trading VAR by risk type

	Foreign exchange £m	Interest rate trading £m	Equity £m	Credit[1] £m	Total £m
At 31 December 2006	**2.7**	**10.3**	**3.2**	**5.6**	**14.0**
At 31 December 2005	2.4	11.7	2.9	–	12.9
Average					
2006	**3.1**	**9.6**	**2.9**	–	**10.2**
2005	3.0	15.7	2.4	–	15.7
Minimum					
2006	**1.5**	**5.3**	**1.3**	–	**6.5**
2005	1.4	8.6	1.1	–	9.1
Maximum					
2006	**6.3**	**16.4**	**4.3**	–	**15.8**
2005	5.8	26.5	4.6	–	24.6

1 *The credit VAR model has been in use by the group since 1 December 2006 and hence is excluded from the total VAR in 2005 and also from the average, minimum and maximum VAR figures disclosed.*

Positions taken with trading intent – VAR by risk type

	Foreign exchange £m	Interest rate trading £m	Equity £m	Credit[1] £m	Total £m
At 31 December 2006	**2.7**	**9.0**	**3.2**	**5.6**	**13.9**
At 31 December 2005	2.4	11.0	2.9	–	12.1
Average					
2006	**3.1**	**9.3**	**2.9**	–	**10.0**
2005	3.0	14.4	2.4	–	14.2
Minimum					
2006	**1.5**	**5.2**	**1.3**	–	**6.4**
2005	1.4	7.9	1.1	–	8.0
Maximum					
2006	**6.3**	**15.3**	**4.3**	–	**15.9**
2005	5.8	23.9	4.6	–	23.2

1 *The credit VAR model has been in use by the group since 1 December 2006 and hence is excluded from the total VAR in 2005 and also from the average, minimum and maximum VAR figures disclosed.*

Positions taken without trading intent – VAR by risk type

	Foreign exchange £m	Interest rate trading £m	Equity £m	Credit[1] £m	Total £m
At 31 December 2006	–	**0.9**	–	–	**0.9**
At 31 December 2005	–	1.4	–	–	1.4
Average					
2006	–	**1.1**	–	–	**1.1**
2005	–	2.0	–	–	2.0
Minimum					
2006	–	**0.3**	–	–	**0.3**
2005	–	–	–	–	–
Maximum					
2006	–	**1.8**	–	–	**1.8**
2005	–	8.0	–	–	8.0

1 *The credit VAR model has been in use by the group since 1 December 2006 and hence is excluded from the total VAR in 2005 and also from the average, minimum and maximum VAR figures disclosed.*

Non-trading

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

Market risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on optionality in certain product areas, for example, mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand, for example, current accounts. This prospective change in future net interest income from non-trading portfolios will be reflected in the current realisable value of these positions should they be sold or closed prior to maturity. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Markets or to separate books managed under the auspices of the local ALCO.

The transfer of market risk to trading books managed by Global Markets or ALCO is usually achieved by a series of internal deals between the business units and these trading books. When the behavioural characteristics of a product differ from its contractual characteristics, the behavioural characteristics are assessed to determine the true underlying interest rate risk. Local ALCOs regularly monitor all such behavioural assumptions and interest rate risk positions, to ensure they comply with interest rate risk limits established by the HSBC Group Management Board.

As noted above, in certain cases, the non-linear characteristics of products cannot be adequately captured by the risk transfer process. For example, both the flow from customer deposit accounts to more attractive investment products and the precise repayment levels of mortgages will vary at different interest rate levels. In such circumstances simulation modelling is used to identify the impact of varying scenarios on valuations and net interest income.

Once market risk has been consolidated in Global Markets or ALCO-managed books, the net exposure is typically managed through the use of interest rate swaps within agreed limits.

The principal non-trading risk which is not included in the VAR reported for Global Markets arises out of Fixed Rate Subordinated Notes issued during 2006. The VAR related to these instruments was £ 8.5 million at 31 December 2006; whilst the average, minimum and maximum during the year was £ 8.4 million, £ 7.6 million and £ 10.3 million respectively.

Market risk also arises within the group's defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. This risk principally derives from the pension schemes holding equities against their future pension obligations. The risk is that market movements in equity prices could result in assets which are insufficient over time to cover the level of projected liabilities. Management, together with the trustees who act on behalf of the pension scheme beneficiaries, assess the level of this risk using reports prepared by independent external actuaries.

The present value of the group's defined benefit pension schemes' liabilities was £13 billion at 31 December 2006 compared to £13 billion at 31 December 2005. Assets of the defined benefit schemes at 31 December 2006

Notes on the Financial Statements (continued)

comprised: equity investments 25 per cent (46 per cent at 31 December 2005); debt securities 59 per cent (30 per cent at 31 December 2005) and other (including property) 16 per cent (24 per cent at 31 December 2005).

Structural foreign exchange exposures

Structural foreign exchange exposures represent net investments in subsidiaries, branches or associated undertakings, the functional currencies of which are currencies other than the sterling.

Revaluation gains and losses on structural exposures are recorded in the consolidated statement of recognised income and expense. The main operating (or functional) currencies of the group's subsidiaries are sterling, euros, US dollars, Swiss francs, Turkish lira and Maltese lira.

The group's policy is to hedge structural foreign currency exposures only in limited circumstances. The group's structural foreign currency exposures are required to be managed with the primary objective of ensuring, where practical, that the group's consolidated capital ratios and the capital ratios of individual banking subsidiaries are protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question.

Market risk in group insurance businesses

Market risk also arises in the group's insurance businesses within their portfolios of investments and policyholder liabilities. The principal market risks are interest rate risk and equity risk, which primarily arise when guaranteed investment return policies have been issued. The insurance businesses have a dedicated HSBC market risk function which oversees management of this risk.

Insurance risk

Within its service proposition, the group offers its personal customers a wide range of insurance products, many of which complement other bank products.

Both life and non-life insurance is underwritten. Life insurance contracts include term assurance and critical illness cover, credit life business in respect of income and payment protection, annuities, pensions and participating business such as endowments. Non-life insurance contracts include motor, fire and other damage, and repayment protection.

The principal insurance risk faced by the group is that the costs of claims combined with acquisition and administration costs may exceed the aggregate amount of premiums received and investment income. The group manages its insurance risks through the application of formal underwriting, reinsurance and claims procedures. These procedures are designed also to ensure compliance with regulations.

The group's overall approach to insurance risk is to seek to maintain a good diversification of insurance business by type and to focus on risks that are straightforward to manage and frequently are directly related to the underlying banking activity. The following tables provide an analysis of the insurance risk exposures by type of business. These tables demonstrate that there is diversification of risk. Separate tables are provided for life and non-life business, reflecting their very distinct risk characteristics. Life business tends to be longer term than non-life and also frequently involves an element of savings and investment in the premium. For this reason the life insurance risk table provides an analysis of the insurance liabilities as the best available overall measure of the insurance exposure. By contrast for non-life business, the table uses written premium as representing the best available measure of risk exposure.

Both life and non-life business insurance risks are controlled through a combination of local and central procedures and policies. These include a centralised approach to the authorisation to write certain classes of business. For life business in particular, use is also made of risk management committees in order to monitor the risk exposures. Market risk limits are also applied centrally as an additional control over the extent of insurance risk that is retained.

As indicated in the specific comments relating to particular classes, use is also made of reinsurance as a means of further mitigating exposure, including protection against aggregations as a result of catastrophe risk.

Analysis of life insurance risk – policyholder liabilities before reinsurance

	2006 £m	2005 £m
Life (non-linked)		
Insurance contracts with DPF[1]	**100**	90
Credit life	**25**	48
Annuities	**138**	117
Term assurance and other long-term contracts	**573**	592
Total life (non-linked)	**836**	847
Life (linked)	**647**	697
Life insurance policyholder liabilities	**1,483**	1,544

1 *Insurance contracts with discretionary participation features ('DPF') give policyholders a contractual right to receive, as a supplement to their guaranteed benefits, additional benefits that are likely to be a significant portion of the total contractual benefits and whose amount or timing is contractually at the discretion of the group. The 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.*

For life insurance business, the insurance risk will vary considerably dependent on the type of business. The principal risks are in relation to mortality, morbidity, lapse and surrender, investment and expense levels. In addition to the local underwriting, claims handling and expense control management functions, the product diversity of the group's life insurance business provides an effective mitigation of exposure to insurance risk.

In general terms, mortality and morbidity risks are mitigated through medical underwriting and the ability in a number of cases to amend the premium in the light of changes in experience. Surrender risks are mitigated by the setting of appropriate surrender values. Market risk is generally mitigated through a combination of investment policy to match liabilities and the risk being shared with policyholders. In the case of unit linked business, all the market risk is borne by policyholders. In the case of life business with a discretionary participation feature, the risk is shared with policyholders through the management of bonuses.

The principal division of life business is between unit linked and non-linked. There are a number of major sub-categories of non-linked life assurance. Insurance contracts with discretionary participation features include with-profits business. Although *prima facie* this business entails significant market risk, this is managed in conjunction with other risks through the investment policy and adjustment to bonus rates. In practice this means that the majority of the market risk is borne by policyholders. The main risk associated with this product is the value of assigned assets falling below that required to support benefit payments. The group manages this risk by conducting regular actuarial investigations on the supportability of the bonus rates.

Credit life insurance business is written in relation to the banking products. The insurance risk relates to mortality and morbidity risk for the duration of the loans advanced. Claims experience is continuously monitored and premium rates adjusted accordingly. For much of this business, the average term of the credit risk exposure is for two to three years, which limits the insurance risk exposure.

Annuities are contracts providing income from capital investment paid in a stream of regular payments for either a fixed period or during the annuitant's lifetime. Deferred annuities are those where payments to the annuitant begin at a designated future date as opposed to immediate annuities where payments begin at once. The principal risks in respect of annuity business relate to longevity and a market risk in relation to the need to match investments against the anticipated cash flow profile of the policies. Investments are managed to match the anticipated cash flow profile, and the mortality risk is regularly monitored. Longevity risk is substantially reinsured out of the group.

The major components of the 'Term assurance and other long-term contracts' category are term assurance, income protection and critical illness. The principal risks are in respect of mortality and morbidity, and are mitigated through a combination of sound underwriting, premium adjustment in light of changes in experience and reinsurance.

For linked insurance business, all market risk is generally borne by policyholders. The principal risk retained by the group relate to expenses, although mortality, disability and morbidity risks are also associated with this product and are managed through the application of the techniques set out above for non-linked lines of business.

Notes on the Financial Statements (continued)

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

	2006 £m	2005 £m
Fire and other damage	**28**	20
Credit (non life)	**34**	124
Other (non life)	**5**	–
Total net written insurance premiums	**67**	144

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

The key risks associated with non-life business are underwriting risk and claims experience risk. Underwriting risk is the risk that the group does not charge premiums appropriate for the cover provided and claims experience risk is the risk that portfolio experience is worse than expected. The group manages these risks through prudent pricing (for example, imposing restrictions and deductibles in the policy terms and conditions), product design, risk selection, claims handling, investment strategy and reinsurance policy. All non-life insurance contracts are annually renewable and the underwriters have the right to refuse renewal or to change the terms and conditions of the contract at renewal.

Motor insurance business covers vehicle damage and liability for personal injury. It includes a substantial book from prior years, which is in run-off. Reinsurance protection has been arranged where necessary to avoid excessive exposure to larger losses, particularly those relating to personal injury claims.

In fire and other damage business the predominant focus is insurance for homes and contents. All portfolios at risk from catastrophic losses are protected by reinsurance in accordance with information obtained from professional risk modelling organisations.

The group's life insurance business is accounted for using the embedded value approach, which, *inter alia*, provides a comprehensive framework for the evaluation of insurance and related risks. The present value of the shareholders' interest in the profits expected to emerge from the book of in-force policies at 31 December 2006 can be stress tested to assess the ability of the book of life business to withstand adverse developments. A key feature of life insurance business is the importance of managing the assets, liabilities and risks in a coordinated fashion rather than individually. This reflects the greater interdependence of these three elements for life insurance than is generally the case for non-life insurance.

The following table shows the effect on the PVIF as at 31 December 2006 of reasonably possible changes in the main economic assumptions within the group's principal insurance underwriting subsidiary:

	2006 £m	2005 £m
+ 100 basis points shift in risk-free rate	–	(3)
– 100 basis points shift in risk-free rate	–	3
+ 100 basis points shift in risk discount rate	**(14)**	(14)
– 100 basis points shift in risk discount rate	**14**	14
+ 100 basis points shift in expenses inflation	**(3)**	(2)
– 100 basis points shift in expenses inflation	**3**	2
+ 100 basis points shift in lapse rate	**(3)**	(5)
– 100 basis points shift in lapse rate	**3**	5

The effects on PVIF shown above are illustrative only and employ simplified scenarios. They do not incorporate actions that could be taken by management to mitigate effects nor do they take account of consequential changes in policyholder behaviour.

General economic and business assumptions

The sensitivity of profit for the year and net assets to reasonably possible changes in conditions at 31 December 2006 across all insurance underwriting subsidiaries is as follows:

	Impact on:		Impact on:	
	Profit after tax for 2006 £m	**Net assets at 31 December 2006 £m**	Profit after tax for 2005 £m	Net assets at 31 December 2005 £m
Economic assumptions				
20 per cent increase in claims costs	**(1)**	**(1)**	(1)	(1)
20 per cent decrease in claims costs	**1**	**1**	1	1
Non-economic assumptions				
10 per cent increase in mortality and/or morbidity rates	**8**	**8**	8	8
10 per cent decrease in mortality and/or morbidity rates	**–**	**–**	1	1
50 per cent increase in lapse rates	**(24)**	**(24)**	(29)	(29)
50 per cent decrease in lapse rates	**35**	**35**	48	48
10 per cent increase in expense rates	**(5)**	**(5)**	(5)	(5)
10 per cent decrease in expense rates	**5**	**5**	5	5

A key aspect of the risk management for insurance business, and life insurance in particular, is the need to actively manage the assets in relation to the liabilities. Of particular importance for a number of lines of business is the need to match the expected pattern of cash flow, which in some cases (such as annuities) can run for many years.

40 Contingent liabilities and contractual commitments

Contingent liabilities and commitments

	The group		**The bank**	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Contract amounts				
Contingent liabilities				
Guarantees and irrevocable letters of credit pledged as collateral security:				
– one year and under	**14,582**	9,677	**11,472**	5,603
– over one year	**9,116**	8,541	**5,251**	4,759
Other contingent liabilities	**59**	60	**-**	-
	23,757	18,278	**16,723**	10,362
Commitments				
Documentary credits and short-term trade-related transactions	**1,414**	1,423	**532**	695
Forward asset purchases and forward forward deposits placed	**54**	160	**–**	–
Undrawn note issuing and revolving underwriting facilities	**32**	28	**–**	–
Undrawn formal standby facilities, credit lines and other commitments to lend:				
– one year and under	**100,248**	95,714	**74,111**	70,126
– over one year	**29,604**	29,834	**19,693**	19,990
	131,352	127,159	**94,336**	90,811

The above table discloses the nominal principal amounts of third party off-balance sheet transactions.

Contingent liabilities and commitments are credit-related instruments which include letters of credit, guarantees and commitments to extend credit. Contractual amounts represent the amounts at risk should contracts be fully drawn upon and clients default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contractual amounts is not representative of future liquidity requirements.

Notes on the Financial Statements (continued)

The bank and its subsidiaries are contingently liable with respect to lawsuits and other matters that arise in the normal course of business. Management is of the opinion that the eventual outcome of the legal and financial liability is not expected to materially affect the group's financial position and operations.

In relation to joint ventures and associates, the group had no contingent liabilities or commitments, incurred jointly or otherwise.

Guarantees

The group provides guarantees and similar undertakings on behalf of both third party customers and other entities within the group. These guarantees are generally provided in the normal course of the group's banking business. The principal types of guarantees provided, and the maximum potential amount of future payments which the group could be required to make at 31 December 2006 were as follows:

The group

	At 31 December 2006		At 31 December 2005	
	Guarantees in favour of third parties £m	**Guarantees by the group in favour of other HSBC group entities £m**	Guarantees in favour of third parties £m	Guarantees by the group in favour of other HSBC group entities £m
Guarantee type				
Financial guarantees[1]	**8,925**	**729**	8,310	592
Standby letters of credit which are financial guarantees[2]	**32**	**–**	172	–
Other direct credit substitutes[3]	**846**	**19**	747	–
Performance bonds[4]	**505**	**19**	628	43
Bid bonds[4]	**82**	**4**	95	3
Standby letters of credit related to particular transactions[4]	**320**	**–**	626	50
Other transaction-related guarantees[4]	**12,156**	**48**	6,895	34
Other items	**72**	**–**	84	(1)
Total	**22,938**	**819**	17,557	721

The bank

	At 31 December 2006		At 31 December 2005	
	Guarantees in favour of third parties £m	**Guarantees by the group in favour of other HSBC group entities £m**	Guarantees in favour of third parties £m	Guarantees by the group in favour of other HSBC group entities £m
Guarantee type				
Financial guarantees[1]	**6,786**	**557**	6,525	464
Standby letters of credit which are financial guarantees[2]	**–**	**–**	–	–
Other direct credit substitutes[3]	**6**	**–**	8	–
Performance bonds[4]	**495**	**19**	604	41
Bid bonds[4]	**30**	**3**	46	3
Standby letters of credit related to particular transactions[4]	**90**	**–**	99	–
Other transaction-related guarantees[4]	**8,713**	**15**	2,535	15
Other items	**9**	**–**	23	(1)
Total	**16,129**	**594**	9,840	522

1 *Financial guarantees include undertakings to fulfill the obligations of customers or group entities should the obligated party fail to do so. Intra-group financial guarantees include a guarantee of a capital nature issued by the group to a group entity for inclusion as capital support by the latter's regulator.*
2 *Standby letters of credit which are financial guarantees are irrevocable obligations on the part of HSBC Bank plc to pay a third party when a customer fails to meet a commitment.*
3 *Other direct credit substitutes include re-insurance letters of credit and trade-related letters of credit issued without provision for the issuing entity to retain title to the underlying shipment.*
4 *Performance bonds, bid bonds, standby letters of credit and other transaction-related guarantees are undertakings by which the requirement to make payment under the guarantee depends on the outcome of a future event which is unconnected to the creditworthiness of the customer.*

The amounts disclosed in the above table reflect the group's maximum amounts payable under a large number of individual guarantee undertakings. The risks and exposures arising from guarantees are captured and managed in accordance with the group's overall credit risk management policies and procedures.

Approximately one half of the above guarantees have a term of less than one year. Guarantees with a term of more than one year are subject to the group's annual credit review process.

When the group gives a guarantee on behalf of a customer, it retains the right to recover from that customer amounts paid under the guarantee.

Provisions in respect of the group's obligations under outstanding guarantees

	2006	2005
	£m	£m
Guarantees and items pledged as collateral security	**14**	12
Other items	**4**	28

The group had commitments to purchase within one year, land and buildings and other fixed assets from a number of suppliers for a value of £330 million at 31 December 2006 (2005: £523 million).

41 Lease commitments

Finance lease commitments

	2006			2005		
	Total future minimum payments £m	**Interest charges £m**	**Present value £m**	Total future minimum payments £m	Interest charges £m	Present value £m
No later than one year	**15**	**(14)**	**1**	14	(14)	–
Later than one year and no later than five years	**66**	**(63)**	**3**	63	(56)	7
Later than five years	**356**	**(32)**	**324**	359	(42)	317
	437	**(109)**	**328**	436	(112)	324

In 2006 £nil (2005: £nil) was paid as contingent rents and charged to 'General and administrative expenses'.

Future minimum sublease payments of £83 million (2005: £14 million) were expected to be received under non-cancellable subleases at 31 December 2006.

Operating lease commitments

At 31 December 2006, the group was obligated under a number of non-cancellable operating leases for properties, plant and equipment for which the future minimum lease payments extend over a number of years.

	Land and buildings	
	2006	2005
	£m	£m
Future minimum lease payments under non-cancellable operating leases expiring:		
– no later than one year	**94**	125
– later than one year and no later than five years	**307**	418
– later than five years	**361**	597
	762	1,140

At 31 December 2006, future minimum sublease payments of £nil (2005: £nil) were expected to be received under the non-cancellable subleases at the balance sheet date.

In 2006, £100 million (2005: £80 million) was charged to 'General and administrative expenses' in respect of lease and sublease agreements, all of which related to minimum lease payments.

Notes on the Financial Statements (continued)

Finance lease receivables

	2006			2005		
	Total future minimum payments £m	**Unearned finance income £m**	**Present value £m**	Total future minimum payments £m	Unearned interest income £m	Present value £m
Lease receivables:						
– no later than one year	**486**	**(87)**	**399**	530	(12)	518
– later than one year and no later than five years	**2,049**	**(380)**	**1,669**	1,319	(372)	947
– later than five years	**3,535**	**(1,169)**	**2,366**	2,973	(1,152)	1,821
	6,070	**(1,636)**	**4,434**	4,822	(1,536)	3,286

At 31 December 2006, unguaranteed residual values of £77 million (2005: £nil) had been accrued, and the accumulated allowance for uncollectible minimum lease payments receivable amounted to £9 million (2005: £1 million).

In 2006, £25 million (2005: £nil) was received as contingent rents and recognised in 'Other operating income'.

Operating lease receivables

	Equipment	
	2006 £m	2005 £m
Future minimum lease payments under non-cancellable operating leases expiring:		
– no later than one year	**228**	203
– later than one year and no later than five years	**737**	587
– later than five years	**292**	236
	1,257	1,026

The group leases a variety of different assets to third parties under operating and finance lease arrangements, including rolling stock, property, aircraft and general plant and machinery.

42 Litigation

The group, through a number of its subsidiary undertakings, is named in and is defending legal actions in various jurisdictions arising from its normal business. No material adverse impact on the financial position of the group is expected to arise from these proceedings.

43 Related party transactions

The ultimate parent company of the group is HSBC Holdings plc, which is incorporated in England.

The Group's related parties include the parent, fellow subsidiaries, associates, joint ventures, post-employment benefit plans for the benefit of HSBC employees, key management personnel, close family members of key management personnel and entities which are controlled, jointly controlled or significantly influenced by key management personnel or their close family members.

Transactions, arrangements and agreements involving Directors and others

The table below sets out transactions which fall to be disclosed under IAS 24 'Related Party Disclosures' between the group and the Key Management Personnel of both the bank and its parent company, HSBC Holdings plc, and their connected persons or controlled companies.

Key Management Personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of HSBC Bank plc and the Group and includes members of the Board of Directors of HSBC Bank Plc and HSBC Holdings Plc and Managing Directors of HSBC Holdings Plc.

	2006			2005		
	Number of persons	**Highest balance during the year[1] £000**	**Balance at 31 December[1] £000**	Number of persons	Highest balance during the year[1] £000	Balance at 31 December[1] £000
Key Management Personnel and connected persons and companies controlled by them						
Loans	**54**	**158,512**	**103,069**	54	201,025	88,141
Credit cards	**47**	**681**	**443**	42	274	121
Guarantees	**3**	**5,911**	**5,202**	1	12	12

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

In addition to the disclosures of related party transactions with Key Management Personnel under IAS 24, the group is required to disclose particulars of transactions, arrangements and agreements entered into by HSBC Bank plc and its subsidiaries with Directors and connected persons and companies controlled by them and with officers of HSBC Bank plc pursuant to section 232 of the Companies Act 1985. Under the Companies Act there is no requirement to disclose transactions with the Key Management Personnel of the bank's parent company, HSBC Holdings plc.

	2006		2005	
	Number of persons	**Balance at 31 December £000**	Number of persons	Balance at 31 December £000
Directors and connected persons and companies controlled by them				
Loans	**17**	**8,369**	19	11,541
Credit cards	**18**	**92**	19	57
Guarantees	**1**	**12**	1	12
Officers				
Loans	**32**	**7,003**	32	3,037
Credit cards	**20**	**113**	18	81
Guarantees	**–**	**–**	–	–

Compensation to the Key Management Personnel of the group under IAS 24

	2006 £000	2005 £000
Short-term employee benefits	**5,534**	6,529
Post-employment benefits	**400**	287
Share-based payment	**3,081**	3,650
	9,015	10,466

All transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Directors' and other key management personnel shareholdings and options

	Balance at 31 December 2006	Balance at 31 December 2005
Number of share options from equity participation plans held by Directors and other key management personnel (and their connected persons)	**1,571,328**	1,584,097
Number of shares held by Directors and other key management personnel (and their connected persons)	**3,900,008**	3,680,910

Notes on the Financial Statements (continued)

Transactions with other related parties

Associates and joint ventures

The group

	2006		2005	
	Highest balance during the year[1]	**Balance at 31 December 2006[1]**	Highest balance during the year[1]	Balance at 31 December 2005[1]
	£m	**£m**	£m	£m
Amounts due from joint ventures				
– Subordinated	**–**	**–**	–	–
– Unsubordinated	**342**	**24**	408	342
Amounts due from associates				
– Subordinated	**19**	**19**	19	–
– Unsubordinated	**54**	**33**	305	18
Amounts due to joint ventures	**804**	**12**	804	804
Amounts due to associates	**166**	**166**	47	47

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

The bank

	2006		2005	
	Highest balance during the year[1]	**Balance at 31 December[1]**	Highest balance during the year[1]	Balance at 31 December[1]
	£m	**£m**	£m	£m
Amounts due from joint ventures				
– Subordinated	**–**	**–**	–	–
– Unsubordinated	**342**	**–**	373	342
Amounts due from associates				
– Subordinated	**–**	**–**	–	–
– Unsubordinated	**18**	**1**	305	18
Amounts due to joint ventures	**763**	**–**	763	763
Amounts due to associates	**47**	**29**	47	47

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Transactions of the group with HSBC Holdings plc and fellow subsidiaries of HSBC Holdings plc

Transactions detailed below include amounts due to/from HSBC Holdings plc and due to/from subsidiaries of HSBC Holdings plc.

	2006		2005	
	Highest balance during the year[1]	**Balance at the year end[1]**	Highest balance during the year[1]	Balance at the year end[1]
	£m	**£m**	£m	£m
Assets				
Trading assets	**3,018**	**2,323**	731	563
Derivatives	**12,981**	**4,061**	9,428	3,413
Loans and advances to banks	**5,441**	**3,685**	6,742	5,200
Loans and advances to customers	**2,661**	**660**	3,627	1,657
Financial investments	**6,342**	**5,494**	6,353	6,120
Other assets	**2,996**	**370**	1,323	296

	2006		2005	
	Highest balance during the year[1]	**Balance at the year end[1]**	Highest balance during the year[1]	Balance at the year end[1]
	£m	**£m**	£m	£m
Liabilities				
Trading liabilities	**3,048**	**2,793**	–	–
Deposits by banks	**7,837**	**4,345**	6,898	6,898
Customer accounts	**5,045**	**3,824**	7,888	3,594
Derivatives	**14,564**	**5,722**	10,967	3,979
Guarantees	**137**	**137**	78	69

	For the year ended 31 December 2006	For the year ended 31 December 2005
	£m	£m
Income Statement		
Interest Income	**491**	437
Interest expense	**445**	343
Dividend income	**10**	4
Fee income	**102**	49
Fee expense	**111**	69
Trading income	**120**	–
Other operating income	**30**	26
General and administrative expenses	**83**	44

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Transactions between HSBC Bank plc and its subsidiaries, HSBC Holdings plc and fellow subsidiaries of HSBC Holdings plc

Transactions detailed below include amounts due to/from HSBC Bank plc and its subsidiaries.

	2006		2005	
	Highest balance during the year[1]	**Balance at the year end[1]**	Highest balance during the year[1]	Balance at the year end[1]
	£m	**£m**	£m	£m
Assets				
Trading assets	**6,706**	**4,961**	27	21
Derivatives	**4,612**	**4,612**	3,546	3,189
Loans and advances to banks	**9,667**	**3,521**	8,360	5,559
Loans and advances to customers	**8,930**	**6,546**	7,722	7,469
Financial investments	**–**	**–**	785	–
Other assets	**–**	**–**	–	–
Liabilities				
Trading liabilities	**5,523**	**2,991**	–	–
Deposits by banks	**12,557**	**8,345**	12,085	9,261
Customer accounts	**10,144**	**10,144**	8,085	8,085
Derivatives	**4,487**	**4,020**	3,061	2,563
Guarantees	**496**	**460**	–	–

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

Notes on the Financial Statements (continued)

Transactions detailed below include amounts due to/from HSBC Bank plc and HSBC Holdings plc and due to/from HSBC Bank plc and fellow subsidiaries of HSBC Holdings plc.

	2006		2005	
	Highest balance during the year[1]	**Balance at the year end[1]**	Highest balance during the year[1]	Balance at the year end[1]
	£m	**£m**	£m	£m
Assets				
Trading assets	**2,949**	**2,204**	197	117
Derivatives	**2,602**	**2,366**	2,438	2,438
Loans and advances to banks	**5,122**	**3,075**	6,250	4,561
Loans and advances to customers	**2,460**	**544**	2,779	1,458
Financial investments	**–**	**–**	–	–
Other assets	**232**	**98**	256	84
Liabilities				
Trading liabilities	**2,984**	**2,733**	–	–
Deposits by banks	**4,317**	**2,105**	3,720	3,720
Customer accounts	**4,591**	**3,562**	5,146	2,991
Derivatives	**3,667**	**3,667**	3,421	2,814
Guarantees	**97**	**97**	–	–

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

Pension funds

At 31 December 2006, fees of £1.6 million (2005: £1.4 million) were earned by group companies for management services related to the group's pension funds held under management. The group's pension funds had placed deposits of £143 million (2005: £105 million) with its banking subsidiaries.

The above outstanding balances arose from the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with third party counterparties.

HSBC Bank (UK) Pension Scheme (the "Scheme") has entered into swap transactions with the bank to manage the inflation and interest rate sensitivity of the liabilities. At 31 December 2006, the gross notional value of the swaps was £7,390 million, the swaps had a positive fair value of £139 million and the bank had delivered collateral of £133 million to the Scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid-offer spreads.

In order to satisfy diversification requirements, the Trustee has requested special collateral provisions for the swap transactions between the bank and the Scheme. The collateral agreement stipulates that the Scheme never posts collateral to the bank. Collateral is posted to the Scheme by the bank at an amount that the Trustee is highly confident would be sufficient to replace the swaps in the event of default by the bank. Under the terms of the agreement, increases in collateral when required, are posted by the bank on a daily basis and any reductions of collateral are repaid to the bank on a monthly basis.

With the exception of the special collateral arrangements detailed above, all other aspects of the swap transactions between the bank and the Scheme are on substantially the same terms as comparable transactions with third party counterparties.

44 Events after the balance sheet date

On 1 January 2007, HSBC Bank plc acquired 100% of the share capital of HSBC Insurance Brokers Holdings Ltd ('HIBHL') for a cash consideration of £115 million, which may be subject to revision following final determination of the fair value of assets acquired. HIBHL and its group of subsidiaries are specialists in the provision of insurance broking, risk management and employee benefits services for commercial and corporate customers, as well as the underwriting of personal and commercial non-life risks.

Details of net assets acquired are as follows:

	£m
Purchase consideration:	
– Cash paid	115
Total purchase consideration	115
Fair value of assets acquired	115

The fair values of the assets, liabilities and contingent liabilities arising from the acquisition, provisionally determined, are as follows:

At date of acquisition	Fair value £m	Carrying value immediately prior to acquisition £m
Cash and cash equivalents	329	329
Trade and other receivables	639	639
Intangible assets	35	35
Property, plant and equipment	4	4
Other investments	126	126
Trade and other payables	(1,018)	(1,018)
Net assets acquired	115	115

As a consequence of inviting proposals for a sale and leaseback of 8 Canada Square, London, under an operating lease arrangement, the property has, after the balance sheet date, been reclassified as a non-current asset held for sale in accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' at its carrying amount. At 31 December 2006, the net book value of the property, included in 'Property, plant and equipment' was £378 million and the carrying amount of the long leasehold land, included in 'Prepayments and accrued income', was £107 million. The building and leasehold land are included in the assets for the United Kingdom geographical segment and the UK Personal Financial Services, UK Commercial Banking and UK Corporate, Investment Banking and Markets business segments.

There have been no other material events after the balance sheet date which would require disclosure or adjustment to the 31 December 2006 financial statements.

On 5 March 2007, the Board of Directors authorised the financial statements for issue.

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