2007

Annual Report and Accounts
HSBC Bank plc

The world's local bank

Annual Report and Accounts 2007

Contents

Page

Financial Highlights 1

Board of Directors and Senior Management 2

Report of the Directors 4

Statement of Directors' Responsibilities in Relation to the Directors' Report and the Financial Statements 28

Independent Auditor's Report to the Member of HSBC Bank plc 29

Financial Statements

Consolidated income statement for the year ended 31 December 2007 30

Consolidated balance sheet at 31 December 2007 31

Consolidated statement of recognised income and expense for the year ended 31 December 2007 32

Consolidated cash flow statement for the year ended 31 December 2007 33

HSBC Bank plc balance sheet at 31 December 2007 34

HSBC Bank plc statement of recognised income and expense for the year ended 31 December 2007 35

HSBC Bank plc cash flow statement for the year ended 31 December 2007 36

Notes on the Financial Statements 37

Presentation of Information

This document comprises the *Annual Report and Accounts 2007* for HSBC Bank plc ('the bank') and its subsidiary undertakings (together 'the group'). It contains the Directors' Report and Accounts, together with the Auditor's 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.

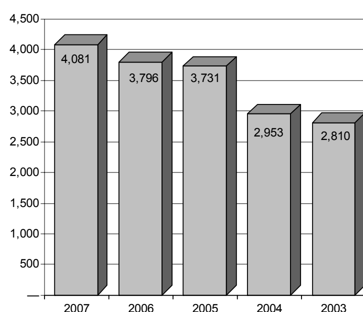
Statements that are not historical facts, including statements about the bank's beliefs and expectations, are forward-looking statements. Words such as 'expects', 'anticipates', 'intends', 'plans', 'believes', 'seeks', 'estimates', 'potential' and 'reasonably possible', variations of these words and 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.

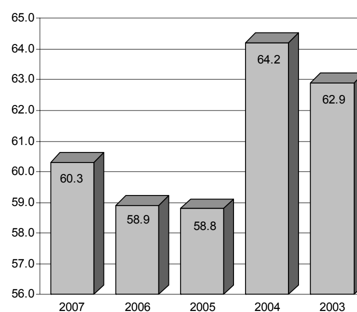
Financial Highlights

	2007	2006	2005[4]	2004	2003
	£m	£m	£m	£m	£m
For the year[1,2]					
Profit on ordinary activities before tax[3]	**4,081**	3,796	3,731	2,953	2,810
Profit attributable to shareholders of the parent company[3]	**3,227**	2,722	2,842	2,057	2,046
At year-end					
Shareholders' funds of the parent company	**24,423**	20,399	19,091	16,828	17,064
Capital resources	**24,231**	21,360	19,677	16,424	14,603
Customer accounts and deposits by banks	**317,055**	265,863	239,673	193,664	175,390
Total assets	**622,280**	440,760	386,422	292,481	246,104
Ratios (%)					
Return on average shareholders' funds (equity) of the parent company	**14.5**	13.6	16.4	12.7	8.5
Capital ratios					
– total capital	**10.9**	11.2	10.8	10.5	10.7
– tier 1 capital	**7.5**	7.5	6.9	7.4	7.4
Cost efficiency ratio[5]	**60.3**	58.9	58.8	64.2	62.9

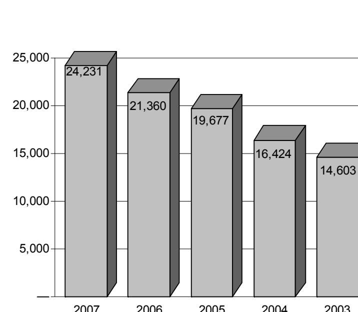
Profit on ordinary activities before tax (£m)



Cost efficiency 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 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 2003 exclude goodwill amortisation.*
4 *Restated 2005 income statement and balance sheet figures.*
5 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*

The financial highlights are influenced by changes in the group structure over the five years. The most significant acquisition during this period was the acquisition of Marks and Spencer Retail Financial Services Holdings Limited in 2004.

Board of Directors and Senior Management

Directors

S K Green, Chairman

Age 59. Chairman since 2005 and a Director since 1995. Deputy Chairman from 2003 to December 2004. Group Chairman of HSBC Holdings plc since 2006. Group Chief Executive of HSBC Holdings plc from 2003 to 2006. Joined HSBC in 1982. Chairman of HSBC North America Holdings Inc. and HSBC Private Banking Holdings (Suisse) SA.

M F Geoghegan, **CBE**, Deputy Chairman

Age 54. Deputy Chairman since 2006 and a Director since 2004. Chief Executive from 2004 to 2006. Group Chief Executive of HSBC Holdings plc since 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.

D D J John, Chief Executive

Age 57. Chief Executive since 2006 and a Director since 2003. A Group Managing Director since 2006. Joined HSBC in 1971.

S P O'Sullivan, Chief Operating Officer

Age 52. A Director and Chief Operating Officer since August 2007. Joined HSBC in 1980. A Director of HFC Bank Limited since June 2007 and Marks and Spencer Financial Services plc since November 2007.

D C Budd, Director International

Age 54. Director International since August 2007. Chief Operating Officer from 2005 to August 2007. A Director since 2005. A Group General Manager since 2005. Joined HSBC in 1972. Chairman of HSBC Bank Polska SA since September 2007 and HSBC Bank (RR) LLC from October 2007.

C-H Filippi*

Age 55. A Director since 2000. Non-Executive Chairman of HSBC France. A Director of HSBC Private Banking Holdings (Suisse) SA.

J D Fishburn**

Age 61. A Director since 2003. Chairman of HFC Bank Limited and an independent non-executive Director of HSBC Finance Corporation.

S T Gulliver

Age 48. A Director since 2006. Head of Global Banking and Markets and HSBC Global Asset Management. A Group Managing Director since 2004. Joined HSBC in 1980. A Director of HSBC Private Banking Holdings (Suisse) SA since September 2007 and HSBC Trinkaus & Burkhardt AG since June 2007. A Director of HSBC Bank USA , N.A. and The Hongkong and Shanghai Banking Corporation Limited.

C M S Jones**

Age 64. A Director since 2001. Formerly Chairman and Managing Director, James Beattie PLC.

R E S Martin**

Age 47. A Director since 2005. General Counsel and Company Secretary of Reuters Group PLC.

A R D Monro-Davies**

Age 67. A Director since 2004. Formerly Chief Executive Officer, Fitch Ratings.

P M Shawyer**

Age 57. A Director since 2004. Formerly a Managing Partner of Deloitte.

J F Trueman**

Age 65. A Director since 2004. Formerly Deputy Chairman of S G Warburg & Co.

* *Non Executive Director*

** *Independent Non-Executive Director*

Secretary

J H McKenzie

Age 54. Joined HSBC in 1987.

Registered Office: 8 Canada Square, London E14 5HQ

Senior executives

J P Armstrong

Age 48. Chief Information Officer, HSBC Technology Services Europe. Joined HSBC in 1982.

P Boyles

Age 52. Chief Executive Officer, HSBC France. Joined HSBC in 1975. A Group General Manager since 2006.

B M Cannon

Age 52. General Manager and Head of Credit and Risk. Joined HSBC in 1982.

J M Flint

Age 39. Group Treasurer and Deputy Head of Global Markets. Joined HSBC in 1989.

J D Garner

Age 38. General Manager, Personal Financial Services and Direct Businesses. Joined HSBC in 2004. A Group General Manager since 2006.

J E Harding

Age 55. Head of Human Resources. Joined HSBC in 1981.

A M Keir

Age 49. General Manager, Commercial Banking. Joined HSBC in 1981. A Group General Manager since 2006.

S J Large

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

A M Mahoney

Age 45. General Manager and Head of the Network. Joined HSBC in 1983. A Group General Manager since 2006.

M S McCombe, OBE

Age 41. Global Chief Executive Officer HSBC Asset Management. Joined HSBC in 1987.

R K McGregor

Age 59. Chief Financial Officer. Joined HSBC in 1977.

P M Nolan

Age 42. Head of UK Corporate Banking. Joined HSBC in 1987.

C Schnor

Age 48. General Manager and Head of Insurance. Joined HSBC in 2007.

D K Sheehan

Age 46. Chief Executive Officer HSBC Private Bank, UK and Channel Islands. Joined HSBC in 2006.

R G Spence

Age 48. General Manager and Head of Special Projects. Joined HSBC in 1978.

Report of the Directors

Results for 2007

The consolidated profit for the year attributable to the shareholders of the bank was £3,227 million.

First and second interim dividends of £840 million and £825 million were paid on the ordinary share capital during the year. The Directors have recommended the payment of an interim dividend of £1,000 million on the ordinary share capital which has not been included as a liability, having been approved after 31 December 2007.

Further information about the results is given in the consolidated income statement on page 30.

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 Global Banking and Markets; International Banking; HSBC France; Private Banking; and HSBC Trinkaus & Burkhardt.

As at 31 December 2007, the bank had 1,475 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, the Hong Kong Special Administrative Region, Ireland, Israel, Italy, the Netherlands, Slovakia, and Spain; it has representative offices in Cyprus, and Venezuela; and its subsidiaries have branches and offices in Armenia, the Channel Islands, the Czech Republic, France, Georgia, Germany, Greece, the Hong Kong Special Administrative Region, Hungary, Ireland, Israel, Kazakhstan, Luxembourg, Malta, Poland, Russia, South Africa, Slovakia, Switzerland and Turkey.

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

Significant events

In February 2007, the Board of Directors of the bank agreed to market its property at 8 Canada Square, London to enter into a sale and leaseback transaction on the property. On 30 April 2007, the bank announced that it had agreed the sale and leaseback of the property, with a wholly owned subsidiary of Metrovacesa, S.A. for £1.09 billion. Under the terms of the transaction, the bank retained full control of occupancy decisions while Metrovacesa took a 998-year lease on the property. The bank has leased the building back for 20 years at an annual rent of £43.5 million with an option to extend for a further five years. The treatment of this transaction within the accounts is described in Note 24 'Other Assets'.

Given funding constraints in the Structured Investment Vehicle ("SIV") sector, the bank announced on 26 November 2007 that it intended to restructure its two SIVs, Cullinan Finance Limited ("Cullinan") and Asscher Finance Limited ("Asscher"). Through a combination of liquidity facilities and term funding, investors in Cullinan and Asscher will be provided with the option to exchange their existing Income Notes and Mezzanine Notes for notes issued by one or more new vehicles. Each of these new vehicles will be funded either by commercial paper backed by a 100 per cent liquidity facility, or by term financing, both to be provided by the bank. This change has resulted in approximately £23 billion of additional assets and related funding being included on the bank's consolidated balance sheet. The bank expects no material impact to its earnings and a limited impact on regulatory capital requirements.

Summary of Financial Performance

	2007 £m	2006 £m
Net interest income	**3,854**	4,196
Net fee income	**4,184**	3,742
Other income	**4,762**	3,680
Net operating income before loan impairment charges and credit risk provisions	**12,800**	11,618
Loan impairment charges and other credit risk provisions	**(1,043)**	(938)
Net operating income	**11,757**	10,680
Total operating expenses	**(7,723)**	(6,844)
Operating profit	**4,034**	3,836
Share of profit / (loss) in associates and joint ventures	**47**	(40)
Profit on ordinary activities before tax	**4,081**	3,796
Tax on profit on ordinary activities	**(767)**	(978)
Profit on ordinary activities after tax	**3,314**	2,818
Attributable to shareholders of the parent company	**3,227**	2,722

In the following commentary, reference to 'underlying basis' refers to results after adjustment for the effects of acquisitions and disposals. The main acquisitions in the year were the transfer of HSBC Insurance Brokers Holdings Limited ('Insurance Brokers') in the UK from elsewhere in the HSBC Group and the acquisition of the remaining shares of life insurer Erisa and the property and casualty insurer Erisa IARD from Swiss Life in France, together now renamed as HSBC Assurances.

Net interest income includes the cost of funding trading assets, while the related revenues are reported in trading income. As the bank has expanded trading activities and enhanced capabilities, the cost of funding has increased accordingly. In segmental results, the cost of funding net long positions is included within Global Banking and Markets' net trading income as an interest expense.

Excluding the cost of funding trading assets noted above, underlying net interest income was £520 million or 10 per cent higher.

Loans and advances to customers increased by 14 per cent during the year. In the UK, interest earned on higher commercial lending and trading assets was partly offset by narrower margins. The tightening of credit criteria in the face of concerns regarding customer over-indebtedness and increasing personal insolvency suppressed personal lending growth.

Strong growth in property lending in France was partially 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 18 per cent mainly in the UK where growth in personal savings and interest bearing current accounts was boosted by higher commercial deposits and increased money market deposits.

Net fee income rose by £442 million, or 12 per cent, with increases across the bank. In the UK, growth from fee-earning packaged current accounts was partly offset by lower income from creditor and life protection.

On an underlying basis and excluding the cost of funding trading assets mentioned above, other income increased £19 million or 1 per cent year on year. Income growth arose mainly from gains on foreign exchange and other trading transactions together with gains on the sale of financial investments partially offset by write downs in the credit and structured derivatives business following the credit market dislocation in the second half of the year.

Loan impairment charges increased by £105 million, or 11 per cent largely from charges on a small number of customers in UK Commercial Banking, a higher charge in International Banking and lower net recoveries in both France and UK Global Banking and Markets. Loan impairment

charges in UK Personal Financial Services were 2 per cent below 2006.

Underlying operating expenses increased by £651 million, or 10 per cent. Excluding ex gratia payments expensed in respect of overdraft fees applied in previous years of £115 million, and a provision for reimbursement of certain charges on historic will trusts and other related services[1], expense growth mainly arose from investment in branch refurbishment and expansion in the UK and Turkey together with investment in core systems in France.

The bank's share of profit in associates and joint ventures increased £87 million largely from higher profits prior to integration of HSBC Assurances together with the non-recurrence of a loss arising from an impairment charge on a private equity investment held by an associate in 2006.

Taxation decreased by £211 million, or 22 per cent predominantly due to tax benefits on the sale and leaseback of various bank owned properties, including the head office building and the release of deferred tax on the restructuring of group companies.

Environment

Economy

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

The expansion of the eurozone economy continued steadily in 2007, with GDP growth of 2.6 per cent. As in the UK, much of the momentum came from strength in business investment and exports as global demand remained strong, particularly from emerging markets. Consumption was relatively subdued, despite declining unemployment, although fiscal reforms (particularly in Germany) and higher inflation are believed to have depressed household expenditure. Eurozone inflation increased steadily during the second half of the year, to an annual rate of 3.1 per cent in December, driven largely by rises in food and energy prices. The European Central Bank raised interest rates by 50 basis points, to finish the year at 4 per cent.

In France GDP growth slowed to 1.9 per cent from 2.2 per cent in 2006 with lower exports and residential investment. The exemption of overtime pay from income and social welfare taxes introduced after the Presidential election has supported household disposable income and the unemployment rate has declined. However, higher fuel and food prices hit real disposable income and weighed heavily on manufactured goods consumption. Nevertheless, household consumption remained a key driver of growth in 2007.

In Turkey, economic activity softened as the year progressed, with GDP rising by 3.9 per cent during the first three quarters of 2007 against the comparable period of 2006. Headline inflation remained under pressure from increases in energy and food prices, though core indicators improved markedly, prompting Turkey's central bank cautiously to ease monetary policy. The current account deficit stabilised at around 7 per cent of GDP with rising service sector receipts from tourism, although high energy costs may cause the trade balance to deteriorate.

Competition and Regulation

Across Europe, in all sectors, HSBC competes with a growing range of institutions. Markets are characterised by rapid innovation, margin compression through competition, and a constant flow of new entrants. Regulators monitor and investigate the financial services sector closely and conduct reviews into the long-term evolution of the industry as well as enforcing legislation with the aim of improving competition and protecting consumers.

The group is committed to undertaking a responsible and forward-thinking role in all of its markets, working closely with regulators, legislators and other stakeholders and seeking to develop its businesses within the spirit and letter of the law and regulatory frameworks.

1 Note 29 on page 108 refers

As major banks move to the new Basel II capital adequacy framework (see page 17), their capital requirements will necessarily and constructively be more closely matched with their risk positions. In an environment of economic uncertainty, many banks may need to reduce lending due to forecast increases in capital requirements arising from any deterioration in the quality of their credit risk exposures. This reduction in risk appetite may potentially accelerate the deterioration in credit quality as credit is withdrawn during a downturn in the economic cycle. Coupled with a lack of market liquidity, this may lead to polarisation within the banking system. Banks with greater capital and liquidity resources are better placed to meet the ongoing banking requirements of their customers than other banks which are more restrained in this regard.

Europe

In November 2007, the European Commission announced that, to improve the competitiveness and efficiency of European retail financial services markets, reviews would be undertaken. These reviews are intended to improve customer choice and mobility within the single market, better facilitate retail insurance markets, progress towards adequate and consistent rules for the distribution of retail investment products and promote financial education, financial inclusion and adequate redress for consumers.

Following a long running investigation, the Competition Directorate-General determined that MasterCard's multilateral interchange fees for cross-border payment card transactions violate EU competition rules. MasterCard has six months to comply or respond. HSBC is fully engaged in the case through its membership of MasterCard.

A number of EU key measures intended to facilitate development of the single market and increase competition came into effect during the year; principally transposition of the Markets in Financial Instruments Directive in November 2007. Implementation of phase 1 of the Single Euro Payments Area programme occurred on 28 January 2008.

UK

Financial services, including retail banking, is a highly competitive sector in the UK, led by several national and international institutions, which compete on both price and service quality. The sector is closely regulated, and a series of investigations with particular relevance to Personal Financial Services remain in progress.

In July 2007, a group of seven banks (including HSBC) and one building society announced that they had agreed with the Office of Fair Trading (‘OFT’) that the legal status and enforceability of certain charges applied to their personal customers in relation to unauthorised overdrafts should be tested in the High Court. Certain preliminary issues in the case came before the High Court in a trial starting in January 2008 and this part of the case concluded in February 2008. At the date of this report, judgement in the case is awaited. The OFT is also conducting a market study into competition for personal current accounts.

The Competition Commission ('CC') commenced an investigation into the Payment Protection Insurance (‘PPI’) market in February 2007 and published its Emerging Thinking document in November 2007. Provisional findings are due in May 2008 and the final report towards the end of the year. The Financial Services Authority (‘FSA’) conducted the third phase of its review of the sales processes and systems around the sale of PPI policies and is now undertaking further assessment of firms’ performance in this area.

In December 2007, the CC announced its decision to lift the price controls imposed in 2003 on HSBC and the other three largest banks providing services to small and medium sized enterprises in the UK. This is expected to result in greater competition and innovation within the market.

During 2007 the OFT continued to investigate competition issues in connection with the setting of multilateral interchange fees for domestic credit card payments.

France

In 2007, interest rates in the eurozone increased while growth in real estate investment stabilised. Income tax relief on new personal real estate loans was introduced following the presidential elections though potential benefits were offset by higher interest rates. Real estate mortgage loans remained the primary product by which banks attracted new customers and, as a result, competitive pricing led to decreased margins.

Report of the Directors (continued)

The French government introduced various fiscal incentives in the second half of 2007, which reduced tax on overtime pay and introduced a cap on the total tax paid by households at 50 per cent of income. These measures will increase the disposable income of wealthier individuals who qualify for HSBC Premier and Private Banking services.

The commercial treasury bills market contracted and companies had difficulty obtaining facilities in the second half of 2007 due to market uncertainty. This trend is expected to continue in 2008.

Turkey

Financial services is a highly competitive market in Turkey mainly comprising large domestic and international banks. A number of international banks entered the market in 2007 largely through acquisition. The privatisation of certain state-owned banks has been suggested although the timing is uncertain.

During 2007, the marketplace was characterised by continued interest margin and price compression and aggressive network expansion to gain new customers.

GDP growth remained strong and inflation continued to moderate. Investor and market confidence remained robust with the New Turkish Lira appreciating substantially against the US dollar and Turkey experiencing record levels of foreign direct investment.

The credit card sector was affected by a number of legislative and regulatory measures, including increased minimum customer payments as a credit calming measure, changes to default interest calculations, reduction by the central transaction agency to interchange fees and the Central Bank of Turkey's reduction of its permissable cap on credit card interest rates which reduced costs to the consumer.

A new mortgage law was passed in 2007 which is expected to bring positive impacts to the Turkish mortgage market, including making residential mortgage credit more readily available and making the terms available to consumers more flexible.

Strategy

HSBC's strategy reflects its position as 'The World's Local Bank' and is focused on delivering superior growth and earnings over time by building on the Group's heritage, skills and investment.

In particular, the group aims to leverage the HSBC brand and network to reach new customers and offer more services to existing customers, to maximise efficiency by taking advantage of local, regional and global economies of scale and to ensure staff are engaged by aligning objectives and incentives.

Central to the way the bank applies Group strategy is the development of the 'Best Place to Bank' strategy, which is made up of three principles, which incorporate every aspect of the group's relationship with customers, including treating them fairly: Make Better Products, Sell Them Properly, and Keep Them Sold. It is the bank's aim that everything the bank does should be driven by all of these principles and that when the bank consistently makes better products, sells them properly and keeps them sold, it will be the Best Place to Bank.

Following the same concept, the bank introduced a 'Best Place to Work' strategy, which emphasises performance management, reward, personal development aligned to business strategy and operating plans, a performance-driven culture and an engaged workforce.

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 group's progress against its strategic objectives on a regular basis. Performance is assessed against the strategy, operating plan targets and actual historical performance using financial and non-financial measures.

Financial KPIs

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

The table below presents, on an underlying basis, the measures for the period 2006-2007. At a business level, KPIs are complemented by various benchmarks, which are relevant to the planning process and to reviewing business performance.

	2007	2006
Revenue growth[2] (%) …………...	**7.6**	8.1
Revenue mix [3] (%) ………………		
Net interest income	**29.0**	36.1
Net fee income	**32.7**	32.2
Other income	**38.3**	31.7
Cost efficiency[4] (%) …………….	**59.9**	58.9
Return on average invested capital[5] (%)	**13.6**	13.1

Revenue growth provides an important guide to the group's success in generating business. In 2007, revenue grew 7.6 per cent on an underlying basis. Growth in both years reflects continued improvements in brand recognition and refined segmentation to meet customer needs, which allowed balance sheet and transactional growth. Also contributing to revenue growth in 2007 were fair value gains, primarily on bank debt designated at fair value, which are expected to reverse over the life of the debt unless it is repaid before its contractual maturity.

Revenue mix represents the relative distribution of revenue streams between net interest income, net fee income and other income. It is used to understand how changing economic factors affect the group, to highlight dependence on balance sheet utilisation for income generation and to indicate success in cross-selling fee-based services to customers with loan facilities. This understanding assists management in making business investment decisions. The percentage of revenue attributable to net interest income fell from 36.1 per cent in 2006 to 29.0 per cent in 2007, partly attributable to the increasing cost of funding trading assets. Excluding this, net interest income was 48.0 per cent of net interest income, broadly in line with 2006. Net fee income also remained in line with 2006 while other operating income, adjusted for the impact of funding cost of trading assets, was 19.3 per cent, a 130 basis point decrease on 2006.

Cost efficiency is a relative measure that indicates the consumption of cost resources in generating revenue. Management uses this to assess the success of technology utilisation and, more generally, the productivity of the group's distribution platforms and sales forces. On an underlying basis, cost efficiency was marginally higher than 2006, however excluding charges for overdraft fee refunds and will trust services referred to on page 6, cost efficiency fell 60 basis points.

Return on average invested capital measures the return on the capital investment made in the business, enabling management to benchmark HSBC against competitors. In 2007, the ratio of 13.7 per cent on an underlying basis was higher than that reported in 2006. The higher ratio reflected the fact that profitability growth in 2007 was faster than growth in capital utilised to generate profit.

Non-financial KPIs

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

Employee engagement is a measure of employees' emotional and rational attachment to HSBC.

In 2007, HSBC conducted its first Global People Survey which comprised questions designed to measure employee engagement levels consistently across the Group.

The response rate in Europe was 87 per cent. Survey results have been shared with all employees and action plans are being developed at all levels of the organisation.

Brand perception

The score for brand health is set by data from surveys that are conducted by accredited, independendent, third party organisations. A weighted score card is used to produce an overall score on a 100 point scale which is then benchmarked against HSBC's main competitors. The scores from each market are weighted according to the risk adjusted revenues earned in that market to obtain the overall company score.

The 2007 brand score for UK PFS and UK CMB were respectively ahead of the competitor average by five and seven points on a 100 point scale. The 2008 brand health target is to increase the gap to eight and seven points respectively.

Customer satisfaction

HSBC has regularly conducted customer satisfaction surveys in its main markets over many years. HSBC now uses a consistent measure of customer recommendation to gauge customer satisfaction with the services provided by the

2 The percentage increase in net operating income before loan impairment and other credit risk charges compared with the previous reporting period.

3 As a percentage of net operating income before loan impairment charges and other credit risk provisions.

4 Total operating expenses divided by net operating income after insurance claims but before loan impairment and other credit risk charges.

5 Profit on ordinary activities after tax divided by average invested capital.

Report of the Directors (continued)

Group's Personal Financial Services business. This survey is also conducted by accredited, independent, third party organisations and the resulting recommendation scores are benchmarked against competitors.

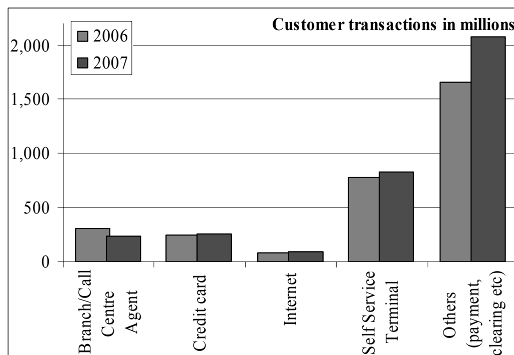
The 2007 customer recommendation score for UK PFS was ahead of the competitor average by one point on a 100 point scale with a 2008 target to increase that gap to three points.

IT performance and systems reliability

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

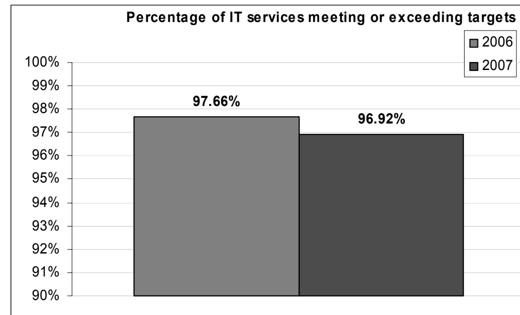
Number of customer transactions processed

The number of customer transactions processed is a reflection of the increasing usage of IT in each of the delivery channels used to service customers. IT's aim is to manage the rate of increase in customer transactions cost effectively and ensure that customer growth is enabled in the appropriate channels. The transition of customer transactions from labour intensive (branch and call centre) to automated (credit card, internet, self-service and other e-channels) is occurring. The following chart shows the 2006 and 2007 volumes per delivery channel.



Percentage of IT services meeting or exceeding targets

HSBC's IT function establishes with its end users agreed service levels for systems performance, such as systems running at 99.9 per cent of the time, credit card authorisations within two seconds, and monitors the achievement of each of these commitments. The following chart reflects the percentage of IT services meeting and/or exceeding the agreed upon service targets. Overall results in 2007 were impacted by a single month's service issue, which skewed a trend of improving service performance.



Outlook

In both the eurozone and the UK, a combination of weaker global demand and softening domestic activity is expected to lead to a reduction in growth rates during 2008. The currently elevated level of inflationary pressure is expected to diminish as growth slows, presenting the possibility of policy easing throughout the course of 2008.

Eurozone GDP growth is expected to weaken to 1.4 per cent in 2008, from a stronger than anticipated 2.6 per cent in 2007. This reflects a general slowdown across the region's major economies.

The bank expects UK growth to slow through the course of 2008. The slowdown in housing activity that developed during the final months of 2007 is expected to continue, with consumer spending being depressed by any further decline in nominal house prices. Although some improvement in export performance is expected, overall GDP growth is expected to moderate to 1.5 per cent in 2008 from the 3.1 per cent growth recorded in 2007.

Gains in energy prices are expected to increase headline consumer price inflation further above the Bank of England's 2 per cent target during the first half of 2008, before a subdued level of demand growth prompts a reversal of this trend in the final months of the year.

Profit on ordinary activities before tax

	2007	2006
	£m	£m
UK Personal Financial Services	**740**	869
UK Commercial Banking	**1,004**	943
UK Global Banking and Markets	**468**	482
Other	**155**	45
International Banking	**397**	305
HSBC France	**526**	488
Private Banking	**643**	555
HSBC Trinkaus & Burkhardt	**148**	109
	4,081	3,796

UK Personal Financial Services ('PFS')

UK Personal Financial Services provides current accounts, savings, personal loans, mortgages, cards, financial planning and general insurance to UK personal customers through a variety of distribution channels under various HSBC brands. These brands include first direct, Marks & Spencer Money and partnership card™.

Pre-tax profit down £129 million, or 15 per cent

Net interest income increased due to higher deposit balances and effective deposit pricing coupled with interest rate rises in the first half of the year, which led to wider deposit spreads. This benefit was partly offset by the impact of a changing portfolio mix as mortgage customers switched to fixed rate products.

There was significant growth in the number of high value current accounts, while savings balances grew strongly. Loans to customers remain tightly controlled, with an improvement in the quality of the loan book compared to the previous year.

In 2007, the bank's straight-through processing programme has focused on completing core product deliverables, which supported internet sales growth. Branch facilities were further enhanced, with 52 new-style stores either opened or refurbished during 2007 in a programme, which has included both the relocation of branches and the opening of new sites across the country.

Other income increased largely due to higher sales of fee-earning packaged current accounts, partly offset by lower year on year profits on the MasterCard Incorporated IPO.

Credit quality remains strong, despite challenging market conditions. Loan impairment charges fell, in part reflecting a strategic decision to sell part of the partnership cards portfolio, mainly the Marbles brand together with initiatives undertaken over the last three years to improve underwriting and collections.

Losses from the secured portfolio remain low. To mitigate the effects of a possible downturn in the property market, maximum loan to value ratios for new business were reduced during the year.

Unsecured loan impairment charges remain predictable largely owing to the improving credit quality of the portfolios following actions taken to combat the effects of increasing customer over-indebtedness. Losses from personal insolvency were broadly flat.

Operating expenses grew by 12 per cent mainly due to ex gratia payments expensed in respect of overdraft fees applied in previous years, a provision for charges on will trusts and other related services [6] and, to a lesser extent, investment in branch, service and distribution facilities. Further to the July announcement of the test case discussed on page 188, no new claims for refunds were charged.

Strategic initiatives and outlook

In line with making HSBC the 'Best Place to Bank', significant progress was made in three key principles – 'Make Better Products' in a simple, innovative and segmented way, 'Sell Them Properly' by better understanding the needs of the customer, and 'Keep Them Sold' through leading customer service and satisfaction. These principles

6 Note 29 on page 108 refers

incorporate every aspect of the group's segmentation strategy and relationship with its customers.

Make Better Products

The bank continued to grow the HSBC brand and stay ahead of the competition, through improving its existing product offerings, such as HSBC Premier, the world's most comprehensively 'joined up' premier service, while the 'Plus' current account offering was further improved. 'Life Choices', a simpler protection product was also created.

Sell Them Properly

The business maintained its drive to provide the right sales environment for its customer base through better segmentation and the repositioning of its customer proposition which enables customers to understand the products they are buying and use channels that keep them informed. For example, to make its fees and charges more transparent, HSBC in the UK began to show warning messages on ATMs if the customer's cash withdrawal would cause a fee to be incurred. It is believed that HSBC was the first bank in the UK to do so. This empowers the customer to decide whether to continue with the transaction and supports the bank's 'fair fees overdraft charging' policy.

Keep Them Sold

The bank's commitment to customer service and satisfaction was demonstrated by the 90 per cent of customers who say they are at least 'satisfied'[7] and first direct's rating as the UK's best bank for service[8]. There were notable improvements to mortgage and current account retention processes, as well as continuous enhancements to 'Passport' and youth current accounts, which resulted in customer migration to 'Plus' accounts and external awards for 'Passport'. Internet based product purchases have been streamlined as far as possible to deliver what the customer needs in a clear, simple and consistent way. New internet functionality is delivered on average every six weeks.

UK Commercial Banking ('CMB')

UK Commercial Banking provides a wide range of products and services to commercial organisations, from sole proprietors to quoted companies with annual turnover greater than £500 million. 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 £61 million, or 6 per cent

Revenues rose due to both balance sheet growth and an increase in fee based product income driven by customer recruitment. These benefits were partly offset by higher loan impairment charges principally on corporate relationship managed accounts and increased operating expenses from ongoing investment in business expansion.

Net interest income increased mainly due to a 10 per cent growth in deposit balances, driven primarily by a successful negotiated rate deposit product launched in 2005, which helped fund lending growth of 14 per cent. LIBOR-linked loan balances increased by 46 per cent, with business loans and commercial mortgages up by 9 per cent and 18 per cent respectively. This was a result of particularly strong growth in Commercial Banking's successful Corporate and Structured Banking business, supported by good growth in lending to commercial centre customers. These income benefits were partly offset by narrower margins on loans and overdrafts from increasingly competitive market conditions.

Other income was higher, driven by strong growth in foreign exchange fees and card activity following the successful small business credit card product launched in May 2006.

Credit quality remains generally good, despite challenging market conditions. Net loan impairment charges increased by £44 million, principally from a small number of large impairments, incurred across differing industry sectors. Overall, the impairment charge was broadly in line with expectations in view of recent growth in the portfolio. To mitigate the effects of a potential downturn in the economy guidelines have been tightened for certain sectors.

Underlying operating expenses were higher from continued frontline staff recruitment and other costs to support business development and expansion.

---

7 GfK NOP

8 GfK NOP

Strategic initiatives and outlook

During 2007, CMB continued to place considerable emphasis on increasing availability of business specialists and relationship managers through the recruitment of frontline staff and investment in direct channels in support of the strategy to become the best bank for small business. Following re-alignment of the relationship management and distribution approach in commercial centres, customer satisfaction improved by eight percentage points. Furthermore, HSBC's award winning business internet banking service has been improved and is now the largest, most functionally rich service of its kind in the UK according to independent surveys. During 2007, over 328,000 priority payments have been sent through the platform.

Business Direct, HSBC's direct commercial banking proposition, has now attracted 66,000 customers since its launch in September 2006, of which 63 per cent are new customers. Of new small and micro customers, 22 per cent now choose to bank with HSBC through the direct proposition and customers are now able to apply and obtain approval for new accounts online without the need for telephone or branch intervention.

In support of HSBC’s strategy to be the leading international commercial bank, a dedicated International corporate banking team was established to drive and support cross-border business. International Banking Centres are now in place for 11 European countries including the UK, simplifying cross border account opening for customers. HSBC’s Multi-Cultural Commercial banking proposition grew significantly during 2007 with specialist relationship managers in 14 locations in the UK and the launch of the UK’s only dedicated Polish Commercial banking proposition. The success of these initiatives in the UK contributed to three-fold growth of outward referrals in Europe through the Global Links referral system.

During 2008, CMB will continue to pursue the strategies set out above which have generated consistent success in recent years. There will be continued investment in people, in automation, and in the bank’s award winning e-business platforms. Investment in more focused marketing will deliver enhanced returns and continue to drive the successful Business Direct proposition. Continued focus on the bank’s international proposition will drive further income growth in strategic international products and support the drive to join up the bank.

UK Global Banking and Markets

(Previously UK Corporate, Investment Banking and Markets)

Global Banking and Markets provides tailored financial solutions to major government, corporate and institutional clients worldwide. The business is managed as four principal business lines: Global Markets, Global Banking, Principal Investments and HSBC Global Asset Management. This structure allows HSBC to focus on relationships and sectors that best fit the Group’s footprint and facilitates seamless delivery of HSBC’s products and services to clients.

Pre-tax profit down £14 million, or 3 per cent

Significant gains from a small number of transactions in principal investments and in asset and structured finance were supplemented by the benefit derived from a wider product offering and higher deposit balances in payments and cash management. These increases were partly offset by lower trading income and write-downs on certain positions in leveraged and acquisition finance.

Net interest income decreased due to increased cost of funding in the rail and structured finance business and lower interest income in balance sheet management, partly offset by the benefit of higher deposit balances and related margins, due to interest rate increases.

Higher net fee income was driven by structured finance deals and increased advisory and equity capital markets revenues due to increased market activity.

Income from trading activities fell due to losses reported in credit and structured credit products. This was partly offset by strong growth in foreign exchange income driven by market volatility and a weakening US dollar. Strong performance in equities was principally due to growth in income from core products.

Securities services revenue benefited from increased volumes and new client mandates. Additional income was generated from value added services such as cash management, securities lending and foreign exchange.

In Global Banking, credit protection initiatives were developed further in 2007. Average corporate

balances remained flat against 2006 and corporate spreads grew. Significant fair value movements flowed through as portfolio management instruments' value appreciated in a widening credit spread environment, offset by leveraged and acquisition finance write-downs.

Payments and Cash Management income grew due to favourable currency account balances and higher margins. Other operating income was higher in money transmission and sterling payments as volume increased in line with greater business activity and the acquisition of new institutional clients.

Corporate credit quality remained good despite challenging market conditions. A net recovery on loan impairment charges, albeit lower than in 2006, reflected the continued low level of corporate credit defaults.

Operating expenses rose due to volume growth in the transaction-based businesses such as payments and cash management and securities services and in trading businesses, particularly equities. Performance-related costs were lower in 2007.

Strategic initiatives and outlook

In 2007, the implementation of the 'emerging markets-led and financing focused' strategy was completed and Corporate, Investment Banking and Markets was renamed Global Banking and Markets. HSBC's strategy is to be a leading wholesale bank by:

- utilising HSBC's extensive distribution network;
- developing Global Banking and Markets hub-and-spoke business model as the foundation on which the business can best meet its clients' needs; and
- continuing to build skills and capabilities in its major centres to support the delivery of an advanced suite of services to corporate, institutional and government clients across the HSBC network.

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

UK Other

Pre-tax profit up £110 million

The main items reported under 'Other' include movements in the fair value of own debt designated at fair value, fees paid to Global Banking and Markets related to asset based finance and tax services rendered on behalf of the group, net under/ over recovery of IT services and exchange movements on US dollar preference shares.

International Banking

The International Banking business segment represents the bank's operations primarily in Europe excluding those of HSBC France, HSBC Trinkaus & Burkhardt and Private Banking. It provides a range of retail financial services to local and expatriate personal and commercial customers and Global Banking and Markets services to corporate and institutional clients.

Pre-tax profit up £92 million, or 30 per cent

Pre-tax profit increased mainly in Turkey, Malta and Spain due to a combination of growth in customer numbers and a stronger performance in Global Banking and Markets partly offset by lower profits in Ireland, Italy and Russia.

Returns from higher asset volumes and yields and higher fee income were partly offset by volatile corporate lending volumes and increased costs as business expansion continues.

In Turkey, pre-tax profit grew by 41 per cent, as the bank continued to invest in branch infrastructure, commercial centres, relationship staff and service standards. Brand awareness and geographic coverage were increased through the opening of a further 45 branches during the year, supported by a number of marketing initiatives. Turkey's balance sheet and related revenues have shown strong growth; average loans and advances increased by 36 per cent and customer numbers increased by 730,000 or 32 per cent during 2007.

Across the international portfolio, average deposit balances rose by 14 per cent, largely driven by customer recruitment, gained through marketing campaigns and the addition of new retail outlets. Deposit spreads remained narrow as interest rates started to decline during the second half of 2007 following rate rises earlier in the year. Average lending balances increased by 11 per cent. The income benefit from these increases was partly offset by market-wide credit calming measures,

which together with increased competition adversely affected margins on lending and credit cards.

Marketing initiatives and cross sales of credit card customers helped to increase unsecured lending balances. Mortgage lending was also strong especially in Turkey, Malta and Greece.

Strategic initiatives and outlook

During 2007, significant investment has been made in Central and Eastern Europe, in IT, premises and staff recruitment in preparation for the opening of a number of branches in 2008 in Poland, the Czech Republic and Slovakia.

New business initiatives are underway in Armenia and Kazakhstan to expand in the personal and commercial customers sectors.

Following the granting of a retail banking licence from the Central Bank of Russia, HSBC's local banking subsidiary in Russia is well advanced in its plans to develop a retail branch network, offering personal and commercial banking services in addition to its current Global Banking and Markets services.

During the second half of the year, the National Bank of Georgia granted a banking licence to HSBC Bank Georgia. The bank will open for business in 2008.

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 £38 million, or 8 per cent

HSBC brand awareness increased from 49 per cent in 2006 to 60 per cent in the last quarter of 2007. Awareness in the Paris region increased to more than 75 per cent. The marked improvement in brand awareness was reflected in continued growth in new personal customers. This led to balance sheet growth mainly 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.

In April 2007, HSBC France acquired the remaining 50.01 per cent of the life insurer Erisa and the property and casualty insurer Erisa IARD from Swiss Life. HSBC France launched an award winning on-line consultation and transaction service in May 2007, which allows customers to make on-line payments and switches of their life insurance contracts. A "Label d'excellence" was awarded to HSBC France by Les Dossiers de l'Epargne magazine for their "HSBC Stratégie Patrimoine" life insurance product. These two subsidiaries have now adopted the HSBC name and are now known as HSBC Assurances Vie and HSBC Assurances IARD.

In commercial banking, focus on brand awareness also led to an increase in new customers, and for most of these HSBC also became their principal relationship banker. The client base grew by more than 6 per cent. A combination of active marketing campaigns, enhanced product and service ranges, synergies with other businesses and the support of the international strength of the HSBC Group led to strong increases in volumes. This translated into growth in average lending and deposits of 19 and 22 per cent, respectively. This, together with improvements in credit margins at the end of the year more than compensated for the unfavourable impact of lower income on higher yielding hedging products.

In Global Banking and Markets, revenue growth was primarily driven by the structured derivatives and rates businesses following the successful implementation of a central risk management function and the global sales and execution capabilities. Robust performance in Global Banking reflected higher fees from advisory and asset and structured finance activity coupled with an increase in cross-border transactions. In HSBC Global Asset Management, successful campaigns on guaranteed funds within HSBC retail network coupled with an increase in cross border institutional business from alternative and emerging market products resulted in significant growth in revenues against 2006. Higher gains were also reported in Principal Investments.

Private banking activities continued to focus on cross referrals both within France and with other private banking members of the HSBC Group. The fund management activities continue to attract awards with the Louvre Gestion France Equity fund "Patrimoine" ranked first in its category.

Report of the Directors (continued)

Tight cost control discipline continued throughout 2007 and the higher level of operating expenses was driven by recruitment of additional sales staff, the acquisition of Erisa and costs associated with the migration to a common IT platform.

Loan impairment costs remain low although increased by £29 million following lower recoveries than in 2006. Overall credit quality in HSBC France remained good.

Strategic initiatives and outlook

In 2008, HSBC France will continue its customer acquisition programme, refurbish and upgrade selected major branches, introduce dedicated commercial banking centres, relaunch Premier banking and develop additional on-line sales products.

Global Banking and Markets will focus on continuing to expand its range of trading activities and increase market share.

Private Banking

Private Banking reflects the operations of HSBC Private Banking Holdings (Suisse) SA and its subsidiaries. The private banking business in France, Germany and International Banking is discussed within respective commentaries for those business segments.

Private Banking offers a range 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 £88 million, or 16 per cent

Excluding the gains on the partial disposal of a seed capital investment in a fund, underlying profit growth was 21 per cent, arising from higher client assets, brokerage and sales of structured products, driven by customer acquisition and expansion of the product range.

Loans and advances to customers increased by 23 per cent to £16 billion, as existing clients further leveraged their portfolios to take advantage of alternative investment opportunities, including hedge fund investments and emerging market opportunities.

Growth in cross-referrals continued, with inward referrals from Personal Financial Services and Commercial Banking contributing £2 billion to total client assets and £9 million to revenues.

The business continued to benefit from the growth in client assets of 19 per cent to £135 billion, with consequently higher brokerage and trading income. Growth of client assets was driven by an overall improvement in global wealth with a trend for clients to invest in offshore regions such as Switzerland.

A strategic move to the growth of higher fee generating discretionary and advisory managed assets contributed to increased fees. Client investments in structured products, brokerage fees and tax advisory services also contributed to the rise in fee income.

Gains from financial investments decreased by 37 per cent, predominantly due to a lower gain from a partial disposal of a seed capital investment in the Hermitage Fund, where a similar but larger gain was recognised in 2006.

Higher operating expenses reflected the launch of regional offices and geographic expansion in Asia, recruitment of front office staff, increased infrastructure and marketing spend. The increase was partially offset by the effect of a change in pension arrangements.

Credit quality remains strong. A small net impairment recovery was received in 2007.

Strategic initiatives and outlook

The strategy for Private Banking is to be one of the world's leading international private banks, by providing excellent client service.

HSBC's global network and brand provides a base from which Private Banking, working in conjunction with HSBC's other customer groups and global businesses, serves the complex international needs of its clients, utilising traditional and innovative ways of managing and preserving the wealth of high net worth individuals while optimising returns.

To deliver the bank's strategy, Private Banking's aim is to reinforce its product capabilities in areas such as credit, hedge funds, investment advice and estate planning. This will be achieved by attracting, retaining and motivating talented individuals, by surveying clients and employees on a regular basis and by increasing

expenditure targeted on marketing and brand awareness initiatives.

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 up £39 million, or 36 per cent

Positive market conditions during the first half of 2007 enabled HSBC Trinkaus & Burkhardt to maintain the double-digit growth rates experienced over the last six years and a return on equity well above the German market average. This positive start to the year allowed the bank to withstand the more challenging markets in the second half of the year and full year results showed growth in all business segments.

Growth in net interest income reflected further increased customer funds. Net fee income was strong, especially from brokerage and asset management products in all customer segments.

Trading income continued to be dominated by equity derivatives trading, particularly in retail products such as discount or bonus certificates and knock out warrants. In addition, interest rate and foreign exchange trading desks were also profitable and higher HSBC Group referrals in 2007 led to higher income from derivatives and structured products.

Operating expenses grew mainly due to increased headcount and higher performance related costs, while loan impairment releases were lower than in 2006.

Strategic initiatives and outlook

Ongoing uncertainty in the markets might lead to a slow down in growth. While the increased customer base in private and corporate banking should be a solid foundation to grow net interest income and fee business, a recurrence of the high trading income from retail equity derivative products greatly depends on the conditions of the markets. In addition, the demand of institutional clients for structured products may weaken compared to 2007.

Increased integration into the HSBC Group will be reflected in a continued distribution of HSBC Group products to the German client base.

Share capital

In March 2007, HSBC Holdings plc subscribed £510 million for one additional ordinary share of £1 credited as fully paid in the ordinary share capital of the bank.

Save for this, there have been no other changes to the authorised or issued ordinary share capital of the bank in the year ended 31 December 2007

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 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.

The group's capital is divided into two tiers. Tier 1 capital comprises core tier 1 capital and innovative tier 1 securities. Core tier 1 capital comprises shareholders' funds, and minority interests in tier 1 capital, after adjusting for items reflected in shareholders' funds which are treated differently for the purposes of capital adequacy. The book values of goodwill and intangible assets are deducted in arriving at 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.

Changes to the definition of capital came into force on 1 January 2007. They include the introduction of proportional consolidation of banking associates, which previously were either fully consolidated or deducted from capital and the relaxation of rules covering the deduction of investments in other banks' capital. Further changes came into force on 1 January 2008, details of which are provided under 'Future developments' below.

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 replaces 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 1 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. Expected losses are calculated by multiplying the probability of default by the loss given default multiplied by the exposure at default. The capital requirement under the internal ratings based approaches is intended to cover unexpected losses and is derived from a formula specified in the regulatory rules, which incorporates these factors and other variables such as maturity and correlation.

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, whereas 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 second pillar of Basel II (Supervisory Review and Evaluation Process) involves both firms and regulators taking a view on whether a firm should hold additional capital against risks not covered in pillar 1. Part of the pillar 2 process is the Internal Capital Adequacy Assessment Process (ICAAP) which is the firm's self assessment of risks not captured by pillar 1. The pillar 2 process culminates with the FSA providing firms with Individual Capital Guidance (ICG). The ICG generally adjusts the pillar 1 capital resources requirement by a specified percentage of not less than one hundred per cent.

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

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 required 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 began on 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 took effect from 1 January 2007 and implemented the CRD in the UK. GENPRU introduced changes to the definition of capital and the methodology for calculating capital ratios. Changes which took effect from 1 January 2008 relate to those portfolios where the internal ratings-based ('IRB') approach is adopted; in these cases the collective impairment allowances relating to those IRB portfolios are no longer eligible for inclusion in tier 2 capital.

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

BIPRU introduced the Basel II requirements for the calculation of capital requirements as well as changes to the consolidation regime, the trading book definition and various ancillary provisions. In respect of counterparty risk in the trading book, certain changes were introduced with effect from 1 January 2007. Otherwise, transitional provisions regarding the implementation of capital requirements calculations meant that, in general, unless firms notified the FSA to the contrary, they continued to apply the existing capital requirements calculations until 1 January 2008.

For credit risk, the group adopted the IRB advanced approach to Basel II for the majority of its business with effect from 1 January 2008, with the remainder on either IRB foundation or standardised approaches. For individual banking subsidiaries, the timing and manner of implementing Basel II varies by jurisdiction according to requirements set by local banking supervisors. Applying Basel II across the group's geographically diverse businesses, which operate in a number of different regulatory environments, presents a significant logistical and technological challenge, and an extensive programme of implementation projects is currently in progress.

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

Report of the Directors (continued)

Regulatory capital position *(audited information except where stated)*

The table below sets out the analysis of regulatory capital

Composition of capital	2007 £m	2006 £m
Tier 1:		
Shareholders' funds of the parent company	**23,574**	20,620
Minority interests and preference shares	**1,007**	984
Innovative tier 1 securities	**1,636**	1,609
Less: goodwill capitalised and intangible assets	**(9,458)**	(8,844)
Total qualifying tier 1 capital	**16,759**	14,369
Tier 2:		
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities	**402**	632
Collective impairment allowances	**873**	884
Perpetual subordinated loan	**1,843**	1,015
Term subordinated loan	**5,323**	5,064
Minority and other interests in tier 2 capital	**734**	671
Total qualifying tier 2 capital	**9,175**	8,266
Unconsolidated investments	**(1,551)**	(432)
Investments in other banks and other financial institutions	**–**	(335)
Other deductions	**(152)**	(508)
Total capital	**24,231**	21,360
Total risk-weighted assets (*unaudited*)	**222,666**	190,860
Capital ratios: (*unaudited*)	**%**	%
Total capital	**10.9**	11.2
Tier 1 capital	**7.5**	7.5

The above figures were computed in accordance with the EU Banking Consolidation Directive and the FSA Prudential Standards. The group complied with the FSA's capital adequacy requirements throughout 2007 and 2006.

Tier 1

The increase of £2.4 billion in tier 1 capital was largely due to retained profits of £1.5 billion.

Tier 2

The increase of £0.9 billion in tier 2 capital was largely due to the issuance of perpetual subordinated debt of £1 billion.

Unconsolidated investments

The increase of £1.1 billion was largely due to the inclusion of the embedded value of life assurance subsidiaries, £0.4 billion, the inclusion of HSBC Assurances Vie (France) and HSBC Assurances IARD (France) following the increase in shareholding, £0.4 billion, and the acquisition of HSBC Insurance Brokers Holdings Limited, £0.1 billion.

Investments in other banks and other financial institutions

Deductions due to investments in other banks and other financial institutions have been included within unconsolidated investments for 2007.

Estimated impact of Basel II

(Unaudited)

As reflected in the table below, the bank's capital base under Basel II is £1.7 billion lower than under Basel I.

As explained above, with effect from 1 January 2008, the basis of calculating capital changed. This had the affect of reducing the bank's capital base by the extent to which expected losses exceed individual and collective impairment allowances on IRB portfolios. Expected losses, which are derived under Basel II rules, represent losses that would be expected in the scenario of a severe downturn over a 12-month period. This definition differs from loan impairment allowances which only address losses inherent within lending portfolios at the balance sheet date. For rapidly revolving credit portfolios such as credit cards, therefore, impairment allowances only capture some of the expected losses predicted over the next 12 months, as a large proportion of them relate to credit advances not made at the measurement date. In addition, under the new rules, collective impairment allowances on IRB portfolios are no longer eligible for inclusion in capital. This reduction in the capital base does not reflect a change in the risk profile of the underlying portfolios and the bank remains strongly capitalised.

The effect of the deduction of the difference between expected losses and total impairment allowances is to set the deduction from capital to be equal to the regulatory definition of expected losses. Because expected losses are based on long term estimates and incorporate through-the-cycle considerations, it is not anticipated that they will be very volatile. The impact of this deduction, however, may vary from time to time as the accounting measure of impairment moves closer to, or further away, from the regulatory measure of expected losses. Because changes in impairment allowances are taken to the profit and loss account, the overall effect on bank capital is unchanged. In other words, the accumulated charges to the profit and loss account for loan impairment allowances plus the deduction of the difference between expected losses and provisions, taken together, always equals expected losses.

The bank's risk weighted assets under Basel II are estimated to be £10.3 billion lower than under Basel I. A reduction in the risk weighted assets related to credit risk is partially offset by the new capital requirement for operational risk.

If the bank had been reporting on a Basel II basis as at 31 December 2007, it is estimated that the capital position would be as follows:

Report of the Directors (continued)

	Estimated Basel II pro-forma £m (Unaudited)	Estimated Basel II pro-forma % [1] (Unaudited)	Actual £m (Audited)
Composition of regulatory capital			
Tier 1 capital			
Shareholders' equity	**23,574**		**23,574**
Minority interests and preference shares	**1,007**		**1,007**
Less :			
Goodwill capitalised and intangible assets	**(9,458)**		**(9,458)**
Other regulatory adjustments	**(161)**		**-**
50% of excess of expected losses over impairment losses	**(422)**		**-**
Core 1 capital	**14,540**	**6.8**	**15,123**
Innovative tier 1 securities	**1,636**	**0.8**	**1,636**
Tier 1 capital ratio – management basis		**7.6**	
Tier 2 capital			
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities	**402**		**402**
Collective impairment allowances			**873**
Perpetual subordinated debt	**1,843**		**1,843**
Term subordinated debt	**6,057**		**6,057**
Minority and other interests in tier 2 capital	**-**		**-**
Total qualifying tier 2 capital before deductions	**8,302**	**3.9**	**9,175**
Total qualifying tier 2 capital before deductions plus innovative tier 1 securities	**9,938**		**10,811**
Unconsolidated investments[2]	**(1,229)**		**(1,551)**
50% of excess of expected losses over impairment losses	**(422)**		
Other deductions	**(313)**		**(152)**
Total deductions other than from tier 1 capital	**(1,964)**	**(0.9)**	**(1,703)**
Total regulatory capital	**22,514**	**10.6**	**24,231**
			(Unaudited)
Risk-weighted assets			
Credit risk	**181,329**		
Market risk	**12,531**		
Operational risk	**18,521**		
Banking book	**–**		**196,561**
Trading book	**–**		**27,310**
Total	**212,381**		**223,871**

1 *Percentage of risk-weighted assets.*
2 *Mainly comprises investment in insurance entities.*

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 contracts.

J Singh retired as a Director on 20 April 2007.

S P O'Sullivan was appointed as a Director on 7 August 2007. Having been appointed since the Annual General Meeting in 2007, he will retire at the forthcoming Annual General Meeting and offer himself for re-election.

C M S Jones, R E S Martin, P M Shawyer and J F Trueman will retire by rotation at the forthcoming Annual General Meeting and, with the exception of C M S Jones, 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, S P O'Sullivan each of whom are executive Directors and P Boyles, B M Cannon, J M Flint, J D Garner, A M Keir, S J Large, A M Mahoney, M McCombe, R K McGregor, P Nolan, C Schnor and D K Sheehan, 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 2007 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 misstatement, 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: Revised Guidance for Directors on the Combined Code issued by the Financial Reporting Council. Such procedures for the ongoing indentification, evaluation and management of the significant risks faced by the group have been in place throughout the year and up to 3 March 2008, the date of approval of the *Annual Report and Accounts 2007*. In the case of companies acquired during the year, the internal controls in place are being reviewed against the group's benchmarks and they are being integrated into the group's systems.

Report of the Directors (continued)

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 are in place 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 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 38 '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 Corporate Real Estate and are implemented by Health, Safety and Fire Coordinators based in each country in which the Group operates.

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

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 HSBC staff, buildings, assets and information are appropriate for the level of threat.

Directors' emoluments

Details on the emoluments of the Directors of the bank for 2007, disclosed in accordance with the Companies Act, are shown in Note 8 'Employee compensation and benefits' in the Notes on the Financial statements.

Employee involvement

The bank launched its 'Best Place to Work' programme in 2006. Based on employee feedback, 15 items for improvement were identified and the banks's Chief Executive committed to deliver these. Since the launch of the programme, 13 out of 15 of the items identified for improvement have been implemented. Work is progressing on the two remaining items with further research being undertaken into employees' views on reward, including pensions and organisational culture through the use of focus groups and random sample surveys, together with feedback via e-mail.

Report of the Directors (continued)

During 2007, the bank has continued to involve its employees through a number of complimentary programmes to 'Best Place to Work' - 'Best Place to Discuss'; 'Best Place to Suggest'; 'Best Place to Workout'; 'Best Place to Blog'; 'Best Place to Meet'; and 'Best Place to Bank for Employees'. These programmes have been delivered through the intranet, 'meet the top leadership team' sessions, intranet delivered TV debates and feedback.

The bank participates in the HSBC Group annual employee engagement survey. This Group-wide survey, launched in September 2007, had a response rate of 88 per cent. The results will form the basis of high level and local action plans for improving employee engagement in 2008.

Employees are encouraged to be further involved 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.

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

Community involvement and donations

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 2007, the bank gave £8 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 continued its focus on employee-led charitable initiatives.

Education

In 2007 HSBC launched a £3.4m partnership with the financial education charity Personal Finance Education Group ('*pfeg'*), called *What Money Means*, this partnership aims to increase the quality and quantity of financial capability education in UK primary schools. *What Money Means* will bring *pfeg*, local authorities and educationalists together to develop resources and approaches that will help primary school teachers feel more confident in teaching money skills to younger children. In addition to HSBC's financial commitment, it is planned that thousands of HSBC employees will, where appropriate, work alongside teachers in the classroom.

2007 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 2,900 young people took part in this programme assisted by 140 HSBC employee volunteers.

The HSBC Global Education Trust directly supports educational initiatives, for example, the British Council's China programme. This programme has continued to evolve, offering opportunities such as a Mandarin immersion summer school for primary school children, a Mandarin speaking competition and the Area Links programme where UK students make links with young people in Chinese schools. As well as sharing experiences and working together to develop joint curriculum projects, some students participating in the Area Links programme are given the opportunity to travel to China. The Trust has continued to support sailing academies and the tall ships voyage, whereby young people learn to sail, together with the Teach First programme where top graduates teach mathematics in inner city schools.

Environment

The group's employees are involved in a variety of projects related to environmental sustainability and climate change.

In 2007 the HSBC Group launched a new global programme aimed at tackling some of the issues generated by climate change. Called the *HSBC Climate Partnership*, this is a US$100 million contribution to the work of four of the world's leading environmental organisations:- The Climate Group; The Earthwatch Institute; WWF; and the Smithsonian Tropical Research Institute. Working with these partners, the *HSBC Climate Partnership* aims to create cleaner, greener cities across the world; create individual HSBC climate champions worldwide; help protect some of the world's major rivers; and conduct the world's largest ever field experiment on the long-term effects of climate change on the world's forests.

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 2007 we continued our policy of allowing our employees to propose local projects for HSBC support.

Over 400 employee-led projects were initiated as a result of this policy with financial support approaching £1.9 million. In addition, over £2.4 million was donated to charities to match funds raised, or time given, by employees through our staff charity scheme.

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

More details of HSBC's community activities can be found at www.hsbccommittochange.com

No political donations were made during the year.

At both the HSBC Holdings plc Annual General Meeting and the bank's Annual General Meeting held in 2007, shareholders renewed the authority for the bank to make EU political donations and incur EU political expenditure up to a maximum aggregate sum of £50,000 as a precautionary measure in light of the wide definitions in The Political Parties, Elections and Referendums Act 2000. These authorities have not been used.

Valuation of freehold and leasehold land and buildings

The group's freehold and long leasehold properties were valued in 2007. The value of these properties was £284 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 BERR Publications Orderline, Admail 528, London SW1W 8YT and on the internet, www.payontime.co.uk.

The amount due to the bank's trade creditors at 31 December 2007 represented 22 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*

3 March 2008

Statement of Directors' Responsibilities in Respect of the *Annual Report and Accounts 2007* and the Financial Statements

The following statement, which should be read in conjunction with the Auditor's 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 a 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* 3 March 2008

Independent Auditor's Report to the Member of HSBC Bank plc

We have audited the consolidated financial statements of HSBC Bank plc and its subsidiaries ('the group') and parent company financial statements of HSBC Bank plc ('the bank') for the year ended 31 December 2007 which comprise the group Income Statement, the group and bank Balance Sheets, the group and bank 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 28.

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 2007 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 2007 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 2007;
- 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

3 March 2008

Financial Statements

Consolidated income statement for the year ended 31 December 2007

	Notes	2007 £m	2006 £m
Interest income		16,439	13,339
Interest expense		(12,585)	(9,143)
Net interest income		**3,854**	4,196
Fee income		5,442	5,018
Fee expense		(1,258)	(1,276)
Net fee income		**4,184**	3,742
Trading income excluding net interest income		1,698	1,699
Net interest income on trading activities		1,789	927
Net trading income		**3,487**	2,626
Net income from financial instruments designated at fair value	*4*	**126**	59
Gains less losses from financial investments		**552**	239
Dividend income		**43**	50
Net earned insurance premiums	*5*	**1,921**	317
Other operating income		**307**	480
Total operating income		**14,474**	11,709
Net insurance claims incurred and movement in policyholders' liabilities	*6*	**(1,674)**	(91)
Net operating income before loan impairment charges and other credit risk provisions		**12,800**	11,618
Loan impairment charges and other credit risk provisions		**(1,043)**	(938)
Net operating income		**11,757**	10,680
Employee compensation and benefits	*8*	**(4,287)**	(3,929)
General and administrative expenses	*9*	**(2,872)**	(2,354)
Depreciation and impairment of property, plant and equipment	*22*	**(422)**	(410)
Amortisation and impairment of intangible assets and impairment of goodwill	*21*	**(142)**	(151)
Total operating expenses		**(7,723)**	(6,844)
Operating profit		**4,034**	3,836
Share of profit/ (loss) in associates and joint ventures		**47**	(40)
Profit before tax		**4,081**	3,796
Tax expense	*11*	**(767)**	(978)
Profit for the year		**3,314**	2,818
Profit attributable to shareholders of the parent company		**3,227**	2,722
Profit attributable to minority interests		**87**	96

Consolidated balance sheet at 31 December 2007

	Notes	2007 £m	2006 £m
ASSETS			
Cash and balances at central banks		**7,146**	3,618
Items in the course of collection from other banks		**2,434**	2,937
Trading assets	*15*	**153,206**	85,994
Financial assets designated at fair value	*16*	**14,969**	5,985
Derivatives	*17*	**60,470**	32,090
Loans and advances to banks	*31*	**60,764**	44,428
Loans and advances to customers	*31*	**227,687**	200,416
Financial investments	*18*	**69,528**	42,380
Interests in associates and joint ventures	*20*	**118**	923
Goodwill and intangible assets	*21*	**9,877**	9,251
Property, plant and equipment	*22*	**4,119**	4,408
Other assets	*24*	**5,936**	4,454
Deferred tax assets	*11*	**50**	29
Prepayments and accrued income		**5,976**	3,847
Total assets		**622,280**	440,760
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	*31*	**48,786**	38,513
Customer accounts	*31*	**268,269**	227,350
Items in the course of transmission to other banks		**1,975**	2,428
Trading liabilities	*25*	**117,454**	52,080
Financial liabilities designated at fair value	*26*	**15,659**	9,460
Derivatives	*17*	**61,539**	32,743
Debt securities in issue	*31*	**50,921**	38,090
Retirement benefit liabilities	*8*	**674**	2,252
Other liabilities	*27*	**6,843**	4,614
Current tax liabilities		**467**	286
Liabilities under insurance contracts issued	*28*	**12,251**	1,886
Accruals and deferred income		**6,509**	4,196
Provisions	*29*	**427**	402
Deferred tax liabilities	*11*	**302**	142
Subordinated liabilities	*30*	**5,205**	5,380
Total liabilities		**597,281**	419,822
Equity			
Called up share capital	*35*	**1,797**	797
Share premium account	*36*	**15,499**	14,558
Other reserves	*36*	**(221)**	78
Retained earnings	*36*	**7,348**	4,966
Total equity attributable to shareholders of the parent company		**24,423**	20,399
Minority interests	*36*	**576**	539
Total equity		**24,999**	20,938
Total equity and liabilities		**622,280**	440,760

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

3 March 2008

Financial Statements (continued)

Consolidated statement of recognised income and expense for the year ended 31 December 2007

	2007 £m	2006 £m
Available-for-sale investments:		
– valuation (losses)/ gains taken to equity	**(964)**	258
– transferred to income statement on disposal net of impairment	**(501)**	(179)
Cash flow hedges:		
– losses taken to equity	**(71)**	(64)
– transferred to income statement	**33**	(118)
Exchange differences arising on net investments in foreign operations	**1,109**	(617)
Share of changes in equity of associates and joint ventures	**101**	137
Actuarial gains on post-employment benefits	**1,267**	9
	974	(574)
Tax on items taken directly to equity	**(311)**	29
Total net income/ (expense) taken directly to equity during the year	**663**	(545)
Profit for the year	**3,314**	2,818
Total recognised income and expense for the year	**3,977**	2,273
Total recognised income and expense for the year attributable to:		
– shareholders of the parent company	**3,875**	2,198
– minority interests	**102**	75

Consolidated cash flow statement for the year ended 31 December 2007

	Notes	**2007 £m**	2006 £m
Cash flows from operating activities			
Profit before tax		**4,081**	3,796
Adjustments for:			
– non-cash items included in profit before tax	*37*	**2,023**	1,861
– change in operating assets	*37*	**(56,617)**	(26,052)
– change in operating liabilities	*37*	**83,551**	39,302
– elimination of exchange differences[1]		**(1,792)**	761
– net gain from investing activities		**(552)**	(239)
– share of (profits)/ losses in associates and joint ventures		**(47)**	40
– distributions from/ (to) associates		**7**	(50)
– contributions paid for defined benefit pension schemes		**548**	142
– tax paid		**(872)**	(766)
Net cash from operating activities		**30,330**	18,795
Cash flows used in investing activities			
Purchase of financial investments		**(71,980)**	(46,621)
Proceeds from the sale of financial investments		**43,217**	46,118
Purchase of property, plant and equipment		**(578)**	(628)
Proceeds from the sale of property, plant and equipment		**67**	179
Purchase of goodwill and intangible assets		**(123)**	(147)
Net cash outflow from acquisition of and increase in stake of subsidiaries		**9**	7
Net cash outflow from acquisition of and increase in stake of associates		**(118)**	(259)
Proceeds from disposal of associates		**982**	270
Purchases of HSBC Holdings plc shares to satisfy share based payment transactions		**182**	142
Net cash used in investing activities		**(28,342)**	(939)
Cash flows used in financing activities			
Issue of share capital		**1,510**	675
Subordinated loan capital issued		**59**	1,207
Subordinated loan capital repaid		**10**	(411)
Dividends paid to shareholders		**(1,706)**	(1,591)
Dividends paid to minority interests		**(7)**	(9)
Net cash used in financing activities		**(134)**	(129)
Net increase in cash and cash equivalents		**1,854**	17,727
Cash and cash equivalents at 1 January		**46,721**	30,515
Effect of exchange rate changes on cash and cash equivalents		**2,660**	(1,521)
Cash and cash equivalents at 31 December	*37*	**51,235**	46,721

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

Notes on the Financial Statements (continued)

HSBC Bank plc balance sheet at 31 December 2007

	Notes	2007 £m	2006 £m
ASSETS			
Cash and balances at central banks		**3,677**	2,496
Items in the course of collection from other banks		**1,377**	1,367
Trading assets	*15*	**149,102**	62,729
Financial assets designated at fair value	*16*	**3,439**	–
Derivatives	*17*	**46,325**	24,361
Loans and advances to banks	*31*	**32,028**	25,121
Loans and advances to customers	*31*	**150,649**	143,964
Financial investments	*18*	**13,821**	12,135
Interests in associates and joint ventures	*20*	**46**	255
Investments in subsidiary undertakings	*23*	**15,754**	14,546
Goodwill and intangible assets	*21*	**540**	557
Property, plant and equipment	*22*	**1,078**	1,521
Other assets	*24*	**2,077**	2,014
Deferred tax assets	*11*	**515**	873
Prepayments and accrued income		**3,601**	2,147
Total assets		**424,029**	294,086
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	*31*	**41,061**	29,182
Customer accounts	*31*	**184,899**	164,054
Items in the course of transmission to other banks		**1,056**	1,019
Trading liabilities	*25*	**99,755**	35,215
Financial liabilities designated at fair value	*26*	**8,082**	4,736
Derivatives	*17*	**47,536**	24,967
Debt securities in issue	*31*	**8,117**	5,408
Retirement benefit liabilities	*8*	**551**	2,069
Other liabilities	*27*	**2,874**	2,414
Current taxation		**198**	106
Accruals and deferred income		**4,214**	2,572
Provisions	*29*	**163**	105
Deferred tax liabilities	*11*	**2**	33
Subordinated liabilities	*30*	**4,744**	4,999
Total liabilities		**403,252**	276,879
Equity			
Called up share capital	*35*	**1,797**	797
Share premium account	*36*	**15,499**	14,558
Other reserves	*36*	**327**	202
Retained earnings	*36*	**3,154**	1,650
Total equity		**20,777**	17,207
Total equity and liabilities		**424,029**	294,086

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

3 March 2008

HSBC Bank plc statement of recognised income and expense for the year ended 31 December 2007

	2007 £m	2006 £m
Available-for-sale investments:		
– valuation gains taken to equity	**238**	63
– transferred to income statement on disposal or impairment	**(167)**	2
Cash flow hedges:		
– gains taken to equity	**10**	56
– transferred to income statement	**19**	(35)
Exchange differences arising on net investments in foreign operations	**(10)**	(1)
Actuarial gains/(losses) on post-employment benefits	**1,231**	(10)
	1,321	75
Tax on items taken directly to equity	**(364)**	(42)
Total net income taken directly to equity during the year	**957**	33
Profit for the year	**2,351**	1,896
Total recognised income and expense for the year attributable to shareholders of the parent company	**3,308**	1,929

Financial Statements (continued)

HSBC Bank plc cash flow statement for the year ended 31 December 2007

	Notes	2007 £m	2006 £m
Cash flows (used in)/ from operating activities			
Profit before tax		**2,859**	2,335
Adjustments for:			
– non-cash items included in net profit	*37*	**1,607**	1,267
– change in operating assets	*37*	**(44,754)**	(13,812)
– change in operating liabilities	*37*	**39,363**	21,446
– elimination of exchange differences[1]		**(2,046)**	(160)
– net gain from investing activities		**(167)**	(48)
– contribution paid for defined pension schemes		**535**	127
– tax paid		**(428)**	(323)
Net cash (used in)/ from operating activities		**(3,031)**	10,832
Cash flows (used in)/ from investing activities			
Purchase of financial investments		**(20,361)**	(17,398)
Proceeds from the sale of financial investments		**19,027**	20,315
Purchase of property, plant and equipment		**(307)**	(373)
Proceeds from the sale of property, plant and equipment		**59**	148
Purchase of goodwill and intangible assets		**(97)**	(110)
Net cash outflow from acquisition/increase stake in associates		**(61)**	(98)
Proceeds from disposal of associates		**298**	46
Purchases of HSBC Holdings plc shares to satisfy share based payment transactions		**26**	84
Net cash (used in)/ from investing activities		**(1,416)**	2,614
Cash flows used in financing activities			
Issue of ordinary share capital		**1,510**	675
Subordinated loan capital issued		**–**	1,110
Subordinated loan capital repaid		**22**	(400)
Dividends paid		**(1,706)**	(1,591)
Net cash used in financing activities		**(174)**	(206)
Net (decrease)/ increase in cash and cash equivalents		**(4,621)**	13,240
Cash and cash equivalents at 1 January		**26,485**	14,053
Effect of exchange rate changes on cash and cash equivalents		**728**	(808)
Cash and cash equivalents at 31 December	*37*	**22,592**	26,485

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

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 from IFRSs as published by the International Accounting Standards Board ('IASB') if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2007, there were no unendorsed standards effective for the year ended 31 December 2007 affecting these consolidated and parent company financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to the group. Accordingly, the group's financial statements for the year ended 31 December 2007 are prepared in accordance with IFRSs as issued by the IASB.

IFRSs comprise accounting standards issued by the IASB and its predecessor body 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 2007, the group adopted IFRIC 10 'Interim Financial Reporting and Impairment'. The application of this interpretation had no significant effect on the consolidated financial statements.

During 2007, the group changed the presentation of its business segments to include 'Other' as an additional segment. All prior period comparative data have been restated to conform to the current year presentation. Additional information on this is set out in Note 2(c).

(b) Presentation of information

In publishing the parent company financial statements 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 audited capital management information presented on pages 17 to 22 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. Newly acquired subsidiaries are consolidated from the date that control is transferred to the group. 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 required, the difference is recognised immediately in the income statement. Entities that are controlled by the group are consolidated until the date that control ceases.

For 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;

Notes on the Financial Statements (continued)

- the group has the rights to obtain the majority of benefits of the SPE and therefore may be exposed to risks incidental 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.

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

Standards and Interpretations issued by the IASB and 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 the chief operating decision maker uses to make operating decisions. The group currently presents two sets of segments in accordance with IAS 14, one geographical and one based on customer groups, which reflect the way the businesses of the group are managed. It is anticipated that IFRS 8 will be adopted by the group with effect from 1 January 2009, and will accordingly present segmental information which reflects the operating segments used to make operating decisions at that time.

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. It is anticipated that this interpretation will be adopted with effect from 1 January 2008, and will have an impact on the group which is currently being assessed.

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

The IASB issued a revised IAS 23 'Borrowing Costs' on 29 March 2007, which is applicable for annual periods beginning on or after 1 January 2009. The revised Standard eliminates the option of recognising borrowing costs immediately as an expense, to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. Adoption of the revised Standard is not expected to have a significant impact on group results.

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.

IFRIC 13 'Customer Loyalty Programmes' ('IFRIC 13') was issued on 28 June 2007 and is effective for annual periods beginning on or after 1 July 2008. IFRIC 13 addresses how companies that grant their customers loyalty award credits (often called 'points') when buying goods or services should account for their obligation to provide free or discounted goods or services, if and when the customers redeem the points. IFRIC 13 requires companies to allocate some of the proceeds of the initial sale to the award credits and recognise these proceeds as revenue only when they have fulfilled their obligations to provide the goods or services. The group is currently assessing the effect of this interpretation.

IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' ('IFRIC 14') was issued on 5 July 2007 and is effective for annual periods beginning on or after

1 January 2008. IFRIC 14 provides guidance regarding the circumstances under which refunds and future reductions in contributions from a defined benefit plan can be regarded as available to an entity for the purpose of recognising a net defined benefit asset. Additionally, in jurisdictions where there is both a minimum funding requirement and restrictions over the amounts that companies can recover from the plan, either as refunds or reductions in contribution, additional liabilities may need to be recognised. IFRIC 14 is not expected to have a significant impact on the group.

A revised IAS 1 'Presentation of Financial Statements', which is applicable for annual periods beginning on or after 1 January 2009, was issued on 6 September 2007. The revised standard aims to improve users' ability to analyse and compare information given in financial statements. Adoption of the revised standard will have no effect on the results reported in the group's consolidated financial statements but will change the presentation of the results and financial position of the group in certain respects.

The IASB issued an amendment to IFRS 2 'Share-based Payment' on 17 January 2008. The amendment, which is applicable for annual periods beginning on or after 1 January 2009, clarifies that vesting conditions comprise only service conditions and performance conditions. It also specifies the accounting treatment for a failure to meet a non-vesting condition. Adoption of the amendment is unlikely to have a significant effect on the group's consolidated financial statements.

A revised IFRS 3 'Business Combinations' and an amended IAS 27 'Consolidated and Separate Financial Statements', were issued on 10 January 2008. The revisions to the standards apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual financial reporting period beginning on or after 1 July 2009. The main changes under the standards are that:

- acquisition-related costs are recognised as expenses in the income statement in the period they are incurred;
- equity interests held prior to control being obtained are remeasured to fair value at the time control is obtained, and any gain or loss is recognised in the income statement;
- changes in a parent's ownership interest in a subsidiary that do not result in a change of control are treated as transactions between equity holders and reported in equity; and
- an option is available, on a transaction-by-transaction basis, to measure any non-controlling interests (previously referred to as minority interests) in the entity acquired either at fair value, or at the non-controlling interest's proportionate share of the net identifiable assets of the entity acquired.

The effect that the changes will have on the results and financial position of the group will depend on the incidence and timing of business combinations occurring on or after 1 January 2010.

The IASB issued amendments to IAS 32 'Financial Instruments: Presentation' and IAS 1 'Presentation of Financial Statements', - 'Puttable Financial Instruments and Obligations Arising on Liquidation', on 14 February 2008. The amendments are applicable for annual periods beginning on or after 1 January 2009. The effect of the amendments, if any, on the consolidated financial statements is currently being assessed by the group.

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)).

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.

Dividend income

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

(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 Global Banking and Markets; International Banking; France; Private Banking; and HSBC Trinkaus & Burkhardt. The 'Other' segment comprises activities, operations and sources of income and expense which are not allocated to any of the other business segments. This includes movements in fair value on debt securities issued by the group designated at fair value and exchange movements on foreign-currency denominated equity instruments issued by the group. Segment income and expenses include transfers between geographical regions and transfers between business segments. These transfers are conducted at arms length.

(d) Determination of fair value

All financial instruments are recognised initially at fair value. In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (that is, the fair value of the consideration given or received). In certain circumstances, however, the initial 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 gain or loss at inception of the financial instrument. When unobservable market data have a significant impact on the valuation of financial instruments, the entire initial difference in fair value indicated by the valuation model from the transaction price is not recognised immediately in the income statement but is recognised over the life of the

transaction on an appropriate basis, or when the inputs become observable, or the transaction matures or is closed out, of when the group enters into an offsetting transaction.

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

When fair values are calculated using valuation techniques factors such as bid-offer spread, credit profile and model uncertainty are taken into account as appropriate. Valuation techniques incorporate assumptions that other market participants would use in their valuations, including assumptions about interest rate yield curves, exchange rates, volatilities and prepayment and default rates. Where a portfolio of financial instruments has quoted prices in an active market, the fair value of the instruments are calculated as the product of the number of units and quoted price and no block discounts are made.

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

The fair values of financial liabilities are measured using quoted market prices where available, or using valuation techniques. These fair values include market participants' assessments of the credit quality of the group's liabilities. The amount of change during the period, and cumulatively, in the fair value of designated financial liabilities and loans and advances that is attributable to changes in their credit risk is determined as the amount of change in the fair value that is not attributable to changes in market conditions that give rise to market risk.

(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. They are derecognised when either borrowers repay their obligations, or the loans are sold or written off or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less impairment losses. Where loans and advances are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the loans and advances so hedged includes a fair value adjustment for the hedged risk only.

(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 groups of loans assessed collectively. Impairment losses are recorded as charges to the income statement. The carrying amount of impaired loans on the balance sheet is reduced through the use of impairment allowance accounts. Losses expected from future events are not recognised.

Individually assessed loans and advances

For all loans that are considered individually significant, the group assesses on a case-by-case basis at each balance sheet date whether there is any objective evidence that a loan is impaired. For those loans where objective evidence of impairment exists, impairment losses are determined considering the following factors:

- 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 ability of the borrower to obtain, and make payments in the currency of the loan if not local currency;
- the amount and timing of expected receipts and recoveries;

- 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;
- the likely dividend available on liquidation or bankruptcy;
- the likely deduction of any costs involved in recovery of amounts outstanding; 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 and advances

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

- to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses that are likely to have been incurred as a result of the risk conditions in existence at the balance sheet date, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

The collective impairment allowance is determined after taking into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, risk rating or product segment);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and
- management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

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

Homogeneous groups of loans

Two methodologies are used to calculate impairment allowances where large numbers of relatively low-value assets are managed using a portfolio approach:

- when appropriate empirical information is available, the group utilises roll rate methodology. This employs a statistical analysis of historical trends of default and the amount of consequential loss, based on the delinquency of accounts within a portfolio of homogenous accounts. Other historical data and current economic conditions are also evaluated when calculating the appropriate level of impairment allowance required to cover inherent loss. In certain highly developed markets, models also take into account behavioural and account management trends revealed in, for example, bankruptcy and rescheduling statistics.

- when the portfolio size is small, or when information is insufficient or not reliable enough to adopt a roll rate methodology, a formulaic approach is used which allocates progressively higher percentage loss rates the longer a customer's loan is overdue. Loss rates reflect the discounted expected future cash flows for a portfolio and are based on historical experience.

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 regulations – management considers the more recent trends in the portfolio risk factors which may not be adequately reflected in its statistical models and, adjusts impairment allowances accordingly.

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

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 as part of an orderly realisation are recorded as assets held for sale and reported in 'Other assets'. The asset acquired is recorded at the lower of its fair value (less costs to sell) and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the income statement in 'Other operating income'. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write down, is also recognised in 'Other operating income', together with any realised gains or losses on disposal.

Write-off of loans and advances

Loans, and the related impairment allowances, are normally written off, either partially or in full, in the case of that portion of the loan amount not covered by the value of security, when there is no realistic prospect of further recovery; and in the case of secured balances, after proceeds from the realisation of security have been received.

Renegotiated loans

Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered to be past due, but are treated as new loans once the minimum number of payments required under the new arrangements have been received. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or are considered to be past due. The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition.

(g) Trading assets and trading liabilities

Treasury bills, debt securities, equity shares, loans, deposits, debt securities in issue, and short positions in securities are classified as held for trading if they have been acquired principally for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These financial assets or financial liabilities are recognised on trade date when 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:

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

(ii) 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.

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

The fair value designation, once made, is irrevocable. Designated financial assets and financial liabilities are recognised when the group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and are normally derecognised when sold (assets) or extinguished (liabilities). Measurement is initially at fair value, with transaction costs taken directly to the income statement. Subsequently, the fair values are remeasured and, 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'.

(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.

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 (net of any principal repayments and amortisation) and its current fair value, less any impairment loss on that asset previously recognised in the income statement) is removed from equity and recognised in the income statement. Reversals of impairment losses are subject to contrasting treatments depending on the nature of the instrument concerned:

– if the fair value of a debt instrument classified as available-for-sale increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement; 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 under these agreements is not normally reflected on the balance sheet. Cash collateral advanced or received is recorded as an asset or a liability respectively.

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

(k) Derivatives and hedge accounting

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

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

Derivatives are classified as assets when their fair value is positive, or as liabilities when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset if the transactions are

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) a hedge 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 the group requires that, at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective. Actual 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'. The interest on derivatives managed in conjunction with debt securities issued by the group that are designated at fair value is recognised in 'Interest expense'. All other gains and losses on these derivatives are reported in 'Net income from financial instruments designated at fair value'.

(l) Derecognition of financial assets and liabilities

Financial assets are derecognised when the right to receive cash flows from the assets has expired, or the group has transferred the financial assets such that it either transfers its contractual rights to receive the cash flows of the financial assets, or retains the rights to receive the cash flows of the financial assets but assumes a contractual obligation to pay the cash flows to recipients in an arrangement where:

- there is no obligation to pass on the cash flows unless equivalent amounts are collected from the asset;
- the terms of the arrangement prohibits the sale or pledging of the asset; and
- cash flows collected are remitted to the recipient without material delay.

When financial assets have been transferred derecognition will occur when, either:

- substantially all the risks and rewards of ownership have been transferred; or
- the group has neither retained nor transferred substantially all the risks and rewards, but has not retained control.

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, associates and joint ventures are stated at cost less impairment losses and, in the case of subsidiaries, 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.

The group's 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 in the 'Associates and joint ventures' reserve.

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.

(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. 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, and whenever there is an indication that the cash-generating unit may be impaired, by comparing the present value of the expected future cash flows from a 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.

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 insurance 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(x).

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

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

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.

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.

(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 in 'Net interest income' over the periods of the leases so as to give a constant rate of return on the net investment in the leases.

When 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 in 'Net interest income' over the period of the lease based on the interest rate implicit in the lease so as to give a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. When acting as lessor 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.

A sale and leaseback transaction involves the sale of an asset followed by the leasing back of the same asset. The resulting lease is classified either as a finance lease or an operating lease and accounted for accordingly. If a sale and leaseback transaction results in the recognition of a finance lease, any excess of sales proceeds over the carrying amount is deferred and amortised over the lease term. If a sale and leaseback transaction results in an operating lease, any profit or loss is recognised immediately.

(r) Income tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in 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 based on tax rates and laws enacted, or substantively enacted by the balance sheet date. Deferred tax assets and liabilities are offset when they arise in the same tax reporting group and relate to income taxes levied by the same taxation authority, and when a legal right to set off exists in the entity.

Deferred tax relating to actuarial gains and losses on post-employment benefits is recognised directly in equity. Deferred tax relating to fair value remeasurement of available-for-sale investments and cash flow hedging instruments which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

(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 defined benefit pension costs and the present value of defined benefit obligations are calculated at the reporting date by the scheme's actuaries using the Projected Unit Credit Method. The charge to the income statement mainly comprises the current service cost, plus the unwinding of the discount rate on plan liabilities, less the expected return on plan assets, and is presented in operating expenses. Past service costs are 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. Actuarial gains and losses arise as a result of differences between previous expectations based on actuarial assumptions and the actual outcome for the period and from changes in actuarial assumptions. They are recognised in shareholders' equity and presented in the Statement of Recognised Income and Expense in the period in which they arise.

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

The costs of obligations arising from other post-employment benefits plans, such as defined benefit health care plans, are accounted for on the same basis as defined benefit pension 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.

Share options granted by HSBC Holdings to group employees are accounted for as equity-settled share-based payment transactions. The expense is recognised in the income statement over the vesting period and 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 fair value of these awards is credited to equity over the vesting period and the awards are satisfied by HSBC Holdings transferring shares to the employees.

Share awards granted to employees of the group by group entities are accounted for as cash-settled share-based payment transaction and are expensed to the income statement over the vesting period at fair value. A liability for the fair value of the share awards is recognised on-balance sheet and this liability is remeasured at each reporting date over the vesting period and on the date of settlement. The employing entity has an obligation to transfer HSBC Holdings shares to the employee if the vesting conditions of the award are satisfied.

If awards of shares and options lapse during the vesting period due to an employee leaving employment with the group, the charge to date is reversed to the income statement. If an award lapses due to an employee leaving a

plan but not employment with the group, this is accounted for as an acceleration of vesting with full immediate recognition of the outstanding charge in the income statement. No accounting entries are made if awards of share options lapse after they have fully vested.

(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 at historical cost in a foreign currency are translated into the functional currency using the rate of exchange at the date of the initial transaction. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated into the functional currency using the rate of exchange at the date the fair value was determined. Any exchange component of a gain or loss on a non-monetary item is recognised in equity if the gain or loss on the non-monetary item is recognised directly in equity. Any exchange component of a gain or loss on a non-monetary item is recognised directly in the income statement if the gain or loss on the non-monetary item is recognised in the income statement.

In the financial statements, the assets, including related goodwill where applicable, and liabilities of branches, subsidiaries, joint ventures and associates whose functional currency is not sterling, are translated into the group's presentational currency at the rate of exchange ruling at the balance sheet date. 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 recognised in equity in the 'foreign exchange reserve'. At the date of transition to IFRSs, the group set the cumulative exchange differences for all foreign operations to zero in accordance with IFRS 1. Exchange differences on a monetary item that is part of a net investment in a foreign operation are recognised in the income statement of the separate financial statements. In consolidated financial statements these exchange differences are recognised in the foreign exchange reserve in shareholders' equity. On disposal of a foreign operation, exchange differences relating thereto and previously recognised in reserves are recognised in the income statement.

(v) Provisions

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

Contingent liabilities, which include certain guarantees and letters of credit pledged as collateral security, are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the group. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

(w) Financial guarantee contracts

Liabilities under financial guarantee contracts that are not classified as insurance contracts, are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, the financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations. Where guarantee contracts have been classified as insurance contracts, they are measured consistently with insurance liabilities.

HSBC Bank plc has issued financial guarantees to other group entities and these are accounted for in accordance with the above.

Notes on the Financial Statements (continued)

(x) 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.

As permitted by IFRS 4 investment contracts with discretionary participation features are accounted for as insurance contracts.

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.

Gross insurance claims for life insurance contracts reflect the total cost of claims arising during the year, including claim handling costs and any policyholder bonuses allocated in anticipation of a bonus declaration. Claims arising in the year include maturities, surrenders and death claims.

Maturity claims are recognised when due for payment. Surrenders are recognised when paid or at an earlier date on which, following notification, the policy ceases to be included within the calculation of the related insurance liabilities. Death claims are recognised when notified.

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

Liabilities under insurance contracts

Outstanding claims liabilities for non-life insurance contracts are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claim-handling costs and a reduction for the expected value of salvage and other recoveries. Liabilities for claims incurred but not reported are made on an estimated basis, using appropriate statistical techniques.

Liabilities under non-linked life insurance contracts are calculated by each life insurance operation based on local actuarial principles.

Liabilities under unit-linked life insurance contracts are at least equivalent to the surrender or transfer value which is calculated by reference to the value of the relevant underlying funds or indices.

A liability adequacy test is carried out on insurance liabilities to ensure that the carrying amount of the liabilities is sufficient in the light of current estimates of future cash flows. When performing the liability adequacy test, all contractual cash flows are discounted and compared against the carrying value of the liability. Where a shortfall is identified it is charged immediately to the income statement.

Present value of in-force long-term insurance business

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

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.

Future profit participation

Where contracts provide discretionary profit participation benefits to policyholders, insurance liabilities include the net unrealised gains recognised in connection with the assets backing the contracts to the extent that policyholders will benefit from such gains. The benefit may arise from the contractual terms, regulation, or past distribution policy on the basis of the contractual terms of the policy, regulation, or past distribution policy. The corresponding movement in the liability is recognised in equity or in the income statement in the same proportion to net unrealised gains on the assets. In the case of net unrealised losses, a deferred participating asset is recognised only to the extent that its recoverability is highly probable.

(y) Investment contracts

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

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

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

(z) Debt securities in issue and deposits by customers and banks

Financial liabilities are recognised when the group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date. Financial liabilities are initially measured at fair value, normally the consideration received net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities, other than those measured at fair value through profit or loss and financial guarantees, is at amortised cost, using the effective interest rate method to amortise the difference between proceeds net of directly attributable transaction costs and the redemption amount over the expected life of the debt.

(aa) Share capital

Financial instruments issued 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.

(ab) Cash and cash equivalents

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

(ac) Non-current assets held for sale

The group classifies a non-current asset or disposal group as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

For the group to use this classification, the asset or disposal group must be available for immediate sale in its present condition and its sale must be highly probable. A sale is highly probable if:

- the appropriate level of management is committed to a plan to sell the asset or disposal group;
- an active plan to locate a buyer and complete the plan has been initiated;
- the asset or disposal group is being actively marketed for sale at a price that is reasonable in relation to its current fair value;
- the sale is expected to be completed within one year from the date of classification; and
- it is unlikely that there will be significant changes to the plan or that the plan will be withdrawn.

When the group classifies an asset or disposal group as held for sale it is measured at the lower of its carrying amount and fair value less costs to sell.

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) on the financial statements. Further information can be seen in Note 38 'Risk Management'.

Losses in respect of impaired loans are reported in the group's income statement under the caption 'Loan impairment charges and other credit risk provisions'. 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:

- Low value, homogenous small business accounts;
- 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).

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.

Significant management judgement is involved in determining the cost of capital assigned to an individual CGU and in estimating its future cash flows. This is discussed in further detail in Note 21 'Impairment of assets other than financial instruments'.

Valuation of financial instruments

The group's accounting policy for valuation of financial instruments is included in Note 2(d) and is discussed further within Note 17 'Derivatives' and Note 31 '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 also considers 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 recognised: 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.

Financial instruments measured at fair value through profit or loss comprise financial instruments held for trading and financial instruments designated at fair value. Changes in their fair value directly impact the group's income statement in the period in which they occur.

A change in the fair value of a financial asset which is classified as 'available-for-sale' is recorded directly in equity until the financial asset is sold, when the cumulative change in fair value is charged or credited to the income statement. When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is removed from equity and recognised in profit or loss, reducing the group's operating profit.

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'.

Consolidation

The circumstances under which the group consolidates special purpose entities are outlined in Note 1(c) and disclosed in Note 38 'Risk Management'.

Notes on the Financial Statements (continued)

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, interest expense and dividend income in respect of:
  - financial assets and liabilities designated at fair value; and
  - derivatives managed in conjunction with the above,

except for interest arising on the group's debt securities in issue and subordinated liabilities, together with the interest element of derivatives managed in conjunction with them, which is recognised in 'Interest expense'.

	2007 **£m**	2006 £m
Net income arising on:		
– financial assets held to meet liabilities under insurance and investment contracts	**368**	395
– other financial assets designated at fair value[1]	**188**	50
– derivatives managed in conjunction with financial assets designated at fair value[1]	**7**	26
	563	471
– liabilities to customers under investment contracts	**(295)**	(350)
– own debt securities in issue and subordinated liabilities[2]	**76**	186
– derivatives managed in conjunction with own debt securities in issue and subordinated liabilities	**(27)**	(186)
– other financial liabilities designated at fair value	**(183)**	(62)
– derivatives managed in conjunction with financial liabilities designated at fair value	**(8)**	–
	(437)	(412)
Net income from financial instruments designated at fair value	**126**	59

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 2007, the group recognised a £**205** million gain (2006: £6 million loss) on changes in the fair value of these instruments arising from changes in own credit risk.*

5 Net earned Insurance premiums

	2007				
	Non-life insurance £m	**Life insurance (non-linked) £m**	**Life insurance (linked) £m**	**Investment contracts with discretionary participation features[2] £m**	**Total £m**
Gross written premiums[1]	**372**	**723**	**129**	**933**	**2,157**
Movement in unearned premiums	**6**	**2**	**–**	**–**	**8**
Gross earned premiums	**378**	**725**	**129**	**933**	**2,165**
Gross written premiums ceded to reinsurers	**(73)**	**(154)**	**(9)**	**–**	**(236)**
Reinsurers' share of movement in unearned premiums	**(8)**	**–**	**–**	**–**	**(8)**
Reinsurers' share of gross earned premiums	**(81)**	**(154)**	**(9)**	**–**	**(244)**
Net earned insurance premiums	**297**	**571**	**120**	**933**	**1,921**

1 *Gross written insurance premiums in 2007 include adjustments on the implementation of FSA Policy Statement PS06/14.*
2 *Investment contracts with with discretionary participation features have been recognised in 2007 as a result of obtaining control of HSBC Assurances VIE (France) and HSBC Assurances IARD (France) during the year.*

	2006				
	Non-life insurance £m	Life insurance (non-linked) £m	Life insurance (linked) £m	Investment contracts with discretionary participation features £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 insurance premiums	94	178	45	–	317

6 Net insurance claims incurred and movement in policyholders' liabilities

	2007				
	Non-life insurance £m	**Life insurance (non-linked) £m**	**Life insurance (linked) £m**	**Investment contracts with discretionary participation features[1] £m**	**Total £m**
Claims, benefits and surrenders paid	250	132	139	537	1,058
Movement in liabilities	36	(123)	19	536	468
Gross claims incurred and movement in liabilities	286	9	158	1,073	1,526
Reinsurers' share of claims, benefits and surrenders paid	(65)	(73)	(8)	–	(146)
Reinsurers' share of movement in liabilities	29	263	2	–	294
Reinsurers' share of claims incurred and movement in liabilities	(36)	190	(6)	–	148
Net insurance claims incurred and movement in policyholders' liabilities	250	199	152	1,073	1,674

1 *Investment contracts with discretionary participation features have been recognised in 2007 as a result of obtaining control of HSBC Assurances VIE (France) and HSBC Assurances IARD (France) during the year.*

Notes on the Financial Statements (continued)

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

7 Net operating income

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

	2007 £m	2006 £m
Income		
Interest on financial instruments, excluding interest on financial assets held for trading or designated at fair value	**16,439**	13,339
Interest recognised on impaired financial assets	**28**	39
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	**2,966**	2,316
Fees earned relating to trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	**767**	691
Expense		
Interest on financial instruments, excluding interest on financial liabilities held for trading or designated at fair value	**12,310**	8,936
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	**571**	478
Fees payable relating to trust and other fiduciary activities where the group holds or invests assets on behalf of its customers	**18**	12
Gains/(losses)		
Gain on disposal of assets held for sale	**111**	–
Impairment losses on:		
– loans and advances	**(1,043)**	(935)
– available-for-sale financial investments	**(23)**	(8)

8 Employee compensation and benefits

	The group		**The bank**	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Wages and salaries	**3,465**	3,221	**1,935**	1,951
Social security costs	**478**	409	**195**	187
Post-employment benefits	**344**	299	**287**	220
	4,287	3,929	**2,417**	2,358

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

	2007	2006
UK PFS, Global Banking and Markets and Commercial Banking	**51,050**	49,484
International Banking	**12,671**	9,279
France	**14,905**	14,620
Private Banking	**4,486**	4,109
HSBC Trinkaus & Burkhardt	**1,817**	1,635
Total	**84,929**	79,127

Post-employment benefit plans

Income statement charge

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Defined benefit pension plans				
- HSBC Bank (UK) Pension Scheme	**245**	182	**245**	182
- Other plans	**(5)**	21	**1**	-
Defined contribution plans	**95**	88	**33**	31
Defined benefit healthcare plans	**9**	8	**8**	7
	344	299	**287**	220

Liabilities recognised on the balance sheet

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Defined benefit pension plans				
- HSBC Bank (UK) Pension Scheme	**403**	1,907	**403**	1,907
- Other plans	**107**	165	**12**	10
Defined benefit healthcare plans	**164**	180	**136**	152
	674	2,252	**551**	2,069

Pension plans

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 13 Directors, four of whom are 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 which are unfunded under plans in the United Kingdom and France. 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 for the year was £9 million (2006: £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-

Notes on the Financial Statements (continued)

employment healthcare benefits at 31 December 2007, which will form the basis for measuring the 2008 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 2007					
UK	**5.80**	**3.30**	**3.30**	**4.30**	**7.30**
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 actuaries 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 2006, which formed the basis for measuring the 2007 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 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 mortality tables and average life expectancy at 65 used at 31 December 2007 were as follows:

	Mortality table	**Life expectancy at age 65 for a male member currently:**		**Life expectancy at age 65 for a female member currently:**	
		Aged 65	**Aged 45**	**Aged 65**	**Aged 45**
UK	PA92U2005	**20.40**	**21.70**	**23.40**	**24.60**
France	TG05	**22.93**	**25.73**	**26.41**	**29.29**
Germany	Heubeck 2005G	**18.06**	**20.84**	**22.20**	**24.85**
Switzerland	BVG2005	**17.90**	**17.90**	**20.98**	**20.98**

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	PA92U2005	20.30	21.60	23.30	24.60
France	TPG93	22.79	25.59	26.28	29.14
Germany	Heubeck 2005G	18.06	20.84	22.20	24.85
Switzerland	EVK2000	17.76	17.76	21.09	21.09

Actuarial assumption sensitivities

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

	HSBC Bank (UK) Pension Scheme	
	2007	2006
	£m	£m
Discount rate		
Change in pension obligation at 31 December from a 25bps increase	**(493)**	(553)
Change in pension obligation at 31 December from a 25bps decrease	**530**	584
Change in pension cost from a 25bps increase	**(10)**	(10)
Change in pension cost from a 25bps decrease	**10**	11
Rate of inflation		
Change in pension obligation at 31 December from a 25bps increase	**530**	584
Change in pension obligation at 31 December from a 25bps decrease	**(493)**	(553)
Change in pension cost from a 25bps increase	**40**	45
Change in pension cost from a 25bps decrease	**(37)**	(39)
Rate of increase for pensions in payment and deferred pensions		
Change in pension obligation at 31 December from a 25bps increase	**410**	463
Change in pension obligation at 31 December from a 25bps decrease	**(378)**	(444)
Change in pension cost from a 25bps increase	**30**	29
Change in pension cost from a 25bps decrease	**(28)**	(28)
Rate of pay increase		
Change in pension obligation at 31 December from a 25bps increase	**120**	146
Change in pension obligation at 31 December from a 25bps decrease	**(115)**	(140)
Change in pension cost from a 25bps increase	**11**	16
Change in pension cost from a 25bps decrease	**(10)**	(14)
Mortality		
Change in pension obligation from each additional year of longevity assumed	**340**	385

	Other plans	
	2007	2006
	£m	£m
Change in pension obligation from each additional year of longevity assumed	**9**	16

Defined benefit pension plans

Value recognised in the balance sheet

	At 31 December 2007			
	HSBC Bank (UK) Pension Scheme		Other plans	
	Expected rate of return	**Value**	**Expected rate of return[2]**	**Value**
	%	**£m**	**%**	**£m**
Equities	**8.3**	**2,283**	**7.2**	**196**
Bonds	**6.1**	**7,646**	**3.6**	**260**
Property	**7.3**	**936**	**5.2**	**11**
Other	**5.1**	**451**	**4.9**	**90**
Fair value of plan assets		**11,316**		**557**
Present value of funded obligations		**(11,719)**		**(610)**
Present value of unfunded obligations		**-**		**(33)**
Defined benefit obligation		**(11,719)**		**(643)**
Effect of limit on plan surpluses		**-**		**(21)**
Unrecognised past service cost		**-**		**-**
Net liability[1]		**(403)**		**(107)**

1 £415 million of the net liability for defined benefit pension plans relates to the bank (2006: £1,917 million)
2 The expected rates of return are weighted on the basis of the fair value of the plan assets.

Notes on the Financial Statements (continued)

	At 31 December 2006			
	HSBC Bank (UK) Pension Scheme		Other plans	
	Expected rate of return %	Value £m	Expected rate of return[1] %	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		(1,907)		(165)

1 The expected rates of return are weighted on the basis of the fair value of the plan assets

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 statement sets out the principles governing how decisions about investments are made.

During 2006, the Trustee undertook 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. 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 42 'Related party transactions'.

Changes in the present value of the defined benefit obligation

	2007		2006	
	HSBC Bank (UK) Pension Scheme £m	**Other plans £m**	HSBC Bank (UK) Pension Scheme £m	Other plans £m
At 1 January	**12,392**	**627**	11,961	601
Current service cost	**227**	**23**	242	24
Interest cost	**623**	**23**	560	21
Contributions by employees	**-**	**16**	–	13
Actuarial gains	**(1,208)**	**(49)**	(2)	(15)
Benefits paid	**(315)**	**(37)**	(369)	(32)
Past service cost – vested immediately	**-**	**3**	–	2
Curtailments	**-**	**(29)**	–	–
Exchange and other movements	**-**	**66**	–	13
At 31 December	**11,719**	**643**	12,392	627

Changes in the fair value of plan assets

	2007		2006	
	HSBC Bank (UK) Pension Scheme	**Other plans**	HSBC Bank (UK) Pension Scheme	Other plans
	£m	**£m**	£m	£m
At 1 January	**10,485**	**460**	10,107	404
Expected return	**605**	**25**	620	22
Contributions by the group	**535**	**13**	127	15
Contributions by employees	**-**	**16**	–	11
Experience gains	**6**	**3**	–	7
Benefits paid	**(315)**	**(24)**	(369)	(16)
Assets distributed on settlements	**-**	**(3)**	–	–
Exchange and other movements	**-**	**67**	–	17
At 31 December	**11,316**	**557**	10,485	460

The actual return on plan assets for the year ended 31 December 2007 was £639million (2006: £649 million). The group expects to make £251 million of contributions to defined benefit pension plans during 2008.

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

	2007		2006		2005	
	HSBC Bank (UK) Pension Scheme	**Other plans**	HSBC Bank (UK) Pension Scheme	Other plans	HSBC Bank (UK) Pension Scheme	Other plans
	£m	**£m**	£m	£m	£m	£m
Current service cost	**227**	**23**	242	20	211	23
Interest cost	**623**	**23**	560	16	540	20
Expected return on plan assets	**(605)**	**(25)**	(620)	(16)	(525)	(15)
Past service cost	**-**	**3**	–	1	-	(2)
(Gains)/losses on curtailments	**-**	**(29)**	–	–	-	-
Total expense	**245**	**(5)**	182	21	226	26

Summary

	2007		2006		2005	
	HSBC Bank (UK) Pension Scheme	**Other plans**	HSBC Bank (UK) Pension Scheme	Other plans	HSBC Bank (UK) Pension Scheme	Other plans
	£m	**£m**	£m	£m	£m	£m
Defined benefit obligation	**(11,719)**	**(643)**	(12,392)	(627)	(11,961)	(601)
Fair value of plan assets	**11,316**	**557**	10,485	460	10,107	404
Effect of limit on plan surpluses	**-**	**(21)**	-	2	-	-
Net deficit	**(403)**	**(107)**	(1,907)	(165)	(1,854)	(197)
Experience gains on plan liabilities	**(30)**	**(4)**	300	1	40	3
Experience gains/(losses) on plan assets	**6**	**3**	–	7	905	9
Gains/(losses) from changes in actuarial assumptions	**1,238**	**53**	(298)	14	(1,166)	(71)
Total net actuarial gains/(losses)	**1,214**	**52**	2	22	(221)	(59)

Total net actuarial gains recognised in equity since transition to IFRSs are £738 million. The total effect of the limit on plan surpluses recognised in equity together with net actuarial losses in 2007 was a £17 million loss (2006: £3 million loss).

Notes on the Financial Statements (continued)

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 was discontinued and the members' benefits bought out with an insurance company, although in practice this may not be possible for a plan of this size, or the Trustee continued to run the 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.

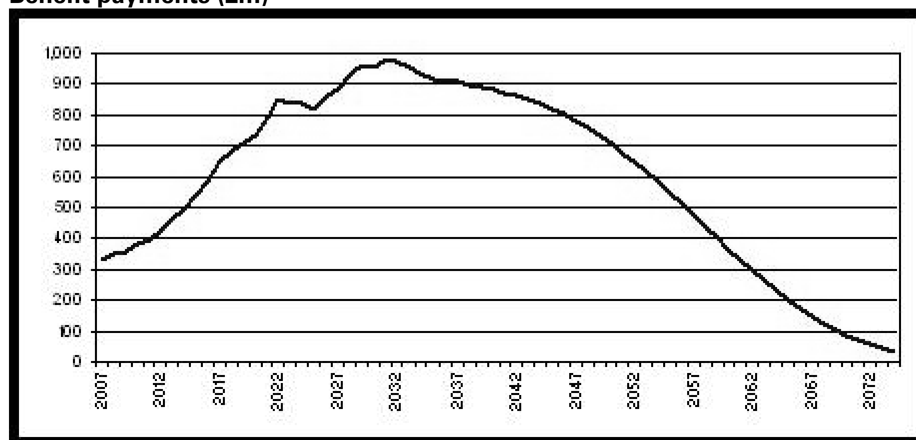
In anticipation of the valuation result, on 22 December 2005 HSBC Bank plc made an additional contribution of £1 billion in order to reduce the deficit of the plan. Following receipt of the valuation the Trustee and the bank have agreed a funding plan to close the deficit over a maximum period of ten 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. The bank has also agreed to a series of additional contributions towards the deficit as detailed below:

	£m
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

	2007 £m	2006 £m
Present value of unfunded obligations	**(164)**	(180)
Net liability[1]	**(164)**	(180)

1 *£136 million of the net liability for post-employment healthcare benefits relates to the bank (2006: £152 million).*

Changes in the present value of the defined benefit obligation

	2007 £m	2006 £m
At 1 January	**180**	168
Current service cost	**1**	1
Interest cost	**8**	7
Actuarial (gains)/losses	**(22)**	12
Past service costs		
- vested immediately	**-**	–
- unvested benefits	**-**	–
Benefits paid	**(6)**	(6)
Exchange and other movements	**3**	(2)
At 31 December	**164**	180

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

	2007 £m	2006 £m
Current service cost	**1**	1
Interest cost	**8**	7
Total expense	**9**	8

Summary

	Year ended 31 December		
	2007 £m	2006 £m	2005 £m
Defined benefit obligation	**(164)**	(180)	(168)
Net deficit	**(164)**	(180)	(168)
Experience gains/(losses) on plan liabilities	**8**	(5)	-
Gains/(losses) from changes in actuarial assumptions	**14**	(7)	(22)
Total net actuarial gains/(losses)	**22**	(12)	(22)

The group expects to make £6m of contributions to healthcare benefit plans during 2008.

Total net actuarial losses recognised in equity to date are £14 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 2007:

	1% increase £m	1% decrease £m
Increase/ (decrease) on the aggregate of the current service cost and interest cost	2	(1)
Increase/ (decrease) on defined benefit obligation	24	(19)

Notes on the Financial Statements (continued)

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:

	2007 £000	2006 £000
Fees	**466**	365
Salaries and other emoluments	**2,026**	1,607
Bonuses	**8,448**[1]	3,316[2]
	10,940	5,288
Vesting of Restricted Share Plan awards	**4,243**	534

1 *Includes the sum of £4,274,098 deferred into shares which are not subject to performance conditions, but are subject to a restricted period.*

2 *In return for the prior waiver of bonus, the employer contribution into the pension scheme of a Director was increased by the amount of £245,458.*

In aggregate, awards of £157,576 (2006: £3,081,494) will be made to one Director under long-term incentive plans in respect of 2007.

Retirement benefits accrue to one Director under a defined benefit scheme and to one Director under a money purchase scheme. A further Director accrued retirement benefits under a money purchase scheme from January to August 2007. Aggregate contributions during the year to money purchase arrangements in respect of Directors services were £395,023.

In addition, there were payments under retirement benefit agreements with former Directors of £700,887 (2006: £690,462), including payments in respect of unfunded pension obligations to former Directors of £386,873 (2006: £397,657). The provision as at 31 December 2007 in respect of unfunded pension obligations to former Directors amounted to £4,653,000 (2006: £5,130,000). During the year, aggregate contributions to pension schemes in respect of Directors were £395,023 (2006: £645,612 - including £245,458 arising from Director's waiver of bonus).

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the bank's parent company, HSBC Holdings plc. The cost of the conditional awards under the HSBC Holdings Restricted Share Plan 2000 and The HSBC Share Plan are recognised through an annual charge based on the fair value of the awards 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:

	2007 £000	2006 £000
Fees	**-**	35
Salaries and other emoluments	**208**	422
Bonuses[1]	**3,064**	845[2]

1 *Includes the sum of £1.2 million deferred into shares which are not subject to performance conditions, but are subject to a restricted period.*

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

The highest paid Director received 424,486 shares as the result of awards under long-term incentive plans that vested during the year. The highest paid Director did not exercise any share options over HSBC Holdings Plc ordinary shares during the year.

Contributions of £180,000 into a defined contribution pension 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 £157,576 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 £9.0 million (2006: £8.1 million).

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

	2007	2006
	£m	£m
Audit fees for HSBC Bank plc statutory audit:		
– fees relating to current year	**3.3**	3.3
– fees relating to prior year	**0.1**	–
	3.4	3.3
Fees payable to KPMG for other services provided to the group		
– audit of subsidiaries, pursuant to legislation	**5.0**	4.4
– other services pursuant to legislation	**2.2**	2.3
– tax services	**0.2**	0.3
– services relating to information technology	**0.2**	0.1
– valuation and actuarial services	**0.1**	0.1
– all other services	**1.9**	1.4
	9.6	8.6
Total fees payable	**13.0**	11.9

'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.

– 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.

– 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 granted by HSBC Holdings to group employees are accounted for as equity-settled share-based payments and 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 2007, £42 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 (2006: £77 million and £122 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. The carrying amount of the share-based payment liability at the balance sheet date was £184 million (2006: £140 million).

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 2007 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] (%)	**5.6**	**5.5**	**5.4**	–
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 10 per cent for the first 3 years (2006: 9 per cent for first year) and 8 per cent thereafter (2006: 8 per cent), consistent with consensus analyst forecasts.

The average share price for 2007 was £9.03 (2006: £9.60). The high mid-market price for the year was £9.72 and the low mid-market price was £7.84 (2006: £10.28 and £9.14 respectively).

The significant weighted average assumptions used to estimate the fair value of the options granted in 2006 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] (%)	4.7	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.*

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, 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.

	2007 Number (000)	2006[2] Number (000)
Outstanding at 1 January	**1,966**	962
Additions during the year	**421**	1,132
Releases during the year	**(203)**	(128)
Forfeited in the year	**–**	–
Outstanding at 31 December[1]	**2,184**	1,966

1 *The above table includes the bank employee awards of 1,735,782 (2006: 1,446,832)*
2 *Restated*

The weighted average fair value of shares awarded by the group for Performance Share Awards in 2007 was £8.96 (2006: £7.38).

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.

Notes on the Financial Statements (continued)

	2007 Number (000)	2006[2] Number (000)
Outstanding at 1 January	**13,333**	214
Additions during the year	**21,035**	13,570
Released during the year	**(2,454)**	(163)
Forfeited in the year	**(2,324)**	(288)
Outstanding at 31 December[1]	**29,590**	13,333

1 *The above table includes the bank employee shares of 11,448,342 granted during the year and 16,576,814 shares outstanding at 31 December 2007.*

2 *Restated*

The weighted average fair value of shares awarded by the group for Restricted Share Awards in 2007 was £8.96 (2006: £9.65).

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 lapse. Options granted in September 2005 are exercisable up to the tenth anniversary of the grant, after which they lapse.

	2007		2006	
	Number (000)	**Weighted average exercise price £**	Number (000)	Weighted average exercise price £
Outstanding at 1 January	**628**	**8.84**	628	8.84
Granted in the year	**–**	**–**	–	–
Forfeited in the year	**(103)**	**8.79**	–	–
Outstanding at 31 December	**525**	**8.85**	628	8.84

No share options were granted in 2007 (fair value of options granted in 2006: nil). The remaining contractual life of options outstanding at the balance sheet date is 2.39 years. (2006: 3 years). The exercise price range of options outstanding at the balance sheet date is £8.794 - £9.17. None of these options are exercisable at the balance sheet date.

No share options were exercised in the year.

Savings-related share 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 (2006: 20 per cent) discount to the market value at the date of grant.

	2007		2006	
		Weighted average exercise		Weighted average exercise
	Number	**price**	Number	price
	(000)	**£**	(000)	£
Outstanding at 1 January	**37,053**	**6.46**	37,164	5.98
Granted in the year	**10,845**	**7.08**	7,890	8.89
Exercised in the year	**(3,623)**	**6.45**	(6,714)	5.63
Transferred in the year	**(1,242)**	**6.89**	134	5.90
Expired in the year	**(2,004)**	**6.76**	(1,421)	6.41
Outstanding at 31 December[1,2]	**41,029**	**6.59**	37,053	6.46

1 *The above table includes the bank employee options of 33,571,481 outstanding at 1 January 2007 (2006: 36,005,997), 8,269,034 options granted in the year (2006: 7,537,041) and 34,569,476 options outstanding at 31 December 2007 (2006: 33,571,481).*

2 *The weighted average exercise price for bank employees at 1 January 2007 was £6.44 (2006: £5.97) and at 31 December 2007 was £6.57.*

The weighted average fair value of options granted in the year as at the date of grant was £2.12 (2006 £2.50). 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

	2007	2006
Exercise price range (£)	**£5.35-£8.02**	£5.35-£8.02
Number (000)	**41,029**	37,053
Weighted average exercise price (£)	**6.59**	6.46
Weighted average remaining contractual life (years)	**1.77**	2.08
Of which exercisable:		
Number (000)	**154**	214
Weighted average exercise price (£)	**6.49**	5.35

The bank

	2007	2006
Exercise price range (£)	**£5.35-£8.02**	£5.35-£8.02
Number (000)	**34,569**	33,571
Weighted average exercise price (£)	**6.57**	6.44
Weighted average remaining contractual life (years)	**1.76**	2.24
Of which exercisable:		
Number (000)	**85**	186
Weighted average exercise price (£)	**6.49**	5.35

The weighted average share price at the dates the share options were exercised was £8.96 (2006: £9.54).

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.

Notes on the Financial Statements (continued)

	2007 Number (000)	2006 Number (000)
Outstanding at 1 January	**1,977**	2,210
Additions during the year	**849**	80
Released in the year	**(1,750)**	(313)
Transferred in the year	**(24)**	–
Outstanding at 31 December[1]	**1,052**	1,977

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

The fair value of the shares at 31 December 2007 was £8.42 (2006: £9.31).

The weighted average remaining vesting period as at 31 December 2007 was 10 months (2006: 15 months).

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

Restricted shares were awarded to eligible employees after taking into account the employee's performance in the prior year, potential and retention requirements. Restricted shares are also awarded as part deferral of annual bonus or for recruitment purposes. Shares are awarded without corporate performance conditions and are generally released to employees between one and three years after the award was made, providing the employees have remained continuously employed by the Group for this period.

	2007 Number (000)	2006 Number (000)
Outstanding at 1 January	**12,867**	26,023
Released in the year	**(7,299)**	(13,960)
Additions during the year	**452**	1,139
Forfeited in the year	**(792)**	(439)
Transferred in the year	**883**	104
Outstanding at 31 December [1]	**6,111**	12,867

1 *The above table includes bank employee shares of 7,525,817 outstanding at 1 January 2007 (2006: 25,617,586), nil shares granted in the year (2006: 515,872) and 3,569,950 outstanding at 31 December 2007.*

No shares were awarded by the group for HSBC Holdings Restricted Share Plan 2000 in 2007 or 2006.

The weighted average remaining vesting period as at 31 December 2007 was 0.14 years (2006: 0.95 years)

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.

	2007		2006	
	Number (000)	**Weighted average exercise price £**	Number (000)	Weighted average exercise price £
Outstanding at 1 January	**45,352**	**7.82**	67,390	7.74
Granted in the year			–	–
Exercised in the year	**(2,098)**	**6.96**	(22,211)	7.45
Transferred in the year	**1,141**	**7.72**	282	7.67
Expired in the year	**(2,173)**	**7.97**	(109)	8.02
Outstanding at 31 December[1,2]	**42,222**	**7.86**	45,352	7.82

1 *The above includes the bank employee awards of 21,402,302 outstanding at 1 January 2007 (2006: 33,341,930), nil options granted in the year (2006: nil) and 21,270,293 options outstanding at 31 December 2007 (2006: 21,402,302).*

2 *The weighted average exercise price for bank employees at 1 January 2007 was £7.80 (2006: £7.61) and at 31 December 2007 was £7.83 (2006: £7.80).*

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 2007 (fair value of options granted in 2006: nil). 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

	2007		2006	
Exercise price range (£)	**£6.00-£8.00**	**£8.01-£10.00**	£6.00-£8.00	£8.01-£10.00
Number (000)	**13,573**	**28,649**	15,807	29,545
Weighted average exercise price (£)	**6.91**	**8.30**	6.91	8.31
Weighted average remaining contractual life (years)	**–**	**0.06**	–	0.52
Of which exercisable:				
Number (000)	**13,573**	**23,383**	15,807	188
Weighted average exercise price (£)	**6.91**	**7.78**	6.91	8.13

The bank

	2007		2006	
Exercise price range (£)	**£6.00-£8.00**	**£8.01-£10.00**	£6.00-£8.00	£8.01-£10.00
Number (000)	**7,029**	**14,241**	7,520	13,882
Weighted average exercise price (£)	**6.91**	**8.29**	6.91	8.28
Weighted average remaining contractual life (years)	**–**	**0.002**	–	0.22
Of which exercisable:				
Number (000)	**7,029**	**14,143**	7,520	108
Weighted average exercise price (£)	**6.91**	**8.28**	6.91	8.13

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

Notes on the Financial Statements (continued)

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.

	2007		2006	
	Number (000)	**Weighted average exercise price €**	Number (000)	Weighted average exercise price €
Outstanding at 1 January	**646**	**142.50**	766	142.50
Exercised in the year	**(44)**	**142.50**	(120)	142.50
Outstanding and exercisable at 31 December	**602**	**142.50**	646	142.50

The weighted average remaining contractual life for options outstanding at the balance sheet date was 2.3 years (2006: 3.3 years).

The weighted average share price at the dates the share options were exercised was £9.03 (2006: £9.58)

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 113,240 shares during the year. (2006: 356,491).

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

	2007		2006	
	Number (000)	**Weighted average exercise price £**	Number (000)	Weighted average exercise price £
Outstanding at 1 January	**35,798**	**8.17**	46,654	8.10
Exercised in the year	**(3,695)**	**7.87**	(11,113)	7.90
Transferred in the year	**2,552**	**8.22**	320	7.83
Expired in the year	**(244)**	**7.81**	(63)	7.74
Outstanding at 31 December[1,2]	**34,411**	**8.20**	35,798	8.17

1 *The above includes the bank employee awards of 21,402,021 options outstanding at 1 January 2007 (2006: 30,424,672), and 20,236,879 options outstanding at 31 December 2007 (2006: 21,402,021).*

2 *The weighted average exercise price for bank employees was £7.97 at 1 January 2007 (2006: £7.93) and £8.02 at 31 December 2007 (2006: £7.97).*

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

	2007		2006	
Exercise price range (£)	**£6.38-£7.46**	**£7.47-£9.54**	£6.38-£7.46	£7.47-£9.54
Number (000)	**7,121**	**27,290**	8,116	27,682
Weighted average exercise price (£)	**6.85**	**8.56**	6.84	8.56
Weighted average remaining contractual life (years)	–	–	–	–
Of which exercisable:				
– number (000)	**7,121**	**27,290**	8,116	27,682
– weighted average exercise price (£)	**6.85**	**8.56**	6.84	8.56

The bank

	2007		2006	
Exercise price range (£)	**£6.38-£7.46**	**£7.47-£9.54**	£6.38-£7.46	£7.47-£9.54
Number (000)	**6,281**	**13,956**	7,207	14,195
Weighted average exercise price (£)	**6.82**	**8.56**	6.81	8.56
Weighted average remaining contractual life (years)	**–**	**–**	–	–
Of which exercisable:				
– number (000)	**6,281**	**13,956**	7,207	14,195
– weighted average exercise price (£)	**6.82**	**8.56**	6.81	8.56

Savings Related Share Option Plan

	2007		2006	
	Number (000)	**Weighted average exercise price £**	Number (000)	Weighted average exercise price £
Outstanding at 1 January	**3,650**	**6.33**	7,347	6.51
Exercised in the year	**(3,465)**	**6.33**	(3,583)	6.70
Transferred in the year	**(24)**	**6.29**	11	6.36
Expired in the year	**(58)**	**6.46**	(125)	6.37
Outstanding at 31 December[1,2]	**103**	**6.32**	3,650	6.33

1 *The above table includes the bank employee options of 3,500,932 outstanding at 1 January 2007 (2006: 7,246,942) and 98,706 options outstanding at 31 December 2007 (2006: 3,500,932).*

2 *The weighted average exercise price for bank employees was £6.33 at 1 January 2007 (2006: £6.51) and £6.32 at 31 December 2007 (2006: £6.33).*

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

	2007	2006
Exercise price range (£)	**£6.04-£6.75**	£6.04-£6.75
Number (000)	**103**	3,650
Weighted average exercise price (£)	**6.32**	6.33
Weighted average remaining contractual life (years)	**–**	0.33
Of which exercisable:		
– number (000)	**103**	82
– weighted average exercise price (£)	**6.32**	6.75

The bank

	2007	2006
Exercise price range (£)	**£6.04-£6.75**	£6.04-£6.75
Number (000)	**99**	3,501
Weighted average exercise price (£)	**6.32**	6.33
Weighted average remaining contractual life (years)	**–**	0.33
Of which exercisable:		
– number (000)	**99**	75
– weighted average exercise price (£)	**6.32**	6.75

Notes on the Financial Statements (continued)

11 Tax expense

	2007	2006
	£m	£m
Current taxation		
United Kingdom corporation tax charge – current year	**661**	466
United Kingdom corporation tax charge – adjustment in respect of prior years	**7**	(82)
Overseas tax – current year	**331**	370
Overseas tax – adjustment in respect of prior years	**26**	(6)
	1,025	748
Deferred taxation		
Origination and reversal of temporary differences	**(220)**	219
Effect of changes in the tax rates	**(20)**	–
Adjustment in respect of previous periods	**(18)**	11
	(258)	230
Tax expense	**767**	978

The bank and its subsidiary undertakings in the United Kingdom provided for UK corporation tax at 30 per cent (2006: 30 per cent). Other overseas subsidiary undertakings and overseas branches provided for taxation at the appropriate rates in the countries in which they operate.

The 2007 Finance Act reduction in the UK corporation tax rate from 30% to 28% and the reduction of the German federal tax rate, both enacted in 2007 but commencing in 2008, has resulted in a one off remeasurement of deferred tax assets and liabilities. This has given rise to a credit to the group's tax charge of £20 million.

	2007		2006	
	£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 (2006: 30 per cent)	**1,224**	**30.0**	1,139	30.0
Impact of overseas profits in principal locations taxed at different rates	**(61)**	**(1.5)**	(65)	(1.7)
Tax-free gains	**(253)**	**(6.2)**	(19)	(0.5)
Impact of profits in associates and joint ventures	**(12)**	**(0.3)**	11	0.3
Previously unrecognised temporary differences	**(53)**	**(1.3)**	(24)	(0.6)
Release of deferred tax consequent on restructuring of group interest	**(180)**	**(4.4)**	-	-
Adjustments in respect of prior period liabilities	**16**	**0.4**	(80)	(2.1)
Other items	**86**	**2.1**	16	0.4
Overall tax charge	**767**	**18.8**	978	25.8

In addition to the amount charged to the income statement the aggregate amount of deferred taxation, relating to items that are taken directly to equity, was a £311 million reduction in equity (2006: £29 million increase in equity).

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.

Deferred taxation

The group

	2007			2006		
	Deferred tax asset £m	**Deferred tax liability £m**	**Total £m**	Deferred tax asset £m	Deferred tax liability £m	Total £m
Temporary differences:						
– retirement benefits	**35**	**262**	**297**	31	749	780
– provision for loan impairment charges	**8**	**58**	**66**	2	68	70
– assets leased to customers	**(21)**	**(577)**	**(598)**	(21)	(790)	(811)
– revaluation of property	**(55)**	**(36)**	**(91)**	(46)	(47)	(93)
– accelerated capital allowances	**–**	**(49)**	**(49)**	–	(60)	(60)
– other short term timing differences	**83**	**(6)**	**77**	63	(110)	(47)
Unused tax losses	**–**	**46**	**46**	–	48	48
	50	**(302)**	**(252)**	29	(142)	(113)

The amount of deferred tax assets for which no deferred tax is recognised in the balance sheet is £53 million (2006: £115 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

	2007			2006		
	Deferred tax asset £m	**Deferred tax liability £m**	**Total £m**	Deferred tax asset £m	Deferred tax liability £m	Total £m
Temporary differences:						
– retirement benefits	**262**	**–**	**262**	730	–	730
– provision for loan impairment charges	**63**	**–**	**63**	73	–	73
– revaluation of property	**(21)**	**–**	**(21)**	(29)	–	(29)
– accelerated capital allowances	**(50)**	**–**	**(50)**	(63)	–	(63)
– other short term timing differences	**218**	**(2)**	**216**	130	(49)	81
Unused tax losses	**43**	**–**	**43**	32	16	48
	515	**(2)**	**513**	873	(33)	840

The amount of temporary differences for which no deferred tax is recognised in the balance sheet is £46 million (2006: £107 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 £3,486 million (2006: £2,977 million).

Movements in deferred taxation during the year

	The group		The bank	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Movements during the year:				
At 1 January	**(113)**	56	**840**	995
Charge/(credit) to income statement	**258**	(230)	**52**	(124)
Foreign exchange movements and other[1]	**(73)**	22	**1**	11
Movements through reserves	**(324)**	39	**(380)**	(42)
At 31 December	**(252)**	(113)	**513**	840

1 *Included in the movement for 2007 are deferred tax liabilities of £68 million recognised from the acquisition of HSBC Assurances VIE (France) and HSBC Assurances IARD (France) during the year.*

Notes on the Financial Statements (continued)

12 Dividends

Dividends declared on ordinary share capital	2007 £ per share	2007 £m	2006 £ per share	2006 £m
Second interim dividend for previous year	**1.05**	**840**	0.88	700
First interim dividend for current year	**1.03**	**825**	1.12	891
	2.08	**1,665**	2.00	1,591

A dividend of £0.91 per share was paid in 2007 (2006: nil) on the HSBC Bank plc Non-cumulative third dollar preference shares. Total dividend paid was £32 million.

Interest of £9 million (2006: nil) was paid in 2007 (2006: nil) on HSBC Bank plc Perpetual subordinated debt.

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
2007					
Total operating income					
Net interest income	**2,275**	**1,188**	**88**	**303**	**3,854**
Net fee income	**2,723**	**1,355**	**106**	**–**	**4,184**
Net trading income	**2,525**	**1,080**	**185**	**(303)**	**3,487**
Net income from financial instruments designated at fair value	**93**	**33**	**–**	**–**	**126**
Gains less losses from financial investments	**364**	**188**	**–**	**–**	**552**
Dividend income	**19**	**23**	**1**	**–**	**43**
Net earned insurance premiums	**693**	**1,228**	**–**	**–**	**1,921**
Other operating income	**191**	**106**	**15**	**(5)**	**307**
Total operating income	**8,883**	**5,201**	**395**	**(5)**	**14,474**
Share of profits/losses in associates and joint ventures	**(1)**	**49**	**(1)**	**–**	**47**
Profit before tax	**2,528**	**1,316**	**237**	**–**	**4,081**
Profit attributable to shareholders	**2,069**	**966**	**192**	**–**	**3,227**
Depreciation and impairment of property, plant and equipment	**(338)**	**(84)**	**–**	**–**	**(422)**
Amortisation and impairment of intangible assets and impairment of goodwill	**(122)**	**(19)**	**(1)**	**–**	**(142)**
Loan impairment charges and other credit risk provisions	**(953)**	**(91)**	**1**	**–**	**(1,043)**
Cost to acquire property, plant and equipment	**(371)**	**(203)**	**(4)**	**–**	**(578)**
Cost to acquire intangibles	**(97)**	**(25)**	**–**	**–**	**(122)**
Total assets	**440,411**	**218,927**	**14,333**	**(51,391)**	**622,280**
Total liabilities	**430,604**	**203,830**	**14,238**	**(51,391)**	**597,281**

	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
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
Dividend income	19	31	–	–	50
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 profits/losses 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 impairment of property, plant and equipment	(332)	(77)	(1)	–	(410)
Amortisation and impairment of intangible assets and impairment of goodwill	(130)	(21)	–	–	(151)
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

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.

	2007 £m	2006 £m
Net operating income before loan impairment charges		
UK Personal Financial Services	**3,745**	3,641
UK Commercial Banking	**2,207**	1,935
UK Corporate, Investment banking and Markets	**2,065**	1,905
UK Other	**106**	52
International Banking	**1,104**	871
France	**1,910**	1,733
Private Banking	**1,299**	1,153
HSBC Trinkaus & Burkhardt	**364**	328
	12,800	11,618

	2007 £m	2006 £m
Profit/(loss) on ordinary activities before tax		
UK Personal Financial Services	**740**	869
UK Commercial Banking	**1,004**	943
UK Corporate, Investment banking and Markets	**468**	482
UK Other	**155**	45
International Banking	**397**	305
France	**526**	488
Private Banking	**643**	555
HSBC Trinkaus & Burkhardt	**148**	109
	4,081	3,796
Total assets		
UK Personal Financial Services	**69,837**	73,723
UK Commercial Banking	**44,905**	34,105
UK Corporate, Investment banking and Markets	**273,791**	175,182
UK Other	**-**	-
International Banking	**22,190**	17,972
France	**156,533**	93,006
Private Banking	**40,900**	34,621
HSBC Trinkaus & Burkhardt	**14,124**	12,151
	622,280	440,760
Cost to acquire property, plant and equipment		
UK Personal Financial Services	**165**	222
UK Commercial Banking	**77**	92
UK Corporate, Investment banking and Markets	**130**	210
UK Other	**-**	-
International Banking	**62**	43
France	**42**	40
Private Banking	**13**	13
HSBC Trinkaus & Burkhardt	**89**	8
	578	628
Cost to acquire other intangibles		
UK Personal Financial Services	**51**	44
UK Commercial Banking	**26**	33
UK Corporate, Investment banking and Markets	**25**	23
UK Other	**-**	-
International Banking	**4**	1
France	**12**	4
Private Banking	**-**	1
HSBC Trinkaus & Burkhardt	**4**	3
	122	109

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:

The group

2007	Held for trading £m	Designated at fair value £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
Financial assets									
Cash and balances at central banks	–	–	–	–	–	7,146	–	–	7,146
Items in the course of collection from other banks	–	–	–	–	–	2,434	–	–	2,434
Trading assets	153,206	–	–	–	–	–	–	–	153,206
Financial assets designated at fair value	–	14,969	–	–	–	–	–	–	14,969
Derivatives	60,103		–	–	–	–	–	367	60,470
Loans and advances to banks	–	–	–	60,764	–	–	–	–	60,764
Loans and advances to customers	–	–	–	227,687	–	–	–	–	227,687
Financial investments	–	–	38	–	69,490	–	–	–	69,528
Other assets	–	–	–	–	–	4,385	–	–	4,385
Accrued income	–	–	–	–	–	5,647	–	–	5,647
Total financial assets	213,309	14,969	38	288,451	69,490	19,612	–	367	606,236
Total non-financial assets									16,044
Total assets									622,280
Financial liabilities									
Deposits by banks	– –	–	–	–	–	48,786	–	–	48,786
Customer accounts	–	–	–	–	–	268,269	–	–	268,269
Items in the course of transmission to other banks	–	–	–	–	–	1,975	–	–	1,975
Trading liabilities	117,454	–	–	–	–	–	–	–	117,454
Financial liabilities designated at fair value	–	15,659	–	–	–	–	–	–	15,659
Derivatives	60,908	–	–	–	–	–	138	493	61,539
Debt securities in issue	–	–	–	–	–	50,921	–	–	50,921
Other liabilities	–	–	–	–	–	6,332	–	–	6,332
Accruals	–	–	–	–	–	5,726	–	–	5,726
Subordinated liabilities	–	–	–	–	–	5,205	–	–	5,205
Total financial liabilities	178,362	15,659	–	–	–	387,214	138	493	581,866
Total non-financial liabilities									15,415
Total liabilities									597,281

Notes on the Financial Statements (continued)

The group

2006	Held for trading £m	Designated at fair value £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
Financial 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	85,994	–	–	–	–	–	–	–	85,994
Financial assets designated at fair value	–	5,985	–	–	–	–	–	–	5,985
Derivatives	31,646	–	–	–	–	–	41	403	32,090
Loans and advances to banks	–	–	–	44,428	–	–	–	–	44,428
Loans and advances to customers	–	–	–	200,416	–	–	–	–	200,416
Financial investments	–	–	76	–	42,304	–	–	–	42,380
Other assets	–	–	–	–	–	3,478	–	–	3,478
Accrued income	–	–	–	–	–	3,533	–	–	3,533
Total financial assets	117,640	5,985	76	244,844	42,304	13,566	41	403	424,859
Total non-financial assets									15,901
Total assets									440,760
Financial 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	32,247	–	–	–	–	–	37	459	32,743
Debt securities in issue	–	–	–	–	–	38,090	–	–	38,090
Other liabilities	–	–	–	–	–	4,141	–	–	4,141
Accruals	–	–	–	–	–	3,812	–	–	3,812
Subordinated liabilities	–	–	–	–	–	5,380	–	–	5,380
Total financial liabilities	84,327	9,460	–	–	–	319,714	37	459	413,997
Total non-financial liabilities									5,825
Total liabilities									419,822

The bank

2007	Held for trading £m	Designated at fair value £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
Financial assets									
Cash and balances at central banks	–	–	–	–	–	3,677	–	–	3,677
Items in the course of collection from other banks	–	–	–	–	–	1,377	–	–	1,377
Trading assets	149,102	–	–	–	–	–	–	–	149,102
Financial assets designated at fair value	–	3,439	–	–	–	–	–	–	3,439
Derivatives	46,093	–	–	–	–	–	–	232	46,325
Loans and advances to banks	–	–	–	32,028	–	–	–	–	32,028
Loans and advances to customers	–	–	–	150,649	–	–	–	–	150,649
Financial investments	–	–	–	–	13,822	–	–	–	13,822
Accrued income	–	–	–	–	–	3,477	–	–	3,477
Other assets	–	–	–	–	–	1,372	–	–	1,372
Total financial assets	195,195	3,439	–	182,677	13,822	9,903	–	232	405,268
Total non-financial assets									18,761
Total assets									424,029
Financial liabilities									
Deposits by banks	–	–	– –	– –	–	41,061	–	–	41,061
Customer accounts	–	–	– –	– –	–	184,899	–	–	184,899
Items in the course of transmission to other banks	–	–	– –	– –	–	1,056	–	–	1,056
Trading liabilities	99,755	–	– –	– –	–	–	–	–	99,755
Financial liabilities designated at fair value	–	8,082	– –	– –	–	– –	–	–	8,082
Derivatives	47,339	–	– –	– –	–	– –	–	197	47,536
Debt securities in issue	–	–	– –	– –	–	8,117	–	–	8,117
Other liabilities	–	–	– –	– –	–	2,767	–	–	2,767
Accruals	–	–	–	–	–	3,745	–	–	3,745
Subordinated liabilities	–	–	–	–	–	4,744	–	–	4,744
Total financial liabilities	147,094	8,082	–	–	–	246,389	–	197	401,762
Total non-financial liabilities									1,490
Total liabilities									403,252

Notes on the Financial Statements (continued)

The bank

2006	Held for trading £m	Designated at fair value £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
Financial 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	62,729	–	–	–	–	–	–	–	62,729
Financial assets designated at fair value	–	–	–	–	–	–	–	–	–
Derivatives	24,270	–	–	–	–	–	–	91	24,361
Loans and advances to banks	–	–	–	25,121	–	–	–	–	25,121
Loans and advances to customers	–	–	–	143,964	–	–	–	–	143,964
Financial investments	–	–	–	–	12,135	–	–	–	12,135
Other assets	–	–	–	–	–	1,818	–	–	1,818
Accrued income	–	–	–	–	–	1,974	–	–	1,974
Total financial assets	86,999	–	–	169,085	12,135	7,655	–	91	275,965
Total non-financial assets									18,121
Total assets									294,086
Financial 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	24,878	–	–	–	–	–	–	89	24,967
Debt securities in issue	–	–	–	–	–	5,408	–	–	5,408
Other liabilities	–	–	–	–	–	2,320	–	–	2,320
Accruals	–	–	–	–	–	2,429	–	–	2,429
Subordinated liabilities	–	–	–	–	–	4,999	–	–	4,999
Total financial liabilities	60,093	4,736	–	–	–	209,411	–	89	274,329
Total non-financial liabilities									2,550
Total liabilities									276,879

15 Trading assets

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Trading assets:				
– which may be repledged or resold by counterparties	**57,912**	22,215	**37,040**	8,811
– not subject to repledge or resale by counterparties	**95,294**	63,779	**112,062**	53,918
	153,206	85,994	**149,102**	62,729
Treasury and other eligible bills	**445**	197	**437**	165
Debt securities	**58,741**	47,101	**37,902**	25,260
Equity securities	**22,419**	10,836	**13,095**	7,279
Loans and advances to banks	**37,020**	10,233	**59,451**	13,560
Loans and advances to customers	**34,581**	17,627	**38,217**	16,465
	153,206	85,994	**149,102**	62,729

16 Financial assets designated at fair value through profit or loss

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Financial assets designated at fair value:				
– not subject to repledge or resale by counterparties	**14,969**	5,985	**3,439**	–

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Treasury and other eligible bills	**25**	28	**–**	–
Debt securities	**7,822**	2,361	**3,439**	–
Equity securities	**7,033**	3,476	**–**	–
Loans and advances to banks	**89**	120	**–**	–
	14,969	5,985	**3,439**	–

17 Derivatives

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

	At 31 December 2007					
	Assets			Liabilities		
	Trading	Hedging	Total	Trading	Hedging	Total
	£m	£m	£m	£m	£m	£m
Exchange rate	**17,279**	**–**	**17,279**	**(17,757)**	**(30)**	**(17,787)**
Interest rate	**31,397**	**367**	**31,764**	**(31,393)**	**(601)**	**(31,994)**
Equities	**7,014**	**–**	**7,014**	**(6,719)**	**–**	**(6,719)**
Credit derivatives	**3,629**	**–**	**3,629**	**(4,294)**	**–**	**(4,294)**
Commodity and other	**784**	**–**	**784**	**(745)**	**–**	**(745)**
Gross total fair values	**60,103**	**367**	**60,470**	**(60,908)**	**(631)**	**(61,539)**
Total			**60,470**			**(61,539)**

Notes on the Financial Statements (continued)

	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)

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

	At 31 December 2007					
	Assets			**Liabilities**		
	Trading	**Hedging**	**Total**	**Trading**	**Hedging**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Exchange rate	**17,428**	**–**	**17,428**	**(17,493)**	**–**	**(17,493)**
Interest rate	**22,240**	**232**	**22,472**	**(23,005)**	**(197)**	**(23,202)**
Equities	**2,036**	**–**	**2,036**	**(1,825)**	**–**	**(1,825)**
Credit derivatives	**3,607**	**–**	**3,607**	**(4,276)**	**–**	**(4,276)**
Commodity and other	**782**	**–**	**782**	**(740)**	**–**	**(740)**
Total	**46,093**	**232**	**46,325**	**(47,339)**	**(197)**	**(47,536)**

	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)
Total	24,270	91	24,361	(24,878)	(89)	(24,967)

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.

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. Derivatives (except for derivatives which are designated as effective hedging instruments as defined in IAS 39) are held for trading. The held for trading classification includes two types of derivatives: those used in sales and trading activities, and those used for risk management purposes but which for various reasons do not meet the qualifying criteria for hedge accounting. The second category includes derivatives managed in conjunction with financial instruments designated at fair value. These activities are described more fully below.

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 matching deals being utilised to achieve this where necessary. When entering into derivative transactions, the group employs the same credit risk management procedures to assess and approve potential credit exposures that are used for traditional lending.

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.

Gains and losses from changes in the fair value of derivatives that do not qualify for hedge accounting are reported in 'Net trading income', except for derivatives managed in conjunction with financial instruments designated at fair value, where gains and losses are reported in 'Net income from financial instruments designated at fair value', together with the gains and losses on the hedged items. Changes in the fair values of trading derivatives are inclusive of contractual interest. Changes in the fair value of derivatives managed in conjunction with financial instruments designated at fair value are included in 'Net income from financial instruments designated at fair value' inclusive of contractual interest unless the derivatives are managed with debt securities in issue, in which case the contractual interest is shown in interest payable with the interest payable on the issued debt.

Notional contract amounts of derivatives held for trading purposes by product type

	Year ended 31 December			
	The group		**The bank**	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
		restated		*restated*
Exchange rate	**1,027,254**	731,098	**996,917**	709,851
Interest rate	**4,089,512**	3,445,072	**2,815,793**	2,438,804
Equities	**119,493**	89,600	**31,186**	22,827
Credit derivatives	**485,976**	256,493	**482,397**	254,538
Commodity	**13,837**	859	**15,283**	668
Total derivatives	**5,736,072**	4,523,122	**4,341,576**	3,426,688

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.

The contract amount of credit derivatives of £485,976 million (2006: £256,493 million) above consists of protection bought of £245,952 million (2006: £131,169 million) and protection sold of £240,024 million (2006: £125,324 million).

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:

Notes on the Financial Statements (continued)

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Unamortised balance at 1 January	**84**	63	**66**	37
Deferral on new transactions	**102**	118	**46**	87
Recognised in the income statement during the period:				
– amortisation	**(26)**	(15)	**(9)**	(5)
– subsequent to observability	**(33)**	(60)	**(26)**	(39)
– maturity or termination	**(37)**	(21)	**(18)**	(14)
– FX movements and other	**–**	(1)	**–**	–
Unamortised balance at 31 December	**90**	84	**59**	66

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.

Notional contract amounts of derivatives held for hedging purposes by product type

	The group			
	At 31 December 2007		At 31 December 2006	
	Cash flow hedge £m	**Fair value hedge £m**	Cash flow hedge £m as restated	Fair value hedge £m as restated
Exchange rate contracts	**93**	**444**	87	400
Interest rate contracts	**69,323**	**9,065**	56,277	3,222
Equities	**–**	**12**	-	-

	The bank			
	At 31 December 2007		At 31 December 2006	
	Cash flow hedge £m	**Fair value hedge £m**	Cash flow hedge £m as restated	Fair value hedge £m as restated
Exchange rate contracts	**–**	**–**	–	–
Interest rate contracts	**21,001**	**3**	18,083	9

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 2007, were assets of nil and liabilities of £138 million (2006: assets of £41 million and liabilities of £37 million).

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

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
(Losses)/ gains arising from the change in fair value of fair value hedges:				
– on hedging instruments	**(58)**	54	**-**	–
– on hedged items attributable to the hedged risk	**62**	(54)	**-**	–

The amount reported in the income statement in respect of the ineffectiveness of fair value hedges was insignificant in the year ended 31 December 2007.

Cash flow hedges

The group's cash flow hedges consist principally of interest rate and cross-currency swaps that are used to protect against exposures to variability in future interest cash flows on non-trading assets and liabilities which bear interest at variable rates or which are expected to be re-funded or reinvested in the future. The amounts and timing of future cash flows, representing both principal and interest flows, are projected for each portfolio of financial assets and liabilities on the basis of their contractual terms and other relevant factors, including estimates of prepayments and defaults. The aggregate principal balances and interest cash flows across all portfolios over time form the basis for identifying gains and losses on the effective portions of derivatives designated as cash flow hedges of forecast transactions. Gains and losses are initially recognised directly in equity, in the cash flow hedging reserve, and are transferred to the income statement when the forecast cash flows affect the income statement.

At 31 December 2007, the fair values of outstanding derivatives designated as cash flow hedges of forecast transactions were assets of £367 million (2006: £403 million) and liabilities of £493 million (2006: £459 million).

The schedule of forecast principal balances on which the expected interest cash flows arise as at 31 December 2007 is as follows:

The group				
At 31 December 2007	**3 months or less £m**	**More than 3 months but less than 1 year £m**	**5 years or less but more than 1 year £m**	**More than 5 years £m**
Assets	**22,133**	**24,583**	**16,648**	**13**
Liabilities	**(11,007)**	**(10,736)**	**(11,582)**	**(571)**
Net exposure	**11,126**	**13,847**	**5,066**	**(558)**

At 31 December 2006	3 months or less £m	More than 3 months but less than 1 year £m	5 years or less but more than 1 year £m	More than 5 years £m
Assets	15,940	14,032	9,362	197
Liabilities	(11,617)	(9,674)	(6,797)	–
Net exposure	4,323	4,358	2,565	197

The bank				
At 31 December 2007	**3 months or less £m**	**More than 3 months but less than 1 year £m**	**5 years or less but more than 1 year £m**	**More than 5 years £m**
Assets	**12,703**	**12,305**	**10,435**	**13**
Liabilities	**(7,516)**	**(7,516)**	**(8,955)**	**(181)**
Net exposure	**5,187**	**4,789**	**1,480**	**(168)**

Notes on the Financial Statements (continued)

At 31 December 2006	3 months or less £m	More than 3 months but less than 1 year £m	5 years or less but more than 1 year £m	More than 5 years £m
Assets	19,733	19,708	10,885	–
Liabilities	(15,930)	(15,861)	(12,002)	–
Net exposure	3,803	3,847	(1,117)	–

The gains and losses on ineffective portions of such derivatives are recognised immediately in the income statement. During the year to 31 December 2007, a loss of £1 million (2006: £2 million) was recognised due to hedge ineffectiveness.

18 Financial investments

	The group		The bank	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Financial investments:				
– which may be pledged or resold by counterparties	**3,710**	2,276	**3,047**	1,171
– not subject to repledge or resale by counterparties	**65,818**	40,104	**10,774**	10,964
	69,528	42,380	**13,821**	12,135

The group

	2007		2006	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Treasury and other eligible bills	**1,882**	**1,882**	3,199	3,199
– available-for-sale	**1,882**	**1,882**	3,199	3,199
– held-to-maturity	**-**	**-**	-	-
Debt securities	**64,594**	**64,594**	37,286	37,286
– available-for-sale	**64,556**	**64,556**	37,210	37,210
– held-to-maturity	**38**	**38**	76	76
Equity securities	**3,052**	**3,052**	1,895	1,895
– available-for-sale	**3,052**	**3,052**	1,895	1,895
Total financial investments	**69,528**	**69,528**	42,380	42,380

The bank

	2007		2006	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Treasury and other eligible bills	**1,397**	**1,397**	2,826	2,826
– available-for-sale	**1,397**	**1,397**	2,826	2,826
– held-to-maturity	**-**	**-**	–	–
Debt securities	**11,497**	**11,497**	8,923	8,923
– available-for-sale	**11,497**	**11,497**	8,923	8,923
– held-to-maturity	**-**	**-**	–	–
Equity securities	**927**	**927**	386	386
– available-for-sale	**927**	**927**	386	386
Total financial investments	**13,821**	**13,821**	12,135	12,135

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, inter alia, 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 without material delay.

(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:

The group

	2007		2006	
	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	**50,868**	**51,338**	18,313	18,168
Securities lending agreements	**10,818**	**10,813**	6,178	5,952
Total	**61,686**	**62,151**	24,491	24,120

The bank

	2007		2006	
	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	**29,376**	**29,942**	4,002	3,871
Securities lending agreements	**10,713**	**10,713**	5,980	5,951
Total	**40,089**	**40,655**	9,982	9,822

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 and rewards 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:

Notes on the Financial Statements (continued)

	Securitisations at 31 December	
	2007[1]	2006
	£m	£m
Carrying amount of assets (original)	**–**	2,035
Carrying amount of assets (currently recognised)	**–**	42
Carrying amount of associated liabilities	**–**	24

1 *As a result of consolidating Cullinan Finance Limited, the securitised assets are reported on-balance sheet at 31 December 2007.*

20 Interests in associates and joint ventures

Principal associates of the group

	At 31 December 2007		
	Country of incorporation	**The group's interest in equity capital**	**Issued equity capital**
VocaLink	England	13.95%	100,000

The above investment is owned by HSBC Bank plc. Although the group owns less than 20% of the voting rights in VocaLink, it is an associate of the group by virtue of the group's influence exerted via board representation.

During 2007, the group's interests in AEA Investors (Cayman) I LP, HSBC PE European No. 2 LP, Private Equity Portfolio (Investment) LP Inc and Montague III LP were restructured. As a result, the group no longer has significant influence over these partnerships and they have ceased to be associates of the group. At 31 December 2007, the group's interests in these partnerships were accounted for as financial investments.

As a result of acquiring additional shares, the group obtained control of HSBC Assurances VIE (France) (previously 'Erisa LIFE') and HSBC Assurances IARD (previously 'Erisa IARD') during 2007 and these entities ceased to be associates of the group. Further information can be seen in Note 23 'Investments'.

Summarised aggregate financial information on associates

	2007	2006
	£m	£m
Assets	**46**	10,539
Liabilities	**41**	10,210
Net income	**56**	30

Interests in joint ventures

	At 31 December 2007		
	Principal activity	**HSBC's interest in equity capital**	**Issued equity capital**
International Transaction Services GmbH	Outsourcing support	51%	£5m
Vaultex (UK) Limited	Cash management	50%	£10m
Holnwoods Termtime Credit	Investment Holdings and management	50%	£1
HSBC Yen Investment Partners	Yen investments	50%	–[1]

1 *HSBC Yen Investment Partners is a partnership and hence has no issued equity capital.*

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

	2007 £m	2006 £m
Assets	**268**	52
Liabilities	**207**	54
Net income	**4**	2

21 Goodwill and intangible assets

Goodwill and intangible assets include goodwill arising on business combinations, the present value of in-force long-term assurance business, and other intangible assets. The carrying amounts of these assets at 31 December was as follows:

	The group		The bank	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Goodwill	**8,974**	8,395	**291**	331
Present value of in-force long-term assurance business ('PVIF')	**444**	407	**–**	–
Other intangible assets	**459**	449	**249**	226
	9,877	9,251	**540**	557

Goodwill

The group

	2007 £m	2006 £m
Cost		
At 1 January	**8,395**	8,664
Additions[1,2]	**1**	38
Disposals	**–**	–
Exchange translation differences	**585**	(312)
Amounts written off[4]	**(33)**	–
Other changes [3]	**26**	5
At 31 December	**8,974**	8,395
Accumulated impairment losses		
At 1 January	**–**	–
Impairment loss recognised[4]	**(33)**	–
Amounts written off[4]	**33**	–
At 31 December	**–**	–
Net book value at 31 December	**8,974**	8,395

1 *2007 additions include goodwill arising on the acquisition of an increased stake in Elysée Forêts of £0.3 million.*
2 *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.*
3 *2007 other changes include the transfer of goodwill of HSBC Insurance Brokers Holdings Ltd from HSBC Holdings to HSBC Bank plc.*
4 *The impairment charge for the year is recognised in the income statement under 'Amortisation and impairment of intangible assets and impairment of goodwill'. The impairment charge for 2007 of £33 million arose on reclassification of certain HFC cards portfolios to assets held for sale during the year. These portfolios were also sold during the year, resulting in the goodwill and related impairment allowance of £33 million being written off.*

Notes on the Financial Statements (continued)

The bank

	2007 £m	2006 £m
Cost		
At 1 January	**331**	321
Additions[1]	**–**	15
Exchange translation differences	**1**	(6)
Amounts written off[2]	**(33)**	–
Other changes	**(8)**	1
At 31 December	**291**	331
Accumulated impairment losses		
At 1 January	**–**	–
Impairment loss recognised[2]	**(33)**	–
Amounts written off[2]	**33**	–
At 31 December	**–**	–
Net book value at 31 December	**291**	331

1 *2006 additions include goodwill arising on the acquisition of the Alternative Fund Services Business of £15 million.*
2 *The impairment charge for the year is recognised in the income statement under 'Amortisation and impairment of intangible assets and impairment of goodwill'. The impairment charge for 2007 of £33 million arose on reclassification of certain HFC cards portfolios to assets held for sale during the year. These portfolios were also sold during the year, resulting in the goodwill and related impairment allowance of £33 million being written off.*

During 2007 goodwill impairment of £33 million was recognised (2006: £nil). Impairment testing of goodwill is performed annually by comparing the recoverable amount of cash generating units ('CGUs') determined at 1 July 2007 based on a value-in-use calculation. That calculation uses cash flow estimates based on management's cash flow projections, extrapolated in perpetuity using a nominal long-term growth rate based on current GDP and inflation for the countries within which the CGU operates. Cash flows are extrapolated in perpetuity due to the long-term perspective within the group of the business units making up the CGUs. The 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 CGU and used to discount its future cash flows can have a significant effect on its valuation. The cost of capital percentage is generally derived from an appropriate Capital Asset Pricing Model, which itself depends on inputs reflecting a number of financial and economic variables including the risk-free rate in the country concerned and a premium 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.

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 2007 £m	Discount rate %	Nominal growth rate beyond initial cash flow projections %
Private Banking	**2,331**	**10.0**	**3.0**
France	**5,375**	**10.0**	**3.5**
Total goodwill in the CGUs listed above	**7,706**		

There was no evidence of impairment arising from this review. In addition, during 2007 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 these investments are impaired.

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

The group

PVIF-specific assumptions

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

	2007	2006
	UK Life	UK Life
Risk free rate	**4.30%**	4.30%
Risk discount rate	**8.00%**	8.00%
Expenses inflation	**3.40%**	3.40%

Movement on the PVIF

	2007	2006
	£m	£m
At 1 January	**407**	463
Addition from current year new business	**67**	25
Movement from in-force business	**(50)**	(81)
Exchange and other adjustments	**20**	–
At 31 December	**444**	407

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.

Notes on the Financial Statements (continued)

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 2007 is as follows:

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 2007	**13**	**675**	**58**	**244**	**17**	**1,007**
Additions[1]	**–**	**103**	**15**	**–**	**4**	**122**
Disposals	**–**	**–**	**(2)**	**–**	**–**	**(2)**
Exchange translation differences	**2**	**9**	**7**	**–**	**1**	**19**
Other changes	**–**	**1**	**–**	**(40)**	**(10)**	**(49)**
At 31 December 2007	**15**	**788**	**78**	**204**	**12**	**1,097**
Accumulated amortisation and impairment						
At 1 January 2007	**(5)**	**(441)**	**(38)**	**(73)**	**(1)**	**(558)**
Amortisation charge for the year[2]	**(1)**	**(75)**	**(12)**	**(19)**	**(1)**	**(108)**
Impairment charge for the year[2]	**–**	**(1)**	**–**	**–**	**–**	**(1)**
Disposals	**–**	**–**	**3**	**–**	**–**	**3**
Exchange translation differences	**(1)**	**(9)**	**(4)**	**–**	**–**	**(14)**
Other changes	**–**	**–**	**–**	**40**	**–**	**40**
At 31 December 2007	**(7)**	**(526)**	**(51)**	**(52)**	**(2)**	**(638)**
Net book value at 31 December 2007	**8**	**262**	**27**	**152**	**10**	**459**
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

1 *The group has £2 million (2006: nil) 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 charge in 2006 arose due to customer delinquency on the HFC cards business which 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 £141 million (2006: £158 million), on which the amortisation charges for the year to 31 December 2007 was £17 million (2006: £16 million). The remaining amortisation period is 7 years.*

The bank

	Internally generated software £m	Customer/ merchant relationships[1] £m	Other £m	Total £m
Cost				
At 1 January 2007	**572**	**41**	**3**	**616**
Additions	**96**	**–**	**–**	**96**
Other changes	**–**	**(41)**	**–**	**(41)**
At 31 December 2007	**668**	**–**	**3**	**671**
Accumulated amortisation				
At 1 January 2007	**(348)**	**(41)**	**(1)**	**(390)**
Amortisation charge for the year[1]	**(72)**	**–**	**(1)**	**(73)**
Impairment charge for the year[1]	**(1)**	**–**	**–**	**(1)**
Other changes	**1**	**41**	**–**	**42**
At 31 December 2007	**(420)**	**–**	**(2)**	**(422)**
Net book value at 31 December 2007	**248**	**–**	**1**	**249**
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 amortization				
At 1 January 2006	(273)	(3)	–	(276)
Amortisation charge for the year[1]	(73)	(2)	(1)	(76)
Impairment charge for the year[1]	(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

1 *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 charge in 2006 arose due to customer delinquency on the HFC cards business which caused the recoverable amount of the intangible asset to be revised.*

Notes on the Financial Statements (continued)

22 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 2007	**966**	**362**	**275**	**2,657**	**3,004**	**7,264**
Additions at cost	**104**	**3**	**84**	**321**	**66**	**578**
Acquisition of subsidiaries	**49**	**–**	**–**	**1**	**–**	**50**
Fair value adjustments	**13**	**–**	**–**	**–**	**–**	**13**
Disposals [4]	**(257)**	**(320)**	**(12)**	**(135)**	**(65)**	**(789)**
Transfers	**–**	**–**	**4**	**(1)**	**–**	**3**
Exchange translation differences	**55**	**–**	**4**	**69**	**–**	**128**
Other changes	**(6)**	**–**	**2**	**(9)**	**–**	**(13)**
At 31 December 2007	**924**	**45**	**357**	**2,903**	**3,005**	**7,234**
Accumulated depreciation						
At 1 January 2007	**(97)**	**(27)**	**(150)**	**(1,656)**	**(926)**	**(2,856)**
Depreciation charge for the year	**(22)**	**(3)**	**(22)**	**(281)**	**(100)**	**(428)**
Disposals [4]	**48**	**15**	**8**	**76**	**58**	**205**
Transfers	**–**	**–**	**(2)**	**–**	**–**	**(2)**
Impairment losses recognised	**–**	**–**	**–**	**–**	**–**	**–**
Impairment losses reversed	**6**	**–**	**–**	**–**	**–**	**6**
Exchange translation differences	**(4)**	**–**	**(2)**	**(39)**	**–**	**(45)**
Other changes	**(6)**	**–**	**(1)**	**12**	**–**	**5**
At 31 December 2007	**(75)**	**(15)**	**(169)**	**(1,888)**	**(968)**	**(3,115)**
Net book value at 31 December 2007	**849**	**30**	**188**	**1,015**	**2,037**	**4,119**

1 *Includes assets held on finance leases with a net book value of £171 million (2006: £169 million), on which the accumulated depreciation as at 31 December 2007 was £1.5 million (2006: £20 million).*

2 *Includes assets with a net book value of £173 million (2006: £172 million) pledged as security for liabilities, on which the accumulated depreciation as at 31 December 2007 was £3 million (2006: £24 million).*

3 *At 31 December 2007, the group had £281 million (2006: £329 million) of contractual commitments to acquire property, plant and equipment.*

4 *Includes transfers to assets held for sale with a net book value of £517 million.*

	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	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

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 2007	**397**	**368**	**240**	**2,105**	**3,110**
Additions at cost[1]	**18**	**2**	**78**	**209**	**307**
Acquisition of subsidiaries	–	–	–	–	–
Disposals [2]	**(191)**	**(320)**	**(9)**	**(109)**	**(629)**
Transfers	–	–	–	**(1)**	**(1)**
Exchange differences	–	–	**1**	**2**	**3**
Other changes	**(3)**	–	**1**	–	**(2)**
At 31 December 2007	**221**	**50**	**311**	**2,206**	**2,788**
Accumulated depreciation					
At 1 January 2007	**(59)**	**(27)**	**(136)**	**(1,367)**	**(1,589)**
Depreciation charge for the year	**(11)**	**(3)**	**(18)**	**(201)**	**(233)**
Disposals [2]	**35**	**15**	**7**	**56**	**113**
Transfers	–	–	–	–	–
Impairment losses recognised	–	–	–	–	–
Impairment losses reversed	–	–	–	–	–
Exchange differences	–	–	–	**(1)**	**(1)**
Other changes	–	–	–	–	–
At 31 December 2007	**(35)**	**(15)**	**(147)**	**(1,513)**	**(1,710)**
Net book value at 31 December 2007	**186**	**35**	**164**	**693**	**1,078**

1 *At 31 December 2007, the bank had £103 million (2006: £111 million) of contractual commitments to acquire property, plant and equipment.*

2 *Includes transfers to assets held for sale with a net book value of £457 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 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

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		The bank	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Cost				
At 1 January	**264**	231	**239**	207
Additions	**84**	56	**78**	54
Disposals	**(12)**	(22)	**(9)**	(22)
Transfers	**3**	–	**–**	–
Exchange translation differences	**3**	(2)	**–**	–
Other changes	**3**	1	**1**	–
At 31 December	**345**	264	**309**	239
Accumulated depreciation				
At 1 January	**(145)**	(150)	**(137)**	(150)
Depreciation charge for the year	**(19)**	(13)	**(17)**	(11)
Disposals	**8**	24	**7**	24
Transfers	**–**	–	**–**	–
Exchange translation differences	**(1)**	–	**–**	–
Other changes	**(1)**	(6)	**–**	–
At 31 December	**(158)**	(145)	**(147)**	(137)
Net book value at 31 December	**187**	119	**162**	102

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 2007	**31**
Additions at cost	**82**
Acquisition of subsidiaries	**49**
Reclassified as held for sale	**(30)**
Fair value adjustments	**13**
Other changes	**7**
At 31 December 2007	**152**
Fair value	
At 1 January 2006	27
Disposals	(1)
Fair value adjustments	6
Other changes	(1)
At 31 December 2006	31

1 *Included in Property, plant and equipment on page 98*

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 £13 million (2006: surplus of £6 million) was credited to the income statement for the year ended 31 December 2007.

Included within 'Other operating income' was rental income of £2 million (2006: £2 million) earned by the group on its investment properties. Direct operating expenses of £ nil (2006: 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 £4 million at 31 December 2007 (2006: £25 million) let under operating leases, net of accumulated depreciation of £5 million (2006: £20 million).

Notes on the Financial Statements (continued)

23 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	99.93
HSBC Bank Malta p.l.c.	Malta	68.19
HSBC Guyerzeller Bank AG	Switzerland	99.93
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	99.93
HSBC Private Bank (Suisse) S.A.	Switzerland	99.49
HSBC Private Bank (UK) Limited	England	99.93
HSBC Trinkaus & Burkhardt AG	Germany	78.60
HSBC Trust Company (UK) Limited	England	100
Marks and Spencer Retail Financial Services Holdings Limited	England	100

SPEs consolidated where HSBC Bank plc owns less than 50 per cent of the voting rights

	Carrying value of total consolidated assets £bn	Nature of SPE
Asscher Finance Limited	3.7	Structured investment vehicle
Bryant Park Funding LLC	2.6	Conduit
Cullinan Finance Limited	16.6	Structured investment vehicle
Regency Assets Limited	4.5	Conduit
Solitaire Funding Limited	10.8	Conduit

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 2007, which were accounted for by applying the purchase method:

- On 1 January 2007 HSBC Bank plc acquired 100% of the share capital of HSBC Insurance Brokers Holdings Limited for a cash consideration of £115m. No goodwill arose on the acquisition. Details of the net assets acquired are as follows:

	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

The acquired business contributed total operating income of £338 million and net profit of £36 million to the group in 2007.

- On 26 March 2007 HSBC Bank plc, through its subsidiary HSBC France, acquired 50.01% of the shares in HSBC Assurances VIE (France) (previously 'Erisa LIFE') and HSBC Assurances IARD (France) (previously 'Erisa IARD') not already owned, taking the total holding in each entity up to 100%.

The group paid cash consideration of £156 million in respect of this acquisition. The fair value of the assets acquired exceeded the cash consideration by £9 million. This excess has been recognized within 'Other operating income' in the income statement.

The fair values of the assets and liabilities and contingent liabilities arising from the acquisition, determined provisionally, were as follows:	**Fair value**	**Carrying value immediately prior to acquisition**
	£m	£m
Financial assets designated at fair value	3,926	3,926
Derivative assets	25	25
Loans and advances to banks	48	48
Financial investments	5,728	5,728
Intangible assets	199	199
Property, plant and equipment	48	48
Prepayments and accrued income	131	131
Other asset categories	41	41
Financial liabilities designated at fair value	(37)	(37)
Derivative liabilities	(7)	(7)
Liabilities under insurance contracts issued	(8,929)	(8,929)
Other liability categories	(844)	(844)
Net assets acquired	329	329

The acquired business contributed total operating income of £1,205 million and net profit of £35 million to the group in 2007. If the acquisition had occurred on 1 January 2007, the group total operating income would have been £15,020 million and profit for the year would have been £3,396 million. These amounts have been calculated using the group's accounting policies.

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.

24 Other assets

	The group		**The bank**	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Bullion	**147**	233	**70**	180
Assets held for sale	**626**	22	**555**	16
Assets of disposal groups held for sale[1]	**78**	–	**78**	–
Reinsurance assets	**528**	633	**–**	–
Current taxation recoverable	**67**	33	**1**	–
Endorsements and acceptances	**375**	353	**251**	238
Other accounts	**4,115**	3,180	**1,122**	1,580
	5,936	4,454	**2,077**	2,014

1 *At 31 December 2007, assets of HFC cards portfolios with a carrying amount of £78 million (2006: nil) were classified as disposal groups held for sale.*

Notes on the Financial Statements (continued)

Assets held for sale

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Non-current assets held for sale				
Property, plant and equipment	**586**	16	**555**	16
Investment Properties	**31**	–	–	–
Financial Assets	**7**	–	–	–
Receivables	**2**	6	–	–
Total assets classified as held for sale	**626**	22	**555**	16

On 31 May 2007, the bank entered into a contract for the sale and leaseback of the property and long leasehold land comprising 8 Canada Square, London to Metrovacesa, S.A. ('Metrovacesa') for £1,090 million. Under the terms of this arrangement, the bank has leased the building back from Metrovacesa for a period of 20 years at an annual rent of £43.5 million, with annual upward-only rent reviews linked to the Retail Price Index (all items) and subject to an annual maximum and minimum increase of 6 per cent and 2.5 per cent respectively. In the normal course of business, the bank has provided finance to Metrovacesa in respect of the debt element of this transaction at arm's length market rates in the form of a bridging loan of £810 million secured by a charge on the property. The bridging loan had a maturity of 30 November 2007 and was extended through a new facility provided by the bank with a maturity of 30 November 2008. The equity portion of £280 million was settled in cash by Metrovacesa on 31 May 2007.

The sale has not been recognised in the financial statements at 31 December 2007 because the bank has retained a significant interest by virtue of the loan provided to part-finance the purchase of the building. Accordingly, 8 Canada Square is presented within property, plant and equipment as a non-current asset held for sale with a carrying value of £432 million and the equity portion received from Metrovacesa is presented in the balance sheet as deferred income. It is expected that the sale will be recognised when the bridging loan is repaid.

Also included within property, plant and equipment classified as held for sale are other properties the group intends to dispose of through sale and leaseback transactions and repossessed property that had been pledged as collateral by customers.

25 Trading liabilities

	Carrying amount			
	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Deposits by banks	**39,382**	8,672	**48,390**	10,497
Customer accounts	**21,999**	9,791	**17,636**	8,610
Other debt securities in issue	**14,353**	9,863	**10,597**	5,972
Other liabilities – net short positions	**41,720**	23,754	**23,132**	10,136
	117,454	52,080	**99,755**	35,215

26 Financial liabilities designated at fair value

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Deposits by banks	**3,635**	108	**3,513**	72
Liabilities to customers under investment contracts	**5,842**	4,553	–	–
Debt securities in issue	**2,820**	1,141	**1,204**	1,003
Subordinated liabilities	**3,084**	3,353	**3,365**	3,661
Preference shares	**278**	305	–	–
	15,659	9,460	**8,082**	4,736

The carrying amount at 31 December 2007 of financial liabilities designated at fair value was £37 million lower (2006:£111 million higher) (the bank: 2007: £19 million lower; 2006:£113 million higher) than the contractual amount at maturity. At 31 December 2007, the accumulated amount of change in fair value attributable to changes in credit risk was a gain of £165 million (2006: £48 million loss) (the bank: 2007: £163 million gain; 2006: £47million loss).

27 Other liabilities

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Amounts due to investors in funds consolidated by the group	**1,225**	396	**–**	–
Share-based payments	**184**	140	**105**	89
Obligations under finance leases	**327**	327	**–**	–
Endorsements and acceptances	**375**	353	**251**	238
Other liabilities	**4,732**	3,398	**2,518**	2,087
	6,843	4,614	**2,874**	2,414
Obligations under finance leases falling due:				
– less than 1 year	**–**	1	**–**	–
– between 1 and 5 years	**–**	3	**–**	–
– over 5 years	**327**	323	**–**	–
	327	327	**–**	–

28 Liabilities under insurance contracts issued

	2007		
	Gross	**Reinsurance**	**Net**
	£m	**£m**	**£m**
Non-life insurance liabilities			
Unearned premium provision	**387**	**(48)**	**339**
Notified claims	**301**	**(129)**	**172**
Claims incurred but not reported	**112**	**(15)**	**97**
Other	**18**	**(18)**	**–**
	818	**(210)**	**608**
Policyholder liabilities			
Life (non-linked)	**1,128**	**(290)**	**838**
Investment contracts with discretionary participation features	**9,447**	**–**	**9,447**
Life (linked)	**858**	**(28)**	**830**
	11,433	**(318)**	**11,115**
Total liabilities under insurance contracts[1]	**12,251**	**(528)**	**11,723**

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.*

	2006		
	Gross	Reinsurance	Net
	£m	£m	£m
Non-life insurance provisions			
Unearned premium reserve	286	(27)	259
Notified claims	75	(32)	43
Claims incurred but not reported	41	(20)	21
Other			
	402	(79)	323
Policyholder liabilities			
Life (non-linked)	837	(525)	312
Investment contracts with discretionary participation features			
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.*

The movement of liabilities under insurance contracts was as follows:

Notes on the Financial Statements (continued)

Non-life insurance liabilities

	Year ended 31 December 2007		
	Gross	**Reinsurance**	**Net**
	£m	**£m**	**£m**
Unearned premium reserve ('UPR')			
At 1 January	**286**	**(27)**	**259**
Changes in UPR recognised as (income)/expense			
– gross written premiums	**(372)**	**73**	**(299)**
– gross earned premiums	**378**	**(81)**	**297**
Foreign exchange and other movements	**95**	**(13)**	**82**
At 31 December	**387**	**(48)**	**339**
Notified and incurred but not reported			
At 1 January	**116**	**(52)**	**64**
– notified claims	**75**	**(32)**	**43**
– claims incurred but not reported	**41**	**(20)**	**21**
Claims paid in respect of current year	**(250)**	**65**	**(185)**
Current year notifications	**302**	**29**	**331**
Foreign exchange and other movements	**245**	**(186)**	**59**
At 31 December			
– notified claims	**301**	**(129)**	**172**
– claims incurred but not reported	**112**	**(15)**	**97**
At 31 December	**413**	**(144)**	**269**

	Year ended 31 December 2006		
	Gross	Reinsurance	Net
	£m	£m	£m
UPR			
At 1 January	313	(23)	290
Changes in UPR recognised as (income)/ expense			
– 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

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 2007		
	Gross	**Reinsurance**	**Net**
	£m	**£m**	**£m**
Life (non-linked)			
At 1 January	**837**	**(525)**	**312**
Benefits paid	**(132)**	**73**	**(59)**
Increase in policyholder liabilities	**9**	**190**	**199**
Foreign exchange and other movements	**414**	**(28)**	**386**
At 31 December	**1,128**	**(290)**	**838**
Investment contracts with discretionary participation features			
At 1 January	**–**	**–**	**–**
Benefits paid	**(537)**	**–**	**(537)**
Increase in policyholder liabilities	**1,073**	**–**	**1,073**
Foreign exchange and other movements[1]	**8,911**	**–**	**8,911**
At 31 December	**9,447**	**–**	**9,447**
Life (linked)			
At 1 January	**647**	**(29)**	**618**
Benefits paid	**(139)**	**8**	**(131)**
Increase in policyholder liabilities	**158**	**(6)**	**152**
Foreign exchange and other movements	**192**	**(1)**	**191**
At 31 December	**858**	**(28)**	**830**
Total policyholder liabilities	**11,433**	**(318)**	**11,115**

1 *As a result of obtaining control of HSBC Assurances VIE (France) and HSBC Assurances IARD (France) during the year, £8,929 million of liabilities under insurance contracts issued were recognised by the group (further information on this acquisition can be found in Note 23).*

	Year ended 31 December 2006		
	Gross	Reinsurance	Net
	£m	£m	£m
Life (non-linked)			
At 1 January	847	(474)	373
Benefits paid	(103)	69	(34)
Increase in policyholder liabilities	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)
Increase in policyholder liabilities	69	6	75
At 31 December	647	(29)	618
Total policyholder liabilities	1,484	(554)	930

The increase in liabilities to policyholders represents 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 policyholders.

Notes on the Financial Statements (continued)

29 Provisions

The group

	Provisions	
	2007	2006
	£m	£m
At 1 January	**402**	384
Additional provisions/increase in provisions[1]	**406**	206
Provisions utilised	**(317)**	(124)
Amounts reversed	**(86)**	(72)
Exchange and other movements	**22**	8
At 31 December	**427**	402

1 *Includes unwinding of discounts of £1 million (2006: £5 million) in relation to vacant space provisions.*

Included above is a provision of £60 million (2006: £58 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	
	2007	2006
	£m	£m
At 1 January	**105**	124
Additional provisions/increase in provisions[1]	**251**	46
Provisions utilised	**(172)**	(43)
Amounts reversed	**(29)**	(23)
Exchange and other movements	**8**	1
At 31 December	**163**	105

1 *Includes unwinding of discounts of £1 million (2006: £5 million) in relation to vacant space provisions.*

Included in the above are:

(i) Provisions for onerous property contracts of £28 million (2006: £54 million), of which £7 million (2006: £13 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.

(ii) Provisions of £85 million (2006: £nil) for the estimated cost of redress in relation to provision of services to a number of trusts by a subsidiary of the bank. The bank has undertaken to reimburse the subsidiary in respect of the initial estimated cost of redress. The total provision is based on a calculation extrapolated from a sample of cases. Uncertainties arise from factors affecting the timing of notifying and reimbursing those affected.

29 Subordinated liabilities

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Subordinated liabilities:				
– At amortised cost	**5,205**	5,380	**4,744**	4,999
Subordinated liabilities	**3,111**	2,960	**4,744**	4,553
Preference shares	**2,094**	2,420	**–**	446
– Designated at fair value	**3,362**	3,658	**3,365**	3,661
Subordinated liabilities	**3,084**	3,353	**3,365**	3,661
Preference shares	**278**	305	**–**	–
	8,567	9,038	**8,109**	8,660

Subordinated borrowings of the group

		Book value	
		2007	2006
		£m	£m
US$300m	6.95% Subordinated Notes 2011	**162**	166
€250m	Floating Rate Subordinated Loan 2015	**183**	168
€600m	4.25% Callable Subordinated Notes 2016[1]	**439**	408
€800m	Callable Subordinated Floating Rate Notes 2016	**586**	536
£350m	Callable Subordinated Variable Coupon Notes 2017[2]	**355**	344
€1,000m	Floating Rate Subordinated Loan 2017	**734**	671
£500m	4.75% Callable Subordinated Notes 2020[3]	**464**	480
€500m	Callable Subordinated Floating Rate Notes 2020	**337**	335
£350m	5% Callable Subordinated Notes 2023[4]	**335**	350
£300m	6.5% Subordinated Notes 2023	**298**	298
US$300m	7.65% Subordinated Notes 2025	**179**	190
£350m	5.375% Callable Subordinated Step-up Notes 2030[5]	**325**	357
£500m	5.375% Subordinated Notes 2033	**474**	531
€900m	7.75% Non-cumulative Subordinated Notes 2040	**660**	604
£225m	6.25% Subordinated Notes 2041	**223**	223
£600m	4.75% Subordinated Notes 2046	**591**	591
£700m	5.844% Non-cumulative Step-up Perpetual Preferred Securities[6]	**700**	700
£300m	5.862% Non-cumulative Step-up Perpetual Preferred Securities[7]	**278**	305
US$750m	Undated Floating Rate Primary Capital Notes	**374**	382
US$500m	Undated Floating Rate Primary Capital Notes	**249**	255
US$300m	Undated Floating Rate Primary Capital Notes (Series 3)	**150**	153
£150m	8.625% Undated Subordinated Step-up Notes	**–**	155
US$875m	Non-cumulative Third US$ Preference Shares[8]	**–**	446
	Other subordinated liabilities less than £50m	**471**	390
		8,567	9,038

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 interest rate on the 5.375% Callable Subordinated Step-up Notes 2030 changes in November 2025 to three month sterling LIBOR plus 1.50%.*
6 *The distribution rate on the 5.844% Non-cumulative Step-up Perpetual Preferred Securities changes in November 2031 to six month sterling LIBOR plus 1.76%.*
7 *The distribution rate on the 5.862% Non-cumulative Step-up Perpetual Preferred Securities changes in April 2020 to six month sterling LIBOR plus 1.85%.*
8 *The terms and conditions of the Non-cumulative Third US$ Preference Shares were changed on 31 July 2007, resulting in their extinguishment as a financial liability of the bank and recognition as equity from that date*

Footnotes 1 to 7 all relate to notes that are repayable at the option of the borrower on the date of the change of the interest rate, and at subsequent interest rate reset dates and interest payment dates in some cases, subject to the prior non-objection of the Financial Services Authority.

31 Fair value of financial instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial instruments measured at fair value on an ongoing basis include trading assets and liabilities, instruments designated at fair value through profit or loss, derivatives, and financial instruments classified as available-for-sale (including treasury and other eligible bills, debt securities and equity securities).

Control framework

Fair values are subject to a control framework that aims to ensure that they are either determined, or validated, by a function independent of the risk taker. To this end, ultimate responsibility for the determination of fair values lies with Finance, which reports functionally to the Group Finance Director. Finance establishes the accounting policies and procedures governing valuation, and is responsible for ensuring that these comply with all relevant accounting standards.

For fair values determined using a valuation model, the control framework may include, as applicable, independent development or validation of valuation models, independent determination or validation of valuation model inputs, independent determination or validation of any adjustments required outside of the valuation model, and, where possible, independent validation of model outputs. For fair values determined without a valuation model, there is independent price determination or validation. The results of independent validation processes are reported to senior management, and adjustments to the fair values made as appropriate.

Determination of fair value of financial instruments carried at fair value

Financial instruments measured at fair value on an ongoing basis include trading assets and liabilities, instruments designated at fair value through profit or loss, derivatives, and financial investments classified as available-for-sale (including treasury and other eligible bills, debt securities, and equity securities).

The reliability of the fair value measurement for financial instruments reported on the group's consolidated balance sheet at fair value is assessed according to how the fair values have been determined, as follows:

(a) *Quoted market price*

Financial instruments with quoted prices for identical instruments in active markets.

(b) *Valuation technique using observable inputs*

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

(c) *Valuation technique with significant non-observable inputs*

Financial instruments valued using models where one or more significant inputs are not observable.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are not observable. For these instruments, the fair value measurement derived is more judgemental. 'Not observable' in this context means that there is little or no current market data available from which to determine the level at which an arm's length transaction would likely occur, but it generally does not mean that there is absolutely no market data available upon which to base a determination of fair value (historical data may, for example, be used). Furthermore, the assessment of hierarchy level is based on the lowest level of input that is significant to the fair value of the financial instrument. Consequently, the level of uncertainty in the determination of the unobservable inputs will generally give rise to valuation uncertainty that is less than the fair value itself.

In certain circumstances, the group applies the fair value option to own debt in issue. Where available, the fair value will be based upon quoted prices in an active market for the specific instrument concerned. Where not available, the fair value will either be based upon quoted prices in an inactive market for the specific instrument concerned, or estimated by comparison with quoted prices in an active market for similar instruments. The fair value of these instruments therefore includes the effect of own credit spread. Gains and losses arising from changes in the credit spread of liabilities issued by the group reverse over the contractual life of the debt.

Issued structured notes and certain other hybrid instrument liabilities are included within trading liabilities, and marked at fair value. The credit spread applied to these instruments is derived from the spreads at which the group issues structured notes. These market spreads are significantly tighter than credit spreads observed in vanilla debt or credit default swap markets.

All net positions in non-derivative financial instruments, and all derivative portfolios, are valued at bid or offer as appropriate. Long positions are marked at bid; short positions are marked at offer.

The fair values of large holdings of non-derivative financial instruments are based on a multiple of the value of a single instrument, and do not include block adjustments for the size of the holding.

The valuation models used where quoted market prices are not available incorporate certain assumptions that the group anticipates would be used by a market participant to establish fair value. Where the group anticipates that there are additional considerations not included within the valuation model, adjustments may be adopted outside the model.

Examples of such adjustments are:

- **Credit risk adjustment**: an adjustment to reflect the credit worthiness of over-the-counter derivative counterparties.
- **Market data/model uncertainty**: an adjustment to reflect uncertainties in fair values based on uncertain market data inputs (e.g. as a result of illiquidity) or in areas where the choice of valuation model is particularly subjective.
- **Inception profit ('day 1 P&L reserves')**: for financial instruments valued, at inception, on the basis of one or more significant unobservable inputs, the difference between transaction price and model value (as adjusted) at inception is not recognised in the consolidated income statement, but is deferred and included as part of the fair value.

Transaction costs are not included in the fair value calculation. Trade origination costs such as brokerage, fee expense, and post-trade costs are included in operating expenses. The future cost of administering the over-the-counter derivative portfolio is also not included in fair value, but is expensed as incurred.

- Loans

  Loans are valued from broker quotes and/or market data consensus providers where available. Where unavailable, fair value will be determined based on an appropriate credit spread derived from other market instruments issued by the same or comparable entities.

- Debt securities, Treasury and other eligible bills, and Equities

  These instruments are valued based on quoted market prices from an exchange, dealer, broker, industry group or pricing service, where available. Where unavailable, fair value is determined by reference to quoted market prices for similar instruments or, in the case of certain mortgage-backed securities and unquoted equities, valuation techniques using inputs determined from observable and unobservable market data.

- Derivatives

  Over-the-counter (i.e. non-exchange traded) derivatives are valued using valuation models. Valuation models calculate the present value of expected future cash flows, based upon 'no-arbitrage' principles. For many vanilla derivative products, such as interest rate swaps and European options, the modelling approaches used are standard across the industry. For more complex derivative products, there may be some divergence in practice. Inputs to valuation models are determined from observable market data wherever possible, including prices available from exchanges, dealers, brokers or providers of consensus pricing. Certain inputs may not be observable in the market directly, but can be determined from observable prices via model calibration procedures. Finally, some inputs are not observable, but can generally be estimated from historic data or other sources. Examples of inputs that are generally observable include foreign exchange spot and forward rates, benchmark interest rate curves and volatility surfaces for commonly traded option products. Examples of inputs that may be unobservable include volatility surfaces, in whole or in part, for less commonly traded option products, and correlations between market factors.

- Private equity

  The group's private equity positions are generally classified as available for sale and are not traded in an active market. In the absence of an active market for the investment, fair value is estimated based upon an analysis of the investee's financial position and results, risk profile, prospects and other factors as well as reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership. The exercise of judgement is required and because of uncertainties inherent in estimating fair value for private equity investments, it is not until realisation of the investment that subjective valuation factors are removed.

The following table provides an analysis of the basis for the valuation of financial assets and financial liabilities measured at fair value in the consolidated financial statements:

Notes on the Financial Statements (continued)

The group

	Quoted market price £m	Valuation techniques: using observable inputs £m	Valuation techniques: with significant non-observable inputs £m	Third Party Total £m	Amounts with HSBC entities £m	Total £m
At 31 December 2007						
Assets						
Trading assets	**80,256**	**61,878**	**3,603**	**145,737**	**7,469**	**153,206**
Financial assets designated at fair value	**10,615**	**4,330**	**-**	**14,945**	**24**	**14,969**
Derivatives	**3,019**	**49,199**	**807**	**53,025**	**7,445**	**60,470**
Financial investments	**17,757**	**42,229**	**3,314**	**63,300**	**6,190**	**69,490**
Liabilities						
Trading liabilities	**56,494**	**41,237**	**2,366**	**100,097**	**17,357**	**117,454**
Financial liabilities designated at fair value	**9,481**	**6,178**	**-**	**15,659**	**-**	**15,659**
Derivatives	**2,871**	**48,808**	**842**	**52,521**	**9,018**	**61,539**
At 31 December 2006						
Assets						
Trading assets	55,947	25,312	569	81,828	4,166	85,994
Financial assets designated at fair value	5,665	191	-	5,856	129	5,985
Derivatives	1,808	25,142	480	27,430	4,660	32,090
Financial investments	11,811	21,380	2,548	35,739	6,565	42,304
Liabilities						
Trading liabilities	35,426	11,893	914	48,233	3,847	52,080
Financial liabilities designated at fair value	8,368	889	-	9,257	203	9,460
Derivatives	2,767	23,149	526	26,442	6,301	32,743

The bank

	Quoted market price £m	Valuation techniques: using observable inputs £m	Valuation techniques: with significant non-observable inputs £m	Third Party Total £m	Amounts with HSBC entities £m	Total £m
At 31 December 2007						
Assets						
Trading assets	**39,935**	**58,777**	**3,603**	**102,315**	**46,787**	**149,102**
Financial assets designated at fair value	**-**	**3,439**	**-**	**3,439**	**-**	**3,439**
Derivatives	**57**	**32,185**	**287**	**32,529**	**13,796**	**46,325**
Financial investments	**6,749**	**5,843**	**1,026**	**13,618**	**(13)**	**13,605**
Liabilities						
Trading liabilities	**33,285**	**34,301**	**2,319**	**69,905**	**29,850**	**99,755**
Financial liabilities designated at fair value	**4,278**	**3,804**	**-**	**8,082**	**-**	**8,082**
Derivatives	**186**	**32,622**	**249**	**33,057**	**14,479**	**47,536**
At 31 December 2006						
Assets						
Trading assets	31,707	22,075	569	54,351	8,378	62,729
Financial assets designated at fair value	-	-	-	-	-	-
Derivatives	-	16,670	241	16,911	7,450	24,361
Financial investments	7,832	3,635	234	11,701	434	12,135
Liabilities						
Trading liabilities	20,600	7,347	914	28,861	6,354	35,215
Financial liabilities designated at fair value	4,254	70	-	4,324	412	4,736
Derivatives	1,108	15,111	175	16,394	8,573	24,967

Movements in unobservable assumptions in fair value valuation models

As discussed above the fair value of financial instruments are, in certain circumstances, measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data. The following table shows the sensitivity of fair values reasonably possible alternative assumptions.

The group

	Reflected in profit/(loss): Favourable Changes £m	Reflected in profit/(loss): Unfavourable Changes £m	Reflected in equity: Favourable Changes £m	Reflected in equity: Unfavourable Changes £m
At 31 December 2007				
Derivatives/trading assets/trading liabilities[1]	**150**	**(93)**	–	–
Financial assets/liabilities designated at fair value	–	–	–	–
Financial investments: available-for-sale	–	–	**171**	**(202)**
At 31 December 2006				
Derivatives/trading assets/trading liabilities	127	(132)]	–	–
Financial assets/liabilities designated at fair value	–	–	–	–
Financial investments: available-for-sale	–	–	28	(28)

Notes on the Financial Statements (continued)

The bank

	Reflected in profit/(loss)		Reflected in equity	
	Favourable Changes £m	Unfavourable Changes £m	Favourable Changes £m	Unfavourable Changes £m
At 31 December 2007				
Derivatives/trading assets/trading liabilities[1]	**135**	**(107)**	–	–
Financial assets/liabilities designated at fair value	–	–	–	–
Financial investments: available-for-sale	–	–	**87**	**(87)**
At 31 December 2006				
Derivatives/trading assets/trading liabilities	90	94	–	–
Financial assets/liabilities designated at fair value	–	–	–	–
Financial investments: available-for-sale	–	–	23	(23)

1 *Derivatives, trading assets and trading liabilities are presented as one category to reflect the manner in which these financial instruments are risk-managed.*

Changes in fair value recorded in the income statement

The following table details changes in fair values recognised in profit or loss during the period, where the fair value is estimated using valuation techniques that incorporate significant assumptions that are not supported by prices from observable current market transactions in the same instrument, and are not based on observable market data:

- the table details the total change in fair value of these instruments; it does not isolate that component of the change that is attributable to the non-observable component;
- instruments valued with significant non-observable inputs are frequently dynamically hedged with instruments valued using observable inputs; the table does not include any changes in fair value of these hedges; and
- there were significant assets and liabilities valued using observable inputs at 31 December 2006 that became valued with significant unobservable inputs during 2007; the table reflects the full change in fair value of those instruments during 2007, not just that element arising following the category change.

The group

	Amounts recognised in the income statement in:	
	2007 £m	2006 £m
Derivatives/trading assets/trading liabilities	**92**	-

The bank

	Amounts recognised in the income statement in:	
	2007 £m	2006 £m
Derivatives/trading assets/trading liabilities	**(27)**	-

Fair value of financial instruments not carried at fair value

The fair values of financial instruments that are not recognised at fair value on the balance sheet are calculated as described below.

The calculation of fair value incorporates the group's estimate of the amount at which financial assets could be exchanged, or financial liabilities settled, between knowledgeable, willing parties in an arm's length transaction. It does not reflect the economic benefits and costs that the group expects to flow from the instruments' cash flows over their expected future lives. Other reporting entities may use different valuation methodologies and assumptions in determining fair values for which no observable market prices are available,

so comparisons of fair values between entities may not be meaningful and users are advised to exercise caution when using this data.

The following types of financial instruments are measured at amortised cost unless they are held for trading or designated at fair value through profit or loss. Where assets or liabilities are hedged by derivatives designated and qualifying as fair value hedges, the carrying value of the assets or liabilities so hedged includes a fair value adjustment for the hedged risk only. Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

(i) Loans and advances to banks and customers

The fair value of loans and advances is based on observable market transactions, where available. In the absence of observable market transactions, fair value is estimated using discounted cash flow models. Performing loans are grouped, as far as possible, into homogeneous pools segregated by amount, customer type, currency, facility grade, maturity and coupon rates. In general, contractual cash flows are discounted using the group's estimate of the discount rate that a market participant would use in valuing instruments with similar maturity, repricing and credit risk characteristics. For maturity buckets where there is no recent price information, a linear trend is assumed between known points.

For loans and deposits, the fair value of the amounts repayable on demand is estimated as the carrying value at the balance sheet date.

The fair value of a loan portfolio reflects both loan impairments at the balance sheet date and estimates of market participants' expectations of credit losses over the life of the loans.

For impaired loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered.

(ii) Financial investments

The fair values of listed financial investments are determined using bid market prices. The fair values of unlisted financial investments are determined using valuation techniques that take into consideration either the prices of, or future earnings streams of, equivalent quoted securities.

(iii) Deposits by banks and customer accounts

For the purposes of estimating fair value, deposits by banks and customer accounts are grouped by residual maturity. Fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities. The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the balance sheet date.

(iv) Debt securities in issue and subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments.

The fair values in this note are stated at a specific date and may be significantly different from the amounts that will actually be paid on the maturity or settlement dates of the instruments. In many cases, it would not be possible to realise immediately the estimated fair values given the size of the portfolios measured. Accordingly, these fair values do not represent the value of these financial instruments to the group as a going concern.

For all classes of financial instruments, fair value represents the product of the value of a single instrument, multiplied by the number of instruments held. No block discount or premium adjustments are made.

The fair values of intangible assets, such as values placed on portfolios of core deposits, credit card and customer relationships, are not included above because they are not financial instruments.

The following table lists those financial instruments for which their carrying amount is a reasonable approximation of fair value because, for example, they are short term in nature or reprice to current market rates frequently:

Notes on the Financial Statements (continued)

Assets
Cash and balances at central banks
Items in the course of collection from other banks
Endorsements and acceptances
Short-term receivables within 'Other assets'
Accrued income

Liabilities
Items in the course of transmission to other banks
Endorsements and acceptances
Short-term payables within 'Other liabilities'
Accruals

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

	2007		2006	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair Value £m
Assets				
Loans and advances to banks	**60,764**	**60,764**	44,428	44,428
Loans and advances to customers	**227,687**	**226,572**	200,416	200,416
Financial investments: debt securities	**254**	**254**	76	76
Liabilities				
Deposits by banks	**48,786**	**48,783**	38,513	38,510
Customer accounts	**268,269**	**268,059**	227,350	227,358
Debt securities in issue	**50,921**	**50,620**	38,090	38,178
Subordinated liabilities	**5,205**	**4,921**	5,380	5,338

The bank

	2007		2006	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair Value £m
Assets				
Loans and advances to banks	**32,028**	**32,028**	25,121	25,121
Loans and advances to customers	**150,649**	**149,876**	143,964	143,964
Liabilities				
Deposits by banks	**41,061**	**41,061**	29,182	29,182
Customer accounts	**184,899**	**184,899**	164,054	164,185
Debt securities in issue	**8,117**	**8,194**	5,408	5,421
Subordinated liabilities	**4,744**	**4,469**	4,999	4,959

32 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.

Trading liabilities and trading derivatives have been included in the 'On demand' time bucket and not by contractual maturity, because trading liabilities are typically held for short periods of time. The undiscounted cash flows on hedging derivative liabilities are classified according to their contractual maturity.

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	**11,564**	**34,031**	**4,375**	**1,561**	**3,043**	**54,574**
Customer accounts	**173,902**	**90,818**	**7,720**	**2,232**	**1,255**	**275,927**
Trading liabilities	**117,454**	**–**	**–**	**–**	**–**	**117,454**
Financial liabilities designated at fair value	**5,828**	**408**	**1,345**	**2,716**	**8,134**	**18,431**
Derivatives	**60,908**	**4**	**246**	**483**	**104**	**61,745**
Debt securities in issue	**316**	**32,903**	**8,741**	**11,527**	**2,962**	**56,449**
Subordinated liabilities	**–**	**36**	**190**	**782**	**7,121**	**8,129**
Other financial liabilities	**2,567**	**6,152**	**861**	**253**	**585**	**10,418**
Loan commitments	**36,914**	**58,332**	**8,610**	**23,791**	**11,497**	**139,144**
Total at 31 December 2007	**409,453**	**222,684**	**32,088**	**43,345**	**34,701**	**742,271**

	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
Trading liabilities	52,080	–	–	–	–	52,080
Financial liabilities designated at fair value	4,540	72	193	2,600	4,460	11,865
Derivatives	34,217	77	27	310	52	34,683
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	4,794	68	71	357	5,939
Loan commitments	42,454	50,090	5,306	17,132	13,931	128,913
Total at 31 December 2006	302,381	174,773	16,252	36,114	31,982	561,502

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	**9,626**	**29,888**	**1,496**	**137**	**112**	**41,259**
Customer accounts	**141,788**	**35,584**	**2,648**	**5,094**	**1,334**	**186,448**
Trading liabilities	**99,755**	**–**	**–**	**–**	**–**	**99,755**
Financial liabilities designated at fair value	**–**	**54**	**161**	**2,401**	**7,769**	**10,385**
Derivatives	**47,339**	**(41)**	**66**	**229**	**5**	**47,598**
Debt securities in issue	**3**	**5,408**	**2,029**	**506**	**1,121**	**9,067**
Subordinated liabilities	**–**	**34**	**102**	**1,894**	**4,542**	**6,572**
Other financial liabilities	**–**	**4,639**	**64**	**15**	**1**	**4,719**
Loan commitments	**16,538**	**55,765**	**1,787**	**14,418**	**8,340**	**96,848**
Total at 31 December 2007	**315,049**	**131,331**	**8,353**	**24,694**	**23,224**	**502,651**

Notes on the Financial Statements (continued)

	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
Trading liabilities	35,215	–	–	–	–	35,215
Financial liabilities designated at fair value	–	43	174	2,435	4,197	6,849
Derivatives	24,878	1	27	64	52	25,022
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	3,108	16	–	–	3,326
Loan commitments	22,500	48,321	1,475	10,761	8,896	91,953
Total at 31 December 2006	218,839	101,475	6,202	20,641	22,703	369,860

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.

The group

	At 31 December 2007		
	Due within one year £m	**Due after more than one year £m**	**Total £m**
Assets			
Financial assets designated at fair value	**2,267**	**12,702**	**14,969**
Loans and advances to banks	**55,163**	**5,601**	**60,764**
Loans and advances to customers	**119,052**	**108,635**	**227,687**
Financial investments	**16,467**	**53,061**	**69,528**
Other financial assets	**4,330**	**413**	**4,743**
	197,279	**180,412**	**377,691**
Liabilities			
Deposits by banks	**44,422**	**4,364**	**48,786**
Customer accounts	**264,976**	**3,293**	**268,269**
Financial liabilities designated at fair value	**4,750**	**10,909**	**15,659**
Debt securities in issue	**39,675**	**11,246**	**50,921**
Other financial liabilities	**6,332**	**358**	**6,690**
Subordinated liabilities	**–**	**5,205**	**5,205**
	360,155	**35,375**	**395,530**

	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

The bank

	At 31 December 2007		
	Due within one year £m	**Due after more than one year £m**	**Total £m**
Assets			
Financial assets designated at fair value	**–**	**3,439**	**3,439**
Loans and advances to banks	**28,479**	**3,549**	**32,028**
Loans and advances to customers	**71,543**	**79,106**	**150,649**
Financial investments	**8,467**	**5,354**	**13,821**
Other financial assets	**1,485**	**154**	**1,639**
	109,974	**91,602**	**201,576**
Liabilities			
Deposits by banks	**38,854**	**2,207**	**41,061**
Customer accounts	**181,340**	**3,559**	**184,899**
Financial liabilities designated at fair value	**3,366**	**4,716**	**8,082**
Debt securities in issue	**7,282**	**835**	**8,117**
Other financial liabilities	**2,793**	**–**	**2,793**
Subordinated liabilities	**–**	**4,744**	**4,744**
	233,635	**16,061**	**249,696**

	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

Further discussion of the group's liquidity and funding management can be found in Note 38 'Risk management'.

33 Foreign exchange exposures

Structural foreign exchange 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 38.

Net structural currency exposures

Currency of structural exposure	**2007**	2006
	£m	£m
Euros	**10,449**	9,433
US dollars	**558**	818
Swiss francs	**1,324**	1,271
Turkish lira	**895**	494
Maltese lira	**135**	137
Others, less than £100 million	**189**	145
Total	**13,550**	12,298

34 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	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Treasury bills and other eligible securities	**1,410**	213	**1,404**	213
Loans and advances to banks	**5,402**	347	**1,113**	347
Loans and advances to customers	**24,664**	11,213	**3,408**	11,213
Debt securities	**100,750**	47,188	**38,696**	32,446
Equity shares	**9,366**	5,887	**9,300**	5,767
	141,592	64,848	**53,921**	49,986

These transactions are conducted under terms that are usual and customary to standard securities lending and repurchase agreements.

Collateral accepted as security for assets

The fair value of financial assets accepted as collateral that the group is permitted to sell or repledge in the absence of default is £104,506 million (2006: £46,794 million).

The fair value of financial assets accepted as collateral that have been sold or repledged is £59,668 million (2006: £24,729 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.

35 Called up share capital

Authorised

The authorised ordinary share capital of HSBC Bank plc at 31 December 2007 and 2006 was £1,000 million divided into 999,999,999 ordinary shares of £1 each and 1 preferred ordinary share of £1.

At 31 December 2007 and 2006, the authorised preference share capital of HSBC Bank plc was £150 million non-cumulative preference shares of £1 each and US$2.44 million non-cumulative preference shares of US$0.01 each.

Issued

HSBC Bank plc Ordinary shares

	Number	£m
At 1 January 2007	**796,969,101**	**797**
Shares issued	**1**	
At 31 December 2007	**796,969,102**	**797**
At 1 January 2006	796,969,099	797
Shares issued	2	-
At 31 December 2006	796,969,101	797

HSBC Bank plc Non-cumulative third dollar preference shares

	Number	£'000
At 1 January 2007	–	–
Recognised during the year	**35,000,000**	**172**
At 31 December 2007	**35,000,000**	**172**

On 31 July 2007, the terms and conditions of the HSBC Bank plc non-cumulative third dollar preference shares were changed. As a result, the preference shares were extinguished as financial liabilities of the bank and recognised as equity from that date with a related credit to share premium of £431 million. The bank has no obligation to redeem the preference shares but may redeem them in part or in whole at any time, with the prior non-objection of the FSA. Dividends on the preference shares are paid annually at the sole and absolute discretion of the Board of Directors. The Board of Directors will not declare a dividend on the preference shares if payment of the dividend would cause the bank not to meet the capital adequacy requirements of the FSA or the profit of the bank available for distribution as dividends are not sufficient to enable the bank to pay in full both dividends on the preference shares and dividends on any other shares that are scheduled to be paid on the same date and have an equal right to dividends or if payment of the dividend is prohibited by the rights attached to any class of shares in the capital of the bank, excluding ordinary shares. The preference shares carry no rights to conversion into ordinary shares of the bank. Holders of the preference shares will be able to attend any general meetings of shareholders of the bank and to vote on any resolution proposed to vary or abrogate any of the rights attaching to the preference shares or any resolution proposed to reduce the paid up capital of the preference shares. If the dividend payable on the preference shares has not been paid in full for the most recent dividend period or any resolution is proposed for the winding-up of the bank or the sale of its entire business then, in such circumstances, holders of preference shares will be entitled to vote on all matters put to general meetings. In the case of unpaid dividends the holders of preference shares will be entitled to attend and vote at any general meetings until such time as dividends on the preference shares have been paid in full, or a sum set aside for such payment in full, in respect of one dividend period.

HSBC Bank plc Perpetual subordinated debt

	£m
At 1 January 2007	–
Issued during the year	**1,000**
At 31 December 2007	**1,000**

Interest on HSBC Bank plc perpetual subordinated debt is paid quarterly at the sole and absolute discretion of the Board of Directors. The perpetual subordinated debt may only be redeemed at the option of the bank and carries no rights to conversion into ordinary shares of the bank.

Notes on the Financial Statements (continued)

36 Equity

The group

	2007										
				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	14,558	4,966	523	(32)	(737)	199	125	20,399	539	20,938
New share capital subscribed, net of costs	1,000	510	–	–	–	–	–	–	1,510	2	1,512
Preference shares recognised in the year[1]	–	431	–	–	–	–	–	–	431	–	431
Profit for the year attributable to shareholders	–	–	3,227	–	–	–	–	–	3,227	–	3,227
Dividends to shareholders of the parent company	–	–	(1,706)	–	–	–	–	–	(1,706)	–	(1,706)
Actuarial gains on defined benefit plans	–	–	1,267	–	–	–	–	–	1,267	3	1,270
Fair value (losses)/ gains taken to equity	–	–	–	(964)	(71)	–	–	101	(934)	–	(934)
Amounts transferred to the income statement	–	–	–	(501)	33	–	–	(122)	(590)	–	(590)
Charge to the income statement in respect of equity settled share-based payment transactions	–	–	–	–	–	–	40	–	40	–	40
Tax on items taken directly to or transferred from equity	–	–	(382)	61	10	–	–	–	(311)	–	(311)
Transfer to minority interest	–	–	–	3	–	–	–	–	3	(3)	–
Profit attributable to minority interests	–	–	–	–	–	–	–	–	–	87	87
Dividends to minority interests	–	–	(7)	–	–	–	–	–	(7)	(67)	(74)
Transfers from Associates	–	–	(16)	120	–	–	–	(104)	–	–	–
Exchange differences	–	–	–	–	–	1,094	–	–	1,094	15	1,109
Other	–	–	(1)	1	–	–	–	–	–	–	–
At 31 December	1,797	15,499	7,348	(757)	(60)	357	239	–	24,423	576	24,999

1 *Share premium arising on the bank's Non-cumulative third dollar preference shares recognised as equity instruments during the year. Further information is provided in Note 35.*

	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 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

The bank

	2007								
				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	14,558	1,650	91	(8)	(2)	121	–	17,207
New share capital subscribed, net of costs	1,000	510	–	–	–	–	–	–	1,510
Preference shares recognised in the year[1]	–	431	–	–	–	–	–	–	431
Profit for the year attributable to shareholders	–	–	2,351	–	–	–	–	–	2,351
Dividends to shareholders of the parent company	–	–	(1,706)	–	–	–	–	–	(1,706)
Actuarial gains on defined benefit plans	–	–	1,231	–	–	–	–	–	1,231
Fair value gains taken to equity	–	–	–	238	10	–	–	–	248
Amounts transferred to the income statement	–	–	–	(167)	19	–	–	–	(148)
Charge to the income statement in respect of equity settled share-based payment transactions	–	–	–	–	–	–	26	–	26
Tax on items taken directly to or transferred from equity	–	–	(372)	16	(8)	–	–	–	(364)
Exchange differences	–	–		–		(10)	–	–	(10)
Other	–	–	–	1	–	–	–	–	1
At 31 December	**1,797**	**15,499**	**3,154**	**179**	**13**	**(12)**	**147**	**–**	**20,777**

1 *Share premium arising on the bank's Non-cumulative third dollar preference shares recognised as equity instruments during the year. Further information is provided in Note 35.*

	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 losses on defined benefit plans	–	–	(10)	–	–	–	–	–	(10)
Fair value gains 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)

37 Notes on the cash flow statement

Non-cash items included in profit before tax

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Depreciation, amortisation and impairment	**564**	561	**340**	348
Loan impairment losses gross of recoveries	**1,043**	938	**825**	798
Provisions raised	**342**	140	**230**	22
Impairment of financial investments	**–**	(4)	**–**	–
Charge for defined benefit pension schemes	**240**	203	**245**	182
Accretion of discounts and amortisation of premiums	**(166)**	23	**(33)**	(83)
	2,023	1,861	**1,607**	1,267

Change in operating assets

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Change in prepayments and accrued income	**(2,129)**	(836)	**(1,454)**	(657)
Change in net trading securities and net derivatives	**(6,299)**	(6,018)	**(25,811)**	(5,775)
Change in loans and advances to banks	**(10,421)**	(547)	**(7,371)**	2,238
Change in loans and advances to customers	**(27,302)**	(17,669)	**(6,616)**	(9,126)
Change in financial assets designated at fair value	**(8,984)**	(640)	**(3,439)**	16
Change in other assets	**(1,482)**	(342)	**(63)**	(508)
	(56,617)	(26,052)	**(44,754)**	(13,812)

Change in operating liabilities

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Change in accruals and deferred income	**2,313**	748	**1,642**	721
Change in deposits by banks	**10,273**	4,315	**11,879**	1,183
Change in customer accounts	**40,919**	21,875	**20,845**	22,293
Change in debt securities in issue	**12,831**	11,289	**2,709**	(2,804)
Change in financial liabilities designated at fair value	**6,199**	1,275	**3,346**	415
Change in other liabilities	**11,016**	(200)	**(1,058)**	(362)
	83,551	39,302	**39,363**	21,446

Cash and cash equivalents comprise

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Cash and balances at central banks	**7,146**	3,618	**3,677**	2,496
Items in the course of collection from other banks	**2,434**	2,937	**1,377**	1,367
Loans and advances to banks of one month or less	**37,751**	31,838	**13,205**	13,669
Treasury bills, other bills and certificates of deposit less than three months	**5,879**	10,756	**5,389**	9,972
Less: items in the course of transmission to other banks	**(1,975)**	(2,428)	**(1,056)**	(1,019)
Total cash and cash equivalents[1]	**51,235**	46,721	**22,592**	26,485

1 *Total cash and cash equivalents include the following amounts that are not available for use by the group: £18 million held by foreign subsidiaries and subject to foreign exchange control restrictions (2006: £65.6 million); and £3,098 million subject to other restrictions (2006: £942 million)*

Total interest paid by the group during the year was £13,318 million (2006: £11,176 million). Total interest received by the group during the year was £14,632million (2006: £16,312 million). Total dividends received by the group during the year was £715 million (2006: £635 million).

38 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. In addition, risk also arises from transactions with special purpose entities, both on and off-balance sheet, and other types of off-balance sheet arrangement, including financial guarantees, letters of credit and commitments to lend.

The management of all risks that are significant to the group is discussed below.

Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from lending, trade finance, treasury and leasing business. Credit risk also arises where assets are held in the form of debt securities, the value of which may fall. The group has standards, policies and procedures dedicated to monitoring and managing risk from all such activities.

HSBC Holdings plc is responsible for the formulation of high-level credit risk policies and provides high-level centralised oversight and management of credit risk for its subsidiaries worldwide. In addition, its responsibilities include:

- controlling exposures to sovereign entities, banks and other financial institutions. HSBC's credit and settlement risk limits to counterparties in these sectors are approved and managed by Group Credit Risk, to optimise the use of credit availability and avoid excessive risk concentration.
- monitoring intra-Group exposures to ensure they are maintained within regulatory limits.
- controlling cross-border exposures, through the imposition of country limits with sub-limits by maturity and type of business. Country limits are determined by taking into account economic and political factors, and applying local business knowledge. Transactions with countries deemed to be higher risk are considered on a case by case basis.

Within the group, the Credit Risk function is headed by the Head of Credit Risk and reports to the Chief Operating Officer. Its responsibilities include:

- formulating and recording in instruction manuals detailed credit policies and procedures, consistent with HSBC policy.
- issuing policy guidelines to subsidiaries and offices on appetite for credit risk exposure to specified market sectors, activities and banking products.
- undertaking independent review and objective assessment of risk. Credit Risk approves all commercial non-bank credit facilities and exposures – including those embedded in derivatives – that are originated or renewed by subsidiaries and offices over designated limits.
- monitoring the performance and management of retail portfolios.
- maintaining policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to the group's capital base and remain within internal and regulatory limits.
- maintaining and developing the governance and operation of HSBC's risk rating framework and systems, to classify exposures.

- reporting to senior executives on aspects of the group's credit risk portfolio. These executives, as well as the Executive Risk Management Committee, Audit Committee and the Board of Directors of the bank receive a variety of regular and ad hoc reports covering:
  - risk concentrations;
  - retail portfolio performance;
  - specific higher-risk portfolio segments, e.g. real estate, banks, and automotive sector;
  - individual large impaired accounts, and impairment allowances/charges for all customer segments;
  - country limits, cross-border exposures and related impairment allowances;
  - portfolio and analytical model performance data, employing Basel 2 metrics; and
  - stress testing results and recommendations.
- where appropriate, establishing specialist units to provide intensive management and control to maximise recoveries of doubtful debts.
- managing and directing credit risk management systems initiatives.
- providing advice and guidance to offices and subsidiaries, to promote best practice on credit-related matters such as:
  - regulatory developments;
  - risk modelling;
  - collective impairment allowances; and
  - new products and credit risk reporting.
- acting on behalf of the group as the primary interface, for credit-related issues, with external parties including the Bank of England, the FSA, rating agencies, corporate analysts, trade associations and counterparts.

Maximum exposure to credit risk

The following table presents the maximum exposure to credit risk of balance sheet and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements unless such credit enhancements meets offsetting requirements as set out in Note 2(m).

The group

	Maximum exposure At 31 December 2007 £m	Maximum exposure At 31 December 2006 £m
Items in course of collection from other banks	**2,434**	2,937
Trading assets	**130,787**	75,158
– treasury and other similar bills	**445**	197
– debt securities	**58,741**	47,101
– loans and advances	**71,601**	27,860
Financial assets designated at fair value	**7,936**	2,509
– treasury and other similar bills	**25**	28
– debt securities	**7,822**	2,361
– loans and advances	**89**	120
Derivatives	**60,470**	32,090
Loans and advances to banks	**60,764**	44,428
Loans and advances to customers	**227,687**	200,416
Financial investments	**66,476**	40,485
– treasury and other similar bills	**1,882**	3,199
– debt securities	**64,594**	37,286
Other assets		
– endorsements and acceptances	**375**	353
– other	**3,293**	2,762
Off-balance sheet		
– financial guarantees and other credit related contingent liabilities	**17,603**	22,938
– loan commitments and other credit related commitments	**146,019**	131,352
	723,844	555,428

The bank

	Maximum exposure At 31 December 2007 £m	Maximum exposure At 31 December 2006 £m
Items in course of collection from other banks	**1,377**	1,367
Trading assets	**136,007**	55,450
– treasury and other similar bills	**437**	165
– debt securities	**37,902**	25,260
– loans and advances	**97,668**	30,025
Financial assets designated at fair value	**3,439**	–
– treasury and other similar bills	**–**	–
– debt securities	**3,439**	–
– loans and advances	**–**	–
Derivatives	**46,325**	24,361
Loans and advances to banks	**32,028**	25,121
Loans and advances to customers	**150,649**	143,964
Financial investments	**12,894**	11,749
– treasury and other similar bills	**1,397**	2,826
– debt securities	**11,497**	8,923
Other assets		
– endorsements and acceptances	**251**	238
– other	**1,086**	1,482
Off-balance sheet		
– financial guarantees and other credit related contingent liabilities	**9,706**	16,129
– loan commitments and other credit related commitments	**102,326**	94,336
	496,088	374,197

Collateral and other credit enhancements

Loans and advances

It is the group's policy when making loans to establish that they are within the customer's capacity to repay, rather than rely excessively on security. Depending on the customer's standing and the type of product, facilities may be unsecured. Nevertheless, collateral can be an important mitigant of credit risk.

When appropriate, operating companies are required to implement guidelines on the acceptability of specific classes of collateral or credit risk mitigation, and determine suitable valuation parameters. Such parameters are expected to be conservative, reviewed regularly and supported by empirical evidence. Security structures and legal covenants are required to be subject to regular review to ensure that they continue to fulfil their intended purpose and remain in line with local market practice. 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;
- in the financial sector, charges over financial instruments such as debt securities and equities in support of trading facilities; and
- credit derivatives are also used to manage credit risk in the group's loan portfolio, including its transfer into synthetic securitisation structures for sale to third party investors.

The group does not disclose the fair value of collateral held as security or other credit enhancements on loans and advances past due but not impaired or on individually assessed impaired loans and advances, as it is not practicable to do so.

Other financial assets

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured with the exception of asset-backed securities and similar instruments that are secured by pools of financial assets.

The ISDA Master Agreement is the group's preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of over-the-counter products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or other pre-agreed termination events occur. It is common, and the group's preferred practice, for the parties to execute a Credit Support Annex ('CSA') in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the market-contingent counterparty risk inherent in the outstanding positions.

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risk arising from the group's investment banking and markets transactions on any single day. Settlement risk on many transactions, particularly those involving securities and equities, is substantially mitigated through being effected via assured payment systems, or on a delivery versus payment basis.

Concentrations of exposure

The group

	2007	2006
	%	%
United Kingdom	**42**	47
France	**18**	12
Germany	**5**	8
Rest of Continental Europe	**20**	21
Continental Europe	**43**	41
United States	**6**	5
Rest of world	**9**	7
	100	100

The bank

	2007	2006
	%	%
United Kingdom	**56**	66
France	**5**	4
Germany	**3**	4
Rest of Continental Europe	**21**	18
Continental Europe	**29**	26
United States	**5**	3
Rest of world	**10**	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 2007 and 31 December 2006 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 2007		At 31 December 2006	
	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	**225,153**	**60,760**	197,999	44,426
– past due but not impaired	**1,375**	**–**	1,412	–
– impaired	**2,953**	**6**	2,767	6
	229,481	**60,766**	202,178	44,432

Notes on the Financial Statements (continued)

The bank

	At 31 December 2007		At 31 December 2006	
	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	**148,837**	**32,025**	142,156	25,118
– past due but not impaired	**1,150**	**–**	1,198	–
– impaired	**1,496**	**6**	1,513	6
	151,483	**32,031**	144,867	25,124

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 2007 can be assessed by reference to the group's legacy credit risk rating system which provides risk grades for unimpaired exposures on the basis of a "composite" assessment of probability of default and risk mitigation. The following information is based on that system:

The group

	At 31 December 2007		At 31 December 2006	
	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	**220,098**	**60,459**	191,896	44,011
Grade 4 – watch list	**3,755**	**82**	4,088	415
Grade 5 – sub-standard but not impaired	**1,300**	**219**	2,015	–
	225,153	**60,760**	197,999	44,426

The bank

	At 31 December 2007		At 31 December 2006	
	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	**145,296**	**31,724**	137,569	25,089
Grade 4 – watch list	**2,762**	**82**	3,042	29
Grade 5 – sub-standard but not impaired	**779**	**219**	1,545	–
	148,837	**32,025**	142,156	25,118

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 valuation ratios, and other retail accounts which are maintained within generally applicable product parameters.

Grade 3 represents satisfactory risk and includes corporate facilities that require closer monitoring, mortgages with higher loan to valuation ratios, credit card exposures and other retail exposures which operate outside generally applicable product parameters without being impaired.

Grades 4 and 5 include facilities that require varying degrees of special attention and all retail exposures that are progressively between 30 and 90 days past due.

Grades 6 or 7 represent impaired exposures.

Loans and advances which are individually assessed for impairment are identified on an individual basis, and classified as grades 6 or 7 when they are impaired. It is not practicable to individually identify impaired loans and

advances within portfolios of homogenous loans which are assessed on a collective basis for impairment. In practice such loans and advances are not individually identified as impaired until the time each impaired loan is written off. It is therefore necessary to estimate the carrying value of impaired loans and advances within these portfolios.

The approach adopted by the group to estimate the carrying value of impaired loans and advances within portfolios of homogenous loans that are collectively assessed for impairment, is to classify these loans and advances as impaired when the balances are 90 days or more past due. These loans and advances are classified as grades 6 and 7. All other collectively assessed loans and advances, including those which are less than 90 days past due, are classified as not impaired, and reported within grades 1 to 5. Collective impairment allowances are recognised in relation to losses that are likely to have been incurred at the balance sheet date on loans which are collectively assessed for impairment and classified in grades 1 to 5, representing a small percentage of the total loans and advances in these grades.

This historical seven grade risk rating system is being phased out and superseded by a more sophisticated and granular methodology based on the probability of default and loss estimates calculated in accordance with the Basel 2 Framework. This is now in use throughout the group for the credit assessment of individually significant customers. Within the group's retail portfolios, risk is assessed and managed using a wide range of risk and pricing models, and while the quality of retail assets has been reported by reference to the group's legacy risk rating scale described above, it will in future be based on the probability of default and expected loss parameters applied to homogenous segments of retail portfolios. The integration of such parameters into reporting structures at all levels will enable Board and regulatory reporting on the new basis in 2008 in accordance with the group's obligations under its advanced IRB permission from the FSA.

Loans and advances which were past due but not impaired

Loans and advances that were past due but not impaired at 31 December 2007 were as follows:

The group

	Loans and advances to customers	
	2007	2006
	£m	£m
Past due up to 29 days	**756**	776
Past due 30 – 59 days	**308**	310
Past due 60 – 89 days	**210**	205
	1,274	1,291
Past due 90 – 179 days	**96**	105
Past due over 180 days but less than 1 year	**3**	14
Past due more than 1 year	**2**	2
	1,375	1,412

The bank

	Loans and advances to customers	
	2007	2006
	£m	£m
Past due up to 29 days	**594**	635
Past due 30 – 59 days	**274**	276
Past due 60 – 89 days	**188**	183
	1,056	1,094
Past due 90 – 179 days	**93**	102
Past due over 180 days but less than 1 year	**1**	1
Past due more than 1 year	**–**	1
	1,150	1,198

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.

Notes on the Financial Statements (continued)

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 2007		
	Book value £m	**Amount for which the group has has a legally enforceable right to off-set[1] £m**	**Net total credit risk[2] £m**
Loans and advances to customers	**227,687**	**(31,816)**	**195,871**
Loans and advances to banks	**60,764**	**(135)**	**60,629**
	288,451	**(31,951)**	**256,500**

	At 31 December 2006		
	Book value £m	Amount for which the group has a legally enforceable right to offset[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

The bank

	At 31 December 2007		
	Book value £m	**Amount for which the group has a legally enforceable right to offset[1] £m**	**Net total credit risk[2] £m**
Loans and advances to customers	**150,649**	**(29,974)**	**120,675**
Loans and advances to banks	**32,028**	**–**	**32,028**
	182,677	**(29,974)**	**152,703**

1 *Against financial liabilities with the same counterparty.*
2 *Excluding the value of any collateral or security held.*

	At 31 December 2006		
	Book value £m	Amount for which the group has a legally enforceable right to offset[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.*

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 2007			
	Treasury bills £m	**Other eligible bills £m**	**Debt securities £m**	**Total £m**
AAA	**562**	**114**	**69,783**	**70,459**
AA – to AA +	**1,043**	**59**	**25,308**	**26,410**
A – to A +	**85**	**–**	**12,487**	**12,572**
Lower than A –	**465**	**–**	**3,658**	**4,123**
Unrated	**–**	**–**	**17,046**	**17,046**
Supporting linked insurance and investment contracts	**24**	**–**	**2,875**	**2,899**
Total	**2,179**	**173**	**131,157**	**133,509**
Of which issued by:				
– governments	**2,042**	**–**	**36,511**	**38,553**
– local authorities	**134**	**–**	**495**	**629**
– asset backed securities	**–**	**–**	**41,942**	**41,942**
– corporates and other	**3**	**173**	**52,209**	**52,385**
Total	**2,179**	**173**	**131,157**	**133,509**
Of which classified as:				
– financial instruments designated at fair value	**25**	**–**	**7,822**	**7,847**
– available-for-sale securities	**1,709**	**173**	**64,556**	**66,438**
– held-to-maturity investments	**–**	**–**	**38**	**38**
– held for trading	**445**	**–**	**58,741**	**59,186**
Total	**2,179**	**173**	**131,157**	**133,509**

Notes on the Financial Statements (continued)

	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
– asset backed securities	–	–	12,649	12,649
– corporates and other	193	255	44,965	45,413
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

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 2007			
	Treasury bills £m	**Other eligible bills £m**	**Debt securities £m**	**Total £m**
AAA	**350**	–	**17,809**	**18,159**
AA – to AA +	**1,031**	–	**9,199**	**10,230**
A – to A +	**17**	–	**8,617**	**8,634**
Lower than A –	**436**	–	**2,921**	**3,357**
Unrated	–	–	**14,292**	**14,292**
Supporting linked insurance and investment contracts	–	–	–	–
Total	**1,834**	–	**52,838**	**54,672**
Of which issued by:				
– governments	**1,813**	–	**9,078**	**10,891**
– local authorities	**21**	–	**147**	**168**
– asset backed securities	–	–	**12,572**	**12,572**
– corporates and other	–	–	**31,041**	**31,041**
Total	**1,834**	–	**52,838**	**54,672**
Of which classified as:				
– financial instruments designated at fair value	–	–	**3,439**	**3,439**
– available-for-sale securities	**1,397**	–	**11,497**	**12,894**
– held-to-maturity investments	–	–	-	-
– held for trading	**437**	–	**37,902**	**38,339**
Total	**1,834**	–	**52,838**	**54,672**

	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
– asset backed securities	–	–	–	–
– corporates and other	193	–	25,819	26,012
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)

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 2007		
	Book value £m	Amount for which the group has a legally enforceable right to offset[1] £m	Net total credit risk[2] £m
Trading assets:			
– treasury and other similar bills	**445**	–	**445**
– debt securities	**58,741**	–	**58,741**
– loans and advances to banks	**37,020**	–	**37,020**
– loans and advances to customers	**34,581**	**(3,307)**	**31,274**
	130,787	**(3,307)**	**127,480**
Financial assets designated at fair value:			
– treasury and other similar bills	**25**	–	**25**
– debt securities	**7,822**	–	**7,822**
– loans and advances to banks	**89**	–	**89**
– loans and advances to customers	**–**	–	**–**
	7,936	–	**7,936**
Derivatives	**60,470**	**(30,452)**	**30,018**
Financial investments:			
– treasury and other similar bills	**1,882**	–	**1,882**
– debt securities	**64,594**	–	**64,594**
	66,476	–	**66,476**
Other assets			
Acceptances and endorsements	**375**	**(111)**	**264**
	266,044	**(33,870)**	**232,174**

1 *Against financial liabilities with the same counterparty.*
2 *Excluding the value of any collateral or security held.*

	At 31 December 2006		
	Book value £m	Amount for which the group has a legally enforceable right to offset[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.*

Notes on the Financial Statements (continued)

The bank

	At 31 December 2007		
	Book value £m	Amount for which the group has a legally enforceable right to offset[1] £m	Net total credit risk[2] £m
Trading assets:			
– treasury and other similar bills	**437**	–	**437**
– debt securities	**37,902**	–	**37,902**
– loans and advances to banks	**59,451**	–	**59,451**
– loans and advances to customers	**38,217**	**(3,307)**	**34,910**
	136,007	**(3,307)**	**132,700**
Financial assets designated at fair value:			
– debt securities	**3,439**	–	**3,439**
Derivatives	**46,325**	**(17,813)**	**28,512**
Financial investments:			
– treasury and other similar bills	**1,397**	–	**1,397**
– debt securities	**11,497**	–	**11,497**
	12,894	–	**12,894**
Other assets			
Acceptances and endorsements	**251**	–	**251**
	198,916	**(21,120)**	**177,796**

1 *Against financial liabilities with the same counterparty.*
2 *Excluding the value of any collateral or security held.*

	At 31 December 2006		
	Book value £m	Amount for which the group has a legally enforceable right to offset[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.*

Impairment assessment

Management regularly evaluates the adequacy of the established allowances for impaired loans by conducting a detailed review of the loan portfolio, comparing performance and delinquency statistics with historical trends and assessing the impact of current economic conditions.

Two types of impairment allowance are in place: individually assessed and collectively assessed which are discussed below.

Individually assessed impairment allowances

These are determined by evaluating the exposure to loss, case by case, on all individually significant accounts and all ther accounts that do not qualify for the collective assessment approach outlined below.

In determining allowances on individually assessed accounts, the following factors are considered:

- aggregate exposure to the customer;
- the viability of the customer's business model and their capacity to trade successfully out of financial difficulties, generating sufficient cash flow to service debt obligations;
- the ability of the borrower to obtain, and make payments in, the currency of the loan if not denominated in local currency;
- the amount and timing of expected receipts and recoveries;
- the extent of other creditors' commitments ranking ahead of, or *pari passu* with, 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;

- the likely dividend available on liquidation or bankruptcy;
- the likely deduction of any costs involved in recovering amounts outstanding, and
- when available, the secondary market price of the debt.

The group's policy requires the level of impairment allowances on individual facilities that are above materiality thresholds to be reviewed at least semi-annually, and more regularly when individual circumstances require. The review normally encompasses 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 assess likely losses on significant individual exposures. Individually assessed impairment allowances are only reversed when the group has reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed impairment allowances

Impairment is assessed on a collective basis in two circumstances:

- to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- for homogeneous groups of loans that are not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of impairment has been specifically identified on an individual basis are grouped together according to their credit risk characteristics. A collective loan loss allowance is calculated to reflect impairment losses incurred at the balance sheet date which will only be individually identified in the future.

The collective impairment allowance is determined having taken into account:

- historical loss experience in portfolios of similar credit risk characteristics (for example, by industry sector, risk rating or product segment);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate allowance against the individual loan; and
- management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

The period between a loss occurring and its identification is estimated, on the basis of local experience, for each identified portfolio. In general, the periods used vary between four and twelve months.

Homogeneous groups of loans

Two methodologies are used to calculate impairment allowances where large numbers of relatively low-value assets are managed using a portfolio approach, typically:

- low-value, homogeneous small business accounts; and
- credit cards and other unsecured consumer lending products.

When appropriate empirical information is available, the group uses roll rate methodology. This employs a statistical analysis of historical trends of default and the amount of consequential loss, based on the delinquency of accounts within a portfolio of homogeneous accounts. Other historical data and current economic conditions are also evaluated when calculating the appropriate level of impairment allowance required to cover inherent loss. In certain highly developed markets, models also take into account behavioural and account management trends revealed in, for example, bankruptcy and rescheduling statistics.

When the portfolio size is small, or when information is insufficient or not reliable enough to adopt a roll rate methodology, a formulaic approach is used which allocates progressively higher percentage loss rates the longer a customer's loan is overdue. Loss rates reflect the discounted expected future cash flows for a portfolio.

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 regulations – management considers the more recent trends in the portfolio risk factors which may not be adequately reflected in its statistical models and, subject to guidance from Group Finance and Group Credit Risk, adjusts impairment allowances accordingly.

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

Collectively assessed allowances are generally calculated monthly and charges for new allowances, or reversals of existing allowances, are determined for each separately identified portfolio.

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.

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 as part of an orderly realisation are recorded as assets held for sale and reported in 'Other assets'. The asset acquired is recorded at the lower of its fair value (less costs to sell) and the carrying amount of the loan (net of impairment allowance) at the date of exchange. No depreciation is charged in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the income statement in 'Other operating income'. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write down, is also recognised in 'Other operating income', together with any realised gains or losses on disposal.

Loan write-offs

Loans, and the related impairment allowances, are normally written off, either partially or in full, in the case of that portion of the loan amount not covered by the value of security, when there is no realistic prospect of further recovery; and in the case of secured balances, after proceeds from the realisation of security have been received. Unsecured consumer facilities are normally written off between 150 and 210 days overdue.

Instances of write-off periods exceeding 360 days overdue are few, but can arise where certain consumer finance accounts are deemed collectible beyond this point or where, in a few countries, regulation or legislation constrain earlier write-off.

In the event of bankruptcy or analogous proceedings, write-off can occur earlier.

Notes on the Financial Statements (continued)

Impaired loans

Individually impaired loans by industry sector and by geographical region

The group

	Year to 31 December 2007				
	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	**253**	**282**	**–**	**535**	**24**
Commercial and corporate	**951**	**786**	**–**	**1,737**	**76**
Total impaired loans and advances to customers	**1,204**	**1,068**	**–**	**2,272**	**100**

	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

The bank

	Year to 31 December 2007				
	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	**236**	**–**	**–**	**236**	**20**
Commercial and corporate	**923**	**30**	**–**	**953**	**80**
Total impaired loans and advances to customers	**1,159**	**30**	**–**	**1,189**	**100**

	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

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 2007		
	Individually assessed £m	**Collectively assessed £m**	**Total £m**
At 1 January	**882**	**884**	**1,766**
Amounts written off	**(185)**	**(1,112)**	**(1,297)**
Release of allowances no longer required	**(194)**	**(113)**	**(307)**
Charge to income statement	**390**	**1,228**	**1,618**
Transfers	**–**	**–**	**–**
Exchange and other movements	**30**	**(14)**	**16**
At 31 December	**923**	**873**	**1,796**

	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)
Release of allowances no longer required	(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

The bank

	Year ended 31 December 2007		
	Individually assessed £m	**Collectively assessed £m**	**Total £m**
At 1 January	**334**	**572**	**906**
Amounts written off	**(96)**	**(1,018)**	**(1,114)**
Release of allowances no longer required	**(78)**	**(46)**	**(124)**
Charge to income statement	**211**	**1,004**	**1,215**
Transfers	**–**	**–**	**–**
Exchange and other movements	**(12)**	**(34)**	**(46)**
At 31 December	**359**	**478**	**837**

	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)
Release of allowances no longer required	(100)	(47)	(147)
Charge to income statement	208	943	1,151
Exchange and other movements	(13)	(3)	(16)
At 31 December	334	572	906

Notes on the Financial Statements (continued)

Impairment allowances against loans and advances to customers

The group

	2007 %	2006 %
Total impairment allowances to gross lending[1]		
Individually assessed impairment allowances	**0.43**	0.45
Collectively assessed impairment allowances	**0.41**	0.45
Total	**0.84**	0.90

The bank

	2007 %	2006 %
Total impairment allowances to gross lending[1]		
Individually assessed impairment allowances	**0.24**	0.23
Collectively assessed impairment allowances	**0.32**	0.40
Total	**0.56**	0.63

1 *Net of reverse repo transactions and settlement accounts.*

Net impairment charge to income statement by geographical region

The group

	Year ended 31 December 2007			
	United Kingdom £m	Continental Europe £m	Rest of the world £m	Total £m
Individually assessed impairment allowances				
New allowances	**233**	**157**	**–**	**390**
Release of allowances no longer required	**(82)**	**(112)**	**–**	**(194)**
Recoveries of amounts previously written off	**(17)**	**(4)**	**–**	**(21)**
	134	**41**	**–**	**175**
Collectively assessed impairment allowances				
New allowances	**1,116**	**112**	**–**	**1,228**
Release of allowances no longer required	**(47)**	**(66)**	**–**	**(113)**
Recoveries of amounts previously written off	**(250)**	**3**	**–**	**(247)**
	819	**49**	**–**	**868**
Total charge for impairment losses	**953**	**90**	**–**	**1,043**
Bank	**–**	**–**	**–**	**–**
Customer	**953**	**90**	**–**	**1,043**
Other credit risk provisions	**–**	**–**	**–**	**–**
Loan impairment charges and other credit risk provisions	**953**	**90**	**–**	**1,043**
Customer charge for impairment losses as a percentage of closing gross loans and advances	**0.59**	**0.14**	**–**	**0.45**
31 December 2007				
Balances outstanding				
Non-performing loans	**1,789**	**1,170**	**–**	**2,959**
Impairment allowances	**1,075**	**721**	**–**	**1,796**
Gross loans and advances	**192,489**	**90,804**	**6,954**	**290,247**
Total allowances cover as a percentage of non-performing loans and advances	**60.09**	**61.62**	**–**	**60.70**

	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)

The bank

	Year ended 31 December 2007			
	United Kingdom £m	Continental Europe £m	Rest of the world £m	Total £m
Individually assessed impairment allowances				
New allowances	210	1	–	211
Release of allowances no longer required	(78)	–	–	(78)
Recoveries of amounts previously written off	(22)	–	–	(22)
	110	1	–	111
Collectively assessed impairment allowances				
New allowances	1,001	3	–	1,004
Release of allowances no longer required	(46)	–	–	(46)
Recoveries of amounts previously written off	(244)	–	–	(244)
	711	3	–	714
Total charge for impairment losses	821	4	–	825
Bank	–	–	–	–
Customer	821	4	–	825
Other credit risk provisions	–		–	–
Loan impairment charges and other credit risk provisions	821	4	–	825
Customer charge for impairment losses as a percentage of closing gross loans and advances	0.56	0.07	–	0.54
31 December 2007				
Balances outstanding				
Non-performing loans	1,470	32	–	1,502
Impairment allowances	822	15	–	837
Gross loans and advances	177,067	5,898	549	183,514
Total allowances cover as a percentage of non-performing loans and advances	55.92	43.75	–	55.73

	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

Collateral and other credit enhancements obtained

During 2007, the group obtained assets by taking control of collateral accepted as security, or through other credit enhancements, as follows:

	Carrying value obtained in 2007		Carrying value obtained in 2006	
	The group £m	**The bank £m**	The group £m	The bank £m
Type of asset				
Residential property	**67**	**65**	20	19
Commercial and industrial property	**–**	**–**	1	–
Other assets	**–**	**–**	3	3
	67	**65**	24	22

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

	2007 £m	2006 £m
Loans and advances to customers	**813**	813
Loans and advances to banks	**–**	–
	813	813

The bank

	2007 £m	2006 £m
Loans and advances to customers	**642**	705
Loans and advances to banks	**–**	–
	642	705

Liquidity and funding management

Liquidity risk is the risk that the group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows. Funding risk (a form of liquidity risk) arises when the necessary liquidity to fund illiquid asset positions cannot be obtained at the expected terms and when required.

The objective of the group's liquidity and funding management is to ensure that all foreseeable funding commitments, including 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 enable the group to respond quickly and smoothly to unforeseen liquidity requirements.

The group requires its operating entities to maintain a strong liquidity position and to manage the liquidity profile of their assets, liabilities and commitments so that the cash flows are appropriately balanced and funding obligations can be met when due.

Policies and procedures

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 liquidity and funding management policy requires:

– projecting cash flows by major currency under various stress scenarios and considering the level of liquid assets necessary in relation thereto;

– monitoring balance sheet liquidity ratios against internal and regulatory requirements;

– maintaining a diverse range of funding sources with adequate back-up facilities;

– managing the concentration and profile of debt maturities;

– managing contingent liquidity commitment exposures within predetermined caps;

– maintaining debt financing plans;

– monitoring depositor concentration in order to avoid undue reliance on large individual depositors and ensure a satisfactory overall funding mix; and

– maintaining liquidity and funding contingency plans. These plans 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 maintaining 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 £597 billion at 31 December 2007, funding from customers amounted to £268 billion, of which £265 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 32.

Assets available to meet these liabilities, and to cover outstanding commitments to lend (£622 billion), included cash, central bank balances, items in the course of collection and treasury and other bills (£12 billion); loans to banks (£61 billion, including £55 billion repayable within one year); and loans to customers (£228 billion, including £119 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 £131 billion. Of these assets, some £102 billion of debt securities and treasury and other bills have been pledged to secure liabilities.

As mentioned above, the group emphasises the importance of current accounts and savings accounts as a source of funds to finance lending to customers and discourages a reliance on short-term professional funding. To achieve this goal, limits are placed on group banking entities which restrict their ability to grow loans to customers without corresponding growth in core current accounts and savings accounts. This measure is referred to as the "Advances to Deposits" ratio and compares loans and advances to customers as a percentage of core customer current and savings accounts together with certain other reliable sources of funding, including loans from banks, non-bank professional funding and securities issued, with a remaining term to maturity in excess of one year. Deposits from customers deemed to be "professional" are excluded. The definition of a professional customer takes account of the size of the customer's total deposit balances by applying a tiering classification. Generally, any customer with funds deposited in excess of £1 million is regarded as professional. Due to the distinction between core and professional depositors, the group's measure of Advances to Deposits will be more restrictive than that which could be inferred from the published financial statements.

Advances to Deposits ratios

	The group		The bank	
	2007	2006	**2007**	2006
	%	%	**%**	%
Year end	**89.2**	92.0	**97.5**	100.7
Maximum	**92.2**	102.8	**101.7**	104.3
Minimum	**86.0**	92.0	**92.6**	98.1
Average	**89.1**	98.4	**97.1**	102.0

Advances to Deposits ratio limits are set by the Risk Management Meeting.

The group would meet unexpected net cash outflows by selling securities and accessing additional funding sources such as interbank or asset-backed securities markets. In addition to the Advances to Deposits ratios outlined above, the group uses a range of other measures for managing liquidity risk. These measures include the ratio of net liquid assets to customer liabilities and projected cash flow scenario analysis.

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 group defines liquid assets for the purposes of the liquidity ratio as cash balances, short-term interbank deposits and highly-rated debt securities available for immediate sale and for which a deep and liquid market exists. As noted above, the definition of a professional customer takes account of the size of the customer's deposits.

Limits for the ratio of net liquid assets to customer liabilities are set for each bank operating entity.

The group uses a number of standard projected cash flow scenarios which are designed to model both group specific and market-wide liquidity crises. The scenarios vary the rate and timing of deposit withdrawals and drawdowns on committed lending facilities, and restrict access to interbank funding, term debt markets, and the ability to generate funds from asset portfolios. The scenarios are modelled by all group banking operations. The assumptions for each scenario are regularly reviewed for appropriateness. In addition to the group's standard projected cash flow scenarios, individual entities are required to design their own scenarios tailored to reflect specific local market conditions, products and funding bases.

Limits for cumulative net cash flows under stress scenarios are set for each banking entity.

Both ratio and cash flow limits reflect local market conditions, the diversity of funding sources available, and the concentration risk from large depositors. Compliance with entity level limits is monitored and reported regularly to the Risk Management Meeting and to local Asset and Liability Management Committees.

Ratio of net liquid assets to customer liabilities

	The group		The bank	
	2007	2006	**2007**	2006
	%	%	**%**	%
Year end	**14.3**	20.4	**12.1**	16.3
Maximum	**22.1**	21.8	**21.5**	19.1
Minimum	**14.3**	17.5	**12.1**	12.8
Average	**19.0**	19.3	**15.6**	15.1

Contingent liquidity risk

In the normal course of its business, the group provides committed facilities to customers; these facilities include committed back stop lines to conduit vehicles sponsored by the group. As noted above, the liquidity risk consequences of drawdowns on these committed loan facilities provided by group entities are reflected in projected cash flow scenario analyses where the level of drawdown is varied under different stress scenarios. The group also sets total notional limits by group entity for non-cancellable contingent funding commitments. The limits are set by the group's Risk Management Meeting after due consideration of the entity's ability to fund the commitments should the facilities be drawn in full. The limits are split according to the borrower, the liquidity of the underlying assets and the size of the committed line.

The group exposures under the contingent liquidity risk limit structures as at 31 December 2007 are set out in the following table:

	The group		The bank	
	2007	2006	**2007**	2006
	£bn	£bn	**£bn**	£bn
Conduits – client originated assets[1]				
Total lines	**4.5**	3.0	**3.2**	2.0
Largest individual lines	**0.8**	0.8	**0.5**	0.5
Assets managed by the group[2]	**12.9**	13.2	**12.9**	13.2
Single issuer liquidity facilities				
Five largest[3]	**5.0**	5.5	**2.3**	3.0
Largest market sector[4]	**5.8**	4.9	**4.2**	3.4

1 *These vehicles provide funding to group customers by issuing debt secured by a diversified pool of customer originated assets.*
2 *These vehicles issue debt secured by highly rated asset-backed securities which are managed by the group.*
3 *These figures represent the 5 largest committed liquidity facilities provided to customers other than those facilities to conduits.*
4 *These figures represent the total of all committed liquidity facilities provided to the largest market sector.*

The exposures in the above table are on a contractual basis. The group recognises that in times of market stress it may choose to provide non-contractual liquidity support to certain non-group sponsored vehicles or group promoted products. Such potential support would not be included in the group's liquidity risk measures until such time as the support becomes legally binding, and would only be provided after careful consideration of the potential funding requirement and the impact on the entity's overall levels of liquidity.

Such was the case in November 2007 when the group announced plans to restructure two Structured Investment Vehicles ("SIVs") sponsored by the group, Cullinan Finance Limited and Asscher Finance Limited. Further information on these SIVs is provided below.

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.

The group separates exposures to market risk into either trading or non-trading portfolios. Trading portfolios include those positions arising from market-making, proprietary position-taking and other marked-to-market positions so designated.

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

The management of market risk is principally undertaken in Global Markets using risk limits approved by the Risk Management Meeting. Limits are set for portfolios, products and risk types, with market liquidity being a principal factor in determining the level of limits set. Traded Credit and Risk, an independent unit within the Group Management Office, develops the Group's market risk management policies and measurement techniques. Each major operating entity has an independent market risk function which is responsible for measuring market risk exposures in accordance with the policies defined by Traded Credit and Market Risk, and monitoring these exposures against the prescribed limits on a daily basis.

Each operating entity is required to assess the market risks which arise on each product in its business and to transfer these risks to either its local Global Markets unit for management, or to separate books managed under the 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 manage such risks professionally.

The group uses a range of tools to monitor and limit market risk exposures. These tools include value at risk sensitivity analysis and stress testing. The following table provides an overview of the reporting of risks within this section:

	Portfolio	
	Trading	**Non-trading**
Risk Type		
Foreign Exchange	VAR	VAR
Interest Rate	VAR	VAR
Equity	VAR	Sensitivity
Credit Spread	VAR	VAR

Value at risk ('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.

The VAR models used by the group are predominantly based on historical simulation. The historical simulation models derive plausible future scenarios from historical market rate and price time series, taking account of inter-relationships between different markets and rates, for example between interest rates and foreign exchange rates. The models also incorporate the impact of option features in the underlying exposures.

The historical simulation models used by the group incorporate the following features:

- potential market movements are calculated with reference to data from the last two years;
- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
- VAR is calculated to a 99 per cent confidence level; and
- VAR is calculated for a 1-day holding period.

The group routinely validates the accuracy of its VAR models by backtesting the actual daily profit and loss results, adjusted to remove non-modelled items such as fees and commissions, against the corresponding VAR numbers. Statistically, the group would expect to see losses in excess of VAR only one per cent of the time over a one-year period. The actual number of excesses over this period can therefore be used to gauge how well the models are performing.

The VAR model was extended to cover Specific Interest Rate Risk ("credit VAR") from 1 December 2006. As a result, the average, minimum and maximum VAR figures disclosed for 2006 exclude Credit VAR in view of the short period in 2006 when this element of the VAR model was used by the group.

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

	£m
Total	
At 31 December 2007[1]	**32.0**
At 31 December 2006[2]	17.9

	Average £m	Minimum £m	Maximum £m
2007[2]	**20.7**	**14.3**	**34.8**
2006[3]	17.8	9.2	37.7

1 *Includes trading and non-trading credit VAR.*
2 *Excludes non- trading credit VAR.*
3 *Excludes trading and non- trading credit VAR.*

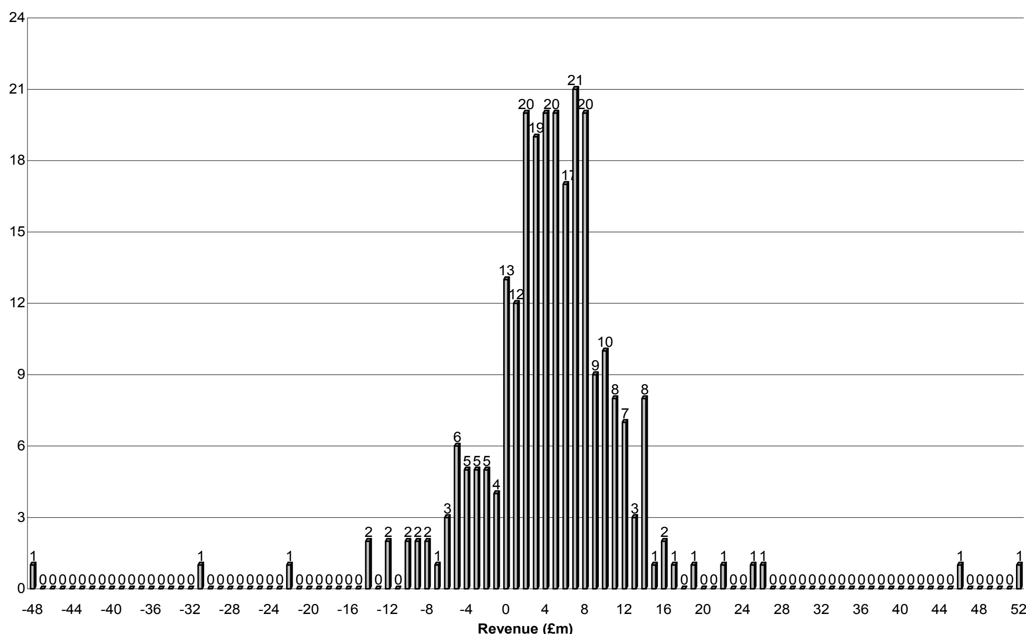
The major contributor to the trading and non-trading VAR for the group was Global Markets.

The histograms below illustrate the frequency of daily revenue arising from Global Markets' trading, balance sheet management and other trading activities. The average daily revenue earned therefrom in 2007 was £5 million, compared with £5.3 million in 2006. The standard deviation of these daily revenues was £8.4 million compared with £4.1 million for 2006. The standard deviation measures the variation of daily revenues about the mean value of those revenues.

An analysis of the frequency distribution of daily revenue shows that there were 42 days with negative revenue during 2007 compared with 16 days in 2006.

Daily distribution of Global Markets' trading, balance sheet management and other trading revenues in 2007

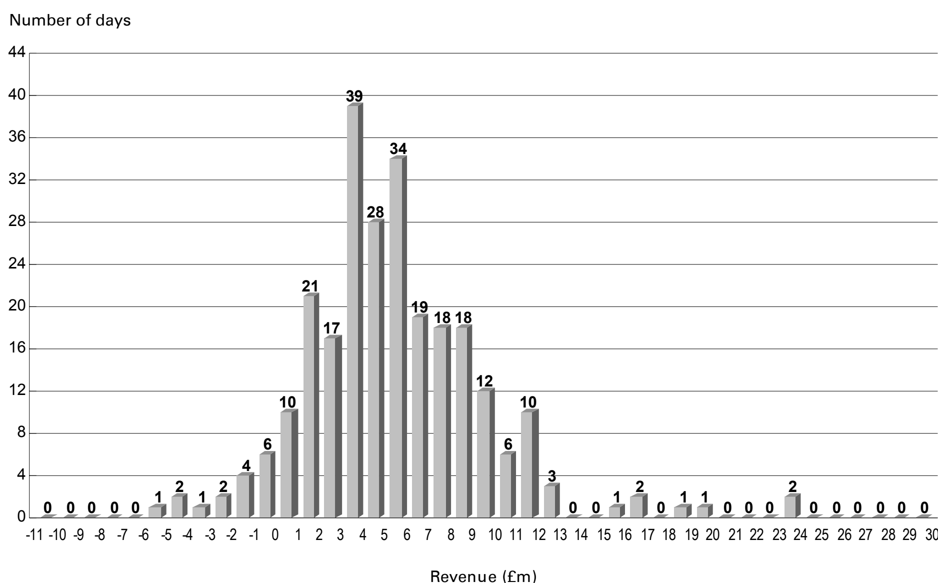
Number of days



The effect of any month end adjustments, not attributable to a specific daily market move, is spread evenly over the days in the month in question.

Notes on the Financial Statements (continued)

Daily distribution of Global Markets' trading, balance sheet management and other trading revenues in 2006



The effect of any month end adjustments, not attributable to a specific daily market move, is spread evenly over the days in the month in question.

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.

Responsibility for determining accounting policies and procedures governing valuation and validation ultimately rests with independent finance functions which report functionally to the Group Finance Director. All significant valuation policies, and any changes thereto, must be approved by senior HSBC 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 comply with all relevant accounting standards.

Trading portfolios

The group's control of market risk is based on a policy of restricting individual operations to trading within a list of permissible instruments authorised for each site by Traded Credit and Market Risk, of enforcing rigorous new product and approval procedures, and of restricting trade in the more complex derivative products only to offices with appropriate levels of product expertise and robust control systems.

In addition, at both portfolio and position levels, market risk in trading portfolios is monitored and controlled using a complementary set of techniques. These include VAR and, for interest rate risk, present value of a basis point movement in interest rates, together with stress and sensitivity testing and concentration limits. These techniques quantify the impact on capital of defined market movements.

Market making and proprietary position taking is undertaken within Global Markets. The VAR for such trading activity at 31 December 2007 was £24.4 million (2006: £14 million). This is analysed below by risk type:

Total trading VAR by risk type

	Foreign exchange £m	Interest rate trading £m	Equity £m	Credit[1] £m	Total £m
At 31 December 2007	**4.6**	**18.7**	**8.2**	**14.4**	**24.4**
At 31 December 2006	2.7	10.3	3.2	5.6	14.0
Average					
2007	**4.9**	**12.5**	**5.0**	**7.3**	**16.5**
2006	3.1	9.6	2.9	–	10.2
Minimum					
2007	**1.9**	**7.6**	**2.9**	**3.1**	**11.3**
2006	1.5	5.3	1.3	–	6.5
Maximum					
2007	**12.2**	**19.6**	**8.9**	**17.5**	**26.6**
2006	6.3	16.4	4.3	–	15.8

1 *The credit VAR model has been in use by the group since 1 December 2006 and hence is excluded from the average, minimum and maximum VAR figures disclosed for 2006. VAR figures for 2007 include trading credit VAR.*

Non-trading portfolios

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. The prospective change in future net interest income from non-trading portfolios will be reflected in the current realisable value of these positions should they be sold or closed prior to maturity. In order to manage this risk optimally, market risk in non-trading portfolios is transferred to Global Markets or to separate books managed under the 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 alternative investment products and the precise prepayment speeds 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 VAR for these portfolios is included within the group VAR.

Fixed-rate securities

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 £15.6 million at 31 December 2007 (2006: £8.5 million); whilst the average, minimum and maximum during the year was £10.3 million, £6.7 million and £18.1 million respectively (2006: £8.4 million, £7.6 million and £10.3 million).

Equity securities held as available-for-sale

Market risk arises on equity securities held as available-for-sale. The fair value of these securities at 31 December 2007 was £2,691 million (2006: £1,605 million) and included private equity holdings of £1,170 million (2006: £254

million). Investments in private equity are primarily made through managed funds. Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio as a whole. Regular reviews are performed to substantiate the valuation of the investments within the portfolio, and Finance is responsible for reviewing the carrying value of the investments. Money market funds represented £923 million (2006: £648 million) and typically related to funds held for short-term cash management. Investments held to facilitate ongoing business, such as holdings in government sponsored enterprises and local stock exchanges, represented £194 million (2006: £247 million). The fair value of the constituents of equity securities held as available-for-sale can fluctuate considerably. A 10 per cent reduction in the value of the available-for-sale equities at 31 December 2007 would have reduced equity by £269 million (2006: £161 million).

Defined benefit pension scheme

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 derives principally from the pension schemes holding equities against their future pension obligations. The risk is that market movements in equity prices could result in assets that 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 £12 billion at 31 December 2007 compared with £13 billion at 31December 2006. Assets of the defined benefit schemes at 31 December 2007 comprised: equity investments 21 per cent (25 per cent at 31 December 2006); debt securities 66 per cent (59 per cent at 31 December 2006) and other (including property) 13 per cent (16 per cent at 31 December 2006).

Sensitivity of net interest income

A principal part of the group's management of market risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). The group aims, through its management of market risk in non-trading portfolios, to mitigate the impact of prospective interest rate movements which could reduce future net interest income, while balancing the cost of hedging such activities on the current revenue stream.

For simulation modelling, businesses use a combination of scenarios relevant to local businesses and local markets and standard scenarios which are required throughout the group. The standard scenarios are consolidated to illustrate the combined proforma effect on the group's consolidated portfolio valuations and net interest income.

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.

Exchange differences 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.

In the second half of 2007, credit risk concerns emanating from the US sub-prime mortgage market led to a deterioration in the fair value of assets supported by sub-prime mortgages. However, there was a consequential impact beyond sub-prime related assets and, to a lesser degree, fair value deterioration occurred in US mortgage-related financial instruments generally, with financial instruments issued by non-US government-sponsored enterprises more significantly affected than sponsored financial instruments.

The following table shows the group's market risk exposure to US mortgage-backed securities ('MBSs'). MBSs include those represented by collateralised debt obligations.

	Principal[1] £m	Carrying amount £m	Unrealised gains and losses[2] £m	Realised gains and losses[2] £m	Impairment losses incurred[3] £m	Fair value movements recognised[4] £m
Year ended 31 December 2007						
US sub-prime mortgage-related assets[5]						
MBSs and MBS CDOs[6]	2,285	2,116	(75)	(1)	–	(92)
– high grade (AAA or AA rated)	2,240	2,082	(63)	–	–	(92)
– rated A to C	32	23	(8)	–	–	–
– not rated	13	11	(4)	–	–	–
Total	2,285	2,116	(75)	(1)	–	(92)
Other US mortgage-related assets						
MBSs and MBS CDOs[6]	10,965	10,369	(81)	23	–	(514)
– high grade (AAA or AA rated)	10,917	10,338	(63)	–	–	(514)
– rated A to C	48	31	(18)	–	–	–
– not rated	–	–	–	–	–	–
Total	10,965	10,369	(81)	23	–	(514)
Total US mortgage-related assets	13,250	12,485	(156)	22	–-	(606)
Year ended 31 December 2006						
US sub-prime mortgage-related assets						
MBSs and MBS CDOs[6]	1,171	1,173	–	–	–	1
– high grade (AAA or AA rated)	1,101	1,103	–	–	–	1
– rated A to C	50	50	–	–	–	-
– not rated	20	20	–	–	–	-
Total	1,171	1,173	–	–	–	1
Other US mortgage-related assets						
MBSs and MBS CDOs[6]	4,096	4,101	–	1	–	(5)
– high grade (AAA or AA rated)	4,034	4,039	–	–	–	(5)
– rated A to C	60	60	–	–	–	–
– not rated	2	2	–	–	–	–
Total	4,096	4,101	–	1	–	(5)
Total US mortgage-related assets	5,267	5,274	–	1	–	(4)

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

In addition to the exposure detailed above, HSBC also holds long positions in MBSs with a carrying value of £336 million (2006: £32 million) and MBS CDOs with a carrying value of £19 million (2006: £126 million) where the exposure has been matched by specific credit derivatives with monolines and other financial institutions.

Insurance risk

Insurance risk is risk other than financial risk, transferred from the holder of a contract to the issuer. Within its service proposition, the group offers its personal customers a wide range of insurance products, many of which complement other bank products. The group's business focus is on life insurance and, accordingly, 86 per cent of the total insurance manufacturing liabilities relate to life insurance contracts. The nature of the contracts influences insurance liabilities. Non-life insurance liabilities are predominantly set based on claims notified to the insurer, claims incurred but not reported and typically reflect the one year period of cover. For life contracts, a liability is established at the inception of the contract to reflect the expected claims over the life of the contract, which can span several years.

The group's insurance businesses are exposed to a range of financial risks, including market risk, credit risk and liquidity risk. The nature and management of these risks is described below. The principal insurance risk faced by the group is that the cost of claims combined with acquisition and administration costs may exceed the aggregate amount of premiums received and investment income. Underwriting subsidiaries are exposed to financial risk, for example, when the proceeds from financial assets are not sufficient to fund the obligations arising from non-linked insurance and investment contracts.

Life insurance business

Life insurance contracts include term assurance and critical illness cover, income and payment protection, annuities, investment bonds, pensions and participating business such as endowments. The key contracts manufactured by the group are described below. For life insurance business, the insurance risk varies considerably depending on the type of business. The principal risks are in relation to mortality, morbidity, lapse and surrender, investment return 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. 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, 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 sustainability of the bonus rates.

Credit life insurance business is written in relation to banking and financial products and provides protection in the event of death or unemployment. 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 on inception. The principal risks in respect of annuity business relate to mortality and a market risk in relation to the need to match investments against the anticipated cash flow profile of the policies. These risks are substantially reinsured out of the group.

The major components of the 'Term assurance and other long-term contracts' category are term assurance income bonds, income protection and critical illness policies written in the UK. The principal risks are in respect of mortality and morbidity, and are managed through a combination of underwriting practices, premium adjustment in light of changes in experience and reinsurance.

Linked life insurance business pays benefits to the policyholder which is typically determined by reference to the value of the investments supporting the policy. For linked insurance business, market risk is generally borne by policyholders. The principal risk retained by the group relate to expenses incurred in managing these products, although mortality, disability and morbidity risks are also associated with these products and are managed through the application of the techniques set out above for non-linked lines of business.

Non-life insurance business

Non-life insurance contracts include motor, fire and other property damage. 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 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 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.

Insurance risk

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.

A key feature of insurance business and life insurance in particular, is the importance of managing the assets, liabilities and risks in a co-ordinated 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. 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.

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. Use is also made of risk management committees in order to monitor 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.

The following tables provide an analysis of the insurance risk exposures by type of business. They 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 contract. 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 premiums as representing the best available measure of risk exposure.

Notes on the Financial Statements (continued)

Analysis of life insurance risk – policyholder liabilities before reinsurance

	2007 £m	2006 £m
Life (non-linked)		
Insurance contracts with DPF[1]	**469**	100
Credit life	**117**	25
Annuities	**205**	138
Term assurance and other long-term contracts	**337**	573
Total life (non-linked)	**1,128**	836
Life (linked)	**858**	647
Life insurance policyholder liabilities	**1,986**	1,483

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.*

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

	2007 £m	2006 £m
Fire and other damage	**64**	28
Credit (non-life)	**18**	34
Accident and health	**11**	–
Motor	**183**	–
Other (non-life)	**23**	5
Total net written insurance premiums	**299**	67

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

Financial risks

The group's insurance businesses are exposed to a range of financial risks, including market risk, credit risk and liquidity risk. The nature and management of these risks is described below.

The following table analyses the assets held in the group's insurance underwriting subsidiaries at 31 December 2007 by type of liability, and provides a view of the exposure to financial risk:

Financial assets held by insurance manufacturing operations

	At 31 December 2007				
	Life linked contracts £m	Life non-linked contracts £m	Non-life insurance £m	Other assets £m	Total £m
Financial assets designated at fair value					
Treasury bills	**25**	–	–	–	**25**
Debt securities	**2,873**	**502**	–	**943**	**4,318**
Equity securities	**3,482**	**3,211**	–	**340**	**7,033**
	6,380	**3,713**	–	**1,283**	**11,376**
Available-for-sale:					
Treasury bills	–	–	**57**	**59**	**116**
Other eligible bills	–	–	**88**	**86**	**174**
Debt securities	–	**6,133**	**152**	**145**	**6,430**
Equity securities	–	–	**7**	–	**7**
	–	**6,133**	**304**	**290**	**6,727**
Derivatives	**150**	**39**	–	**15**	**204**
Other financial assets	**439**	**298**	**375**	**350**	**1,462**
	6,969	**10,183**	**679**	**1,938**	**19,769**

	At 31 December 2006				
	Life linked Contracts £m	Life non-linked contracts £m	Non-life insurance £m	Other assets £m	Total £m
Financial assets designated at fair value					
Treasury bills	28	–	–	–	28
Debt securities	1,593	359	–	358	2,310
Equity securities	3,429	27	–	18	3,474
	5,050	386	–	376	5,812
Available-for-sale:					
Other eligible bills	–	–	181	73	254
Debt securities	–	–	99	8	107
	–	–	280	81	361
Derivatives	367	–	–	–	367
Other financial assets	97	1	77	33	208
	5,514	387	357	490	6,748

In life linked insurance, premium income less charges levied is invested in unit-linked funds. The group manages the financial risk of this product by holding appropriate assets in segregated funds or portfolios to which the liabilities are linked. This substantially transfers the financial risk to the policyholder. The assets held to support life linked liabilities represented 35 per cent of the total financial assets of the group's insurance underwriting subsidiaries at the end of 2007 (2006: 82 per cent).

Market risk

Market risk can be further sub-categorised into interest rate risk and equity risk. Each of these categories is discussed further below.

Interest rate risk

The group's insurance underwriting subsidiaries are exposed to interest rate risk when there is a mismatch in terms of duration or yields between the assets and liabilities.

The group manages the interest rate risk arising from its insurance underwriting subsidiaries by establishing limits centrally. These govern the sensitivity of the net present values of expected cash flows from subsidiaries' assets and liabilities to a one basis point parallel upward shift in the discount curve used to calculate values. Adherence to these limits is monitored by local ALCOs. Interest rate risk is also assessed by measuring the impact of defined movements in interest yield curves on the profits after tax and net assets of the insurance underwriting subsidiaries. An immediate and permanent movement in interest yield curves as at 31 December 2007 in all territories in which the group's insurance subsidiaries operate would have the following impact on the profit for the year and net assets at that date:

	2007		2006	
	Impact on profit for the year £m	**Impact on net assets £m**	Impact on profit for the year £m	Impact on net assets £m
+ 100 basis points shift in yield curves	**(2)**	**(14)**	(27)	(31)
– 100 basis points shift in yield curves	**4**	**17**	32	37

The interest rate sensitivities set out above are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. The sensitivities do not incorporate actions that could be taken by management to mitigate the effect of the interest rate movements, nor do they take account of any resultant changes in policyholder behaviour.

Equity risk

Equity risk is the risk of changes in the fair value of an equity instrument. The group manages the equity risk arising from its holdings of equity securities centrally by setting limits on the maximum market value of equities that each insurance underwriting subsidiary may hold. Equity risk is also monitored by estimating the effect of predetermined

Notes on the Financial Statements (continued)

movements in equity prices on the profit and total net assets of the insurance underwriting subsidiaries. The following table illustrates the impact on the aggregated profit for the year and net assets of a reasonably possible 10 per cent variance in equity prices:

	2007		2006	
	Impact on profit for the year £m	**Impact on net assets £m**	Impact on profit for the year £m	Impact on net assets £m
10 per cent increase in equity prices	**8**	**8**	8	8
10 per cent decrease in equity prices	**(7)**	**(7)**	(4)	(4)

These equity sensitivities are illustrative only and employ simplified scenarios. It should be noted that the effects may not be linear and therefore the results cannot be extrapolated. They do not allow for the effect of management actions which may mitigate the equity price decline, nor for any resultant changes, such as in policyholder behaviour, that might accompany such a fall.

Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. In the context of the group's insurance underwriting business, the exposure to credit risk arises primarily from the invested assets held and the reinsurance contracts. The group's insurance underwriting subsidiaries are exposed to credit risk in respect of their investment portfolios and their reinsurance transactions.

The group's underwriting insurance subsidiaries are responsible for the quality and performance of the investment portfolios. Investment guidelines are set at group level. Local subsidiary ALCOs set investment parameters appropriate to the local environment within the framework of the group guidelines and review investment performance and compliance with the guidelines. The assessment of the creditworthiness of issuers and counterparties is based primarily upon internationally recognised credit ratings and other publicly available information. In addition, to reduce the impact of individual entity or industry sector failures, centrally determined issuer and industry sector concentration limits are complied with. Investment credit exposures are aggregated and reported to HSBC's Group Credit and Risk function.

The following table presents the analysis of treasury bills, other eligible bills and debt securities within the group's insurance business by rating agency designation based on Standard and Poor's ratings or equivalent

	Treasury bills £m	Other eligible bills £m	Debt securities £m	Total £m
At 31 December 2007				
Supporting liabilities under non-linked insurance contracts				
AAA	**57**	**33**	**3,943**	**4,033**
AA– to AA+	**–**	**56**	**2,105**	**2,161**
A– to A+	**–**	**–**	**1,152**	**1,152**
Lower than A–	**–**	**–**	**226**	**226**
Unrated	**–**	**–**	**122**	**122**
	57	**89**	**7,548**	**7,694**
Supporting shareholders' funds[1]				
AAA	**59**	**82**	**143**	**284**
AA– to AA+	**–**	**3**	**132**	**135**
A– to A+	**–**	**–**	**37**	**37**
Lower than A–	**–**	**–**	**1**	**1**
Unrated	**–**	**–**	**13**	**13**
	59	**85**	**326**	**470**
Total				
AAA	**116**	**115**	**4,086**	**4,317**
AA– to AA+	**–**	**59**	**2,237**	**2,296**
A– to A+	**–**	**–**	**1,189**	**1,189**
Lower than A–	**–**	**–**	**227**	**227**
Unrated	**–**	**–**	**135**	**135**
	116	**174**	**7,874**	**8,164**
Of which issued by:				
– corporates and other	**116**	**174**	**7,875**	**8,165**
	116	**174**	**7,875**	**8,165**
Of which classified as:				
– financial instruments designated at fair value	**–**	**–**	**1,444**	**1,444**
– available-for-sale securities	**116**	**174**	**6,431**	**6,721**
	116	**174**	**7,875**	**8,165**

Notes on the Financial Statements (continued)

	Treasury bills £m	Other eligible bills £m	Debt securities £m	Total £m
At 31 December 2006				
Supporting liabilities under non-linked insurance contracts				
AAA	–	74	278	352
AA– to AA+	–	107	41	148
A– to A+	–	–	136	136
Unrated	–	–	3	3
	–	181	458	639
Supporting shareholders' funds[1]				
AAA	–	69	206	275
AA– to AA+	–	4	109	113
A– to A+	–	–	47	47
Lower than A–	–	–	1	1
Unrated	–	–	2	2
	–	73	365	438
Total[2]				
AAA	–	143	483	626
AA– to AA+	–	111	150	261
A– to A+	–	–	185	185
Lower than A–	–	–	1	1
Unrated	–	–	5	5
	–	254	824	1,078
Of which issued by:				
– corporates and other	–	254	824	1,078
	–	254	824	1,078
Of which classified as:				
– financial instruments designated at fair value	–	–	717	717
– available-for-sale securities	–	254	107	361
	–	254	824	1,078

1 Shareholders' funds comprise solvency and unencumbered assets.
2 Excludes treasury bills, other eligible bills and debt securities held by insurance manufacturing associate, HSBC Assurances.

Credit risk also arises when part of the insurance risk incurred by the group is assumed by reinsurers. The credit risk exposure for reinsurers is monitored centrally. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries, analysed by Standard and Poor's reinsurance credit rating data or their equivalent, was as follows:

	Reinsurers' share of liabilities under insurance contracts			
	Linked insurance contracts £m	**Non-linked insurance contracts £m**	**Total £m**	**Reinsurance debtors £m**
At 31 December 2007				
AAA	**3**	**9**	**12**	**–**
AA– to AA+	**14**	**105**	**119**	**7**
A– to A+	**–**	**284**	**284**	**2**
Lower than A–	**11**	**3**	**14**	**–**
Unrated	**–**	**97**	**97**	**–**
Total[1]	**28**	**498**	**526**	**9**
At 31 December 2006				
AAA	5	31	36	–
AA– to AA+	17	328	345	14
A– to A+	–	181	181	1
Lower than A–	8	10	18	–
Unrated	–	54	54	–
Total[2]	30	604	634	15

Liquidity risk

It is an inherent characteristic of almost all insurance contracts that there is uncertainty over the amount and the timing of settlement of claims liabilities that may arise, and this leads to liquidity risk. As part of the management of this exposure, estimates are prepared for most lines of insurance business of cash flows expected to arise from insurance funds at the balance sheet date. The estimates always include future renewal premiums and new business cash flows.

There is a greater spread of anticipated duration for the life business where, in a large proportion of cases, the liquidity risk is borne in conjunction with policyholders (wholly in the case of unit-linked business). To ensure adequate cash resources are available to meet short-term requirements that can arise as a consequence of large claims events, the insurance operations have an objective to manage liquidity on a prudent basis. The following table shows the expected maturity of insurance contract liabilities at 31 December 2007:

Expected maturity of insurance contract liabilities

	Expected cash flows (undiscounted)				
	Within 1 year £m	1-5 years £m	5-15 years £m	Over 15 years £m	Total £m
At 31 December 2007					
Non-life insurance	**402**	**381**	**36**	**-**	**819**
Life insurance (non-linked)	**329**	**294**	**424**	**217**	**1,264**
Life insurance (linked)	**75**	**301**	**411**	**191**	**978**
	806	**976**	**871**	**408**	**3,061**
At 31 December 2006					
Non-life insurance	360	362	14	-	736
Life insurance (non-linked)	38	69	153	928	1,188
Life insurance (linked)	75	257	281	36	649
	473	688	448	964	2,573

Remaining contractual maturity of investment contract liabilities

	Liabilities under investment contracts by insurance underwriting subsidiaries			
	Linked investment contracts £m	Non-linked investment contracts £m	Investment contracts with DPF £m	Total £m
At 31 December 2007				
Remaining contractual maturity:				
– due within 1 year	**137**	**-**	**-**	**137**
– due between 1 and 5 years	**615**	**-**	**-**	**615**
– due between 5 and 10 years	**475**	**-**	**-**	**475**
– due after 10 years	**1,679**	**-**	**-**	**1,679**
– undated	**2,899**	**36**	**9,447**	**12,382**
	5,805	**36**	**9,447**	**15,288**
At 31 December 2006				
Remaining contractual maturity:				
– due within 1 year	124	-	-	124
– due between 1 and 5 years	628	-	-	628
– due between 5 and 10 years	425	-	-	425
– due after 10 years	1,644	-	-	1,644
– undated	1,733	-	-	1,733
	4,554	-	-	4,554

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

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 value of the PVIF asset at 31 December 2007 was £444m (2006: £407m). The present value of the shareholders' interest in the profits expected to emerge from the book of in-force policies at 31 December 2007 can be stress tested to assess the ability of the book of life business to withstand adverse developments.

Notes on the Financial Statements (continued)

The following table shows the effect on the PVIF as at 31 December 2007 of reasonably possible changes in the main economic and business assumptions within the group's principal insurance underwriting subsidiary:

	2007	2006
	£m	£m
+ 100 basis points shift in risk-free rate	**9**	–
– 100 basis points shift in risk-free rate	**(20)**	–
+ 100 basis points shift in risk discount rate	**(21)**	(14)
– 100 basis points shift in risk discount rate	**23**	14
+ 100 basis points shift in expenses inflation	**6**	(3)
– 100 basis points shift in expenses inflation	**(5)**	3
+ 100 basis points shift in lapse rate	**(6)**	(3)
– 100 basis points shift in lapse rate	**6**	3

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.

The sensitivity of profit for the year and net assets to reasonably possible changes in conditions at 31 December 2007 across all insurance underwriting subsidiaries is as follows:

	Impact on:		Impact on:	
	Profit after tax for 2007	**Net assets at 31 December 2007**	Profit after tax for 2006	Net assets at 31 December 2006
	£m	**£m**	£m	£m
20 per cent increase in claims costs	**(32)**	**(32)**	(1)	(1)
20 per cent decrease in claims costs	**32**	**32**	1	1
10 per cent increase in mortality and/or morbidity rates	**6**	**6**	8	8
10 per cent decrease in mortality and/or morbidity rates	**(9)**	**(9)**	–	–
50 per cent increase in lapse rates	**(28)**	**(28)**	(24)	(24)
50 per cent decrease in lapse rates	**45**	**45**	35	35
10 per cent increase in expense rates	**(5)**	**(5)**	(5)	(5)
10 per cent decrease in expense rates	**5**	**5**	5	5

Special purpose entities (including on and off-balance sheet arrangements)

The group enters into certain transactions with customers in the ordinary course of business which involve the establishment of special purpose entities ('SPEs') some of which have been included in the group's consolidated balance sheet.

Where transactions involve the use of SPEs these are authorised centrally upon establishment to ensure appropriate purpose and governance. The activities of SPEs administered by the group are closely monitored by senior management. The use of SPEs is not a significant part of the group's activities and the group is not reliant on the use of SPEs for any material part of its business operations or profitability. The group's involvements with SPE transactions are described below.

Vehicles sponsored by the group

The group sponsors the formation of entities to accomplish certain narrow and well-defined objectives, such as securitisations of financial assets or to effect a lease. The group consolidates these SPEs when the substance of the relationship indicates that the group controls the SPE. In assessing control, all relevant factors need to be considered. Such factors may have qualitative and quantitative aspects, for example:

Qualitative factors - in substance:

- the activities of the SPE are being conducted on behalf of the group according to the group's specific business needs so that it obtains benefit from the SPE's operation. This might be evidenced, for example, by the group providing a significant level of support to the SPE; and
- the group has the decision-making powers to obtain the majority of the benefits of the activities of the SPE.

Quantitative factors – hereinafter referred to as 'the majority of risks and rewards of ownership'. In substance:

- the group has rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incidental to the activities of the SPE; and
- 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.

In a number of cases, these SPEs are accounted for off-balance sheet under IFRSs where the group does not have the majority of the risks and rewards of ownership of the SPE. However in certain circumstances, after careful consideration of the facts, the group consolidates an SPE where, although it does not obtain the majority of risks and rewards of ownership, the qualitative features of the group's involvement indicates that, in substance, the activities of the SPE are being conducted on behalf of the group.

The group re-assesses the required consolidation accounting tests whenever there is a change in the substance of a relationship between the group and an SPE for example, when there is a change in the group's involvement or there is a change in the governing rules, contractual arrangements or capital structure of the SPE. The most significant categories of SPE are discussed in more detail below.

Structured Investment Vehicles ('SIVs')

SIVs are SPEs which are established to invest in diversified portfolios of interest-earning assets, generally comprising asset-backed securities and other securities issued by financial institutions or corporates. SIVs are typically funded through the issue of commercial paper ('CP'), medium term notes or other senior debt (collectively referred to as 'senior debt'), repo financing and subordinated income or mezzanine notes (commonly referred to as 'capital notes'). The sponsor of the SIV often provides limited liquidity support to the senior debt investors through committed liquidity facilities which are designed to accommodate temporary market disruption in the CP and medium-term notes issuance markets.

SIVs are structured to provide investors with the opportunity to invest in a range of assets depending on their risk preference. Senior debt issued by SIVs is generally highly rated and the SIVs are managed within strict operating criteria. SIV liquidity is primarily managed by rolling over debt at maturity or, if that is not possible, the sale of assets to provide protection to senior note holders. SIVs are typically subject to market value and net asset value triggers which underpin the external credit ratings of the senior debt. The liquidity risk in SIVs is managed by controlling the maximum cumulative cash outflow in defined time periods.

The group established two SIVs, Cullinan Finance Limited ('Cullinan') and Asscher Finance Limited ('Asscher') in August 2005 and May 2007 respectively, which were successful in obtaining funding from investors, who subscribed for senior debt and capital notes. The SIVs were not consolidated on inception because the group did not have the majority of risks and rewards of ownership and it was not anticipated that the group would provide significant funding to the SIVs. The group is the fund manager for both SIVs and it was committed only to providing limited support through contractually committed liquidity lines on normal commercial terms.

The maximum size of each SIV during 2007, as measured by the fair value of the SIV's total assets, together with the maximum exposure the group had under its committed liquidity facilities, was as follows:

	Maximum size of SIV £bn	bank committed liquidity facility £bn
Cullinan	**21.0**	**0.25**
Asscher	**4.3**	**0.12**
	25.3	**0.37**

From mid-August 2007, normal funding in the wholesale markets became severely disrupted, principally as a result of valuation concerns over securities linked to US sub-prime mortgage loans, resulting in funding difficulties for many SPEs including SIVs. At the outset, bank-sponsored SIVs were less affected and, initially, Cullinan and Asscher continued to fund themselves in the CP market.

By the end of the third quarter of 2007, it became clear that the disruption in the supply of CP funding for the SIV market was not a temporary situation and, as a consequence the group provided £8.3 billion of funding to Cullinan

and Asscher in the form of repos, CP purchases and the acquisition of £2.0 billion of assets at fair value from Cullinan.

During the same period, the market value of certain assets held by Cullinan and Asscher fell because the market liquidity position had weakened and credit spreads had widened.

From October 2007, all the capital note holders of Cullinan were given the option to switch their capital note holdings for a share of the assets of the SIV. As part of this offer, HSBC switched its entire holding in Cullinan capital notes for Cullinan assets. The par value and market value of the assets purchased amounted to £353 million and £341 million respectively. The consideration paid comprised capital notes with an aggregate par value of £25 million (fair value £12 million) and cash of £328 million. In addition, in January 2008, HSBC purchased Cullinan capital notes from existing holders with a par value of £85 million (fair value £19 million), and then exchanged such Cullinan capital notes, together with cash of £1,147 million, for Cullinan assets with a par value of £1,233 million and a market value of £1,167 million.

In November 2007, the group announced its intention to make proposals to the investors of Cullinan and Asscher under which an option would be made available for investors to invest in new SPEs to be established with term funding and liquidity provided by the group.

Based on a careful evaluation of all the facts and circumstances, the group concluded that this announcement had substantively changed the relationship the group had with these SIVs. Accordingly, the group consolidated Cullinan and Asscher from the end of November 2007.

After the announcement in November 2007, two new SPEs, an asset-backed commercial paper ('ABCP') conduit and a term funding vehicle, were established in respect of Cullinan. Each SPE has been set up so that its continuing operation is not as sensitive as Cullinan to market value fluctuations in its underlying assets. These SPEs will be funded either by CP backed by a liquidity facility provided by the bank, or by term funding provided by the group. This reorganisation addresses the two main challenges for the SIV sector which could force asset sales: the inability to fund in the CP markets, and the sensitivity of the continuing operation of SIVs to changes in the market value of the underlying assets.

The new SPEs have agreed to purchase Cullinan's assets, over a time period that is anticipated to coincide with the maturity of Cullinan's senior debt. The purchase price was based on the fair value of Cullinan's assets as at 21 January 2008.

In January 2008, investors in the capital notes issued by Cullinan were given the option to exchange their existing capital notes for the capital notes in the new SPEs.

All the capital note holders of Cullinan elected to exchange their notes for capital notes in the new SPEs. The holders of such capital notes will bear the risk of any losses arising in the new SPEs up to the notional principal value of their holding in the capital notes.

The holders of the capital notes in Asscher continue to bear the risk of any first losses in the assets held by the SIV. It is proposed to reorganise Asscher following the completion of the Cullinan exchange.

The effect of consolidating Cullinan and Asscher on the group's balance sheet was to include £20.6 billion of assets and liabilities at the end of November 2007. This included capital notes of £18 million and CP of £2.3 billion and repos of £4.2 billion previously recognised on the group's balance sheet.

An analysis of the assets held by Cullinan and Asscher is set out below.

Cullinan – Ratings by class of asset

	2007	2006
	£m	£m
S&P Ratings		
AAA	**11,057**	11,753
AA	**1,451**	1,149
A	**1,536**	1,807
BBB	**85**	44
Total investments	**14,129**	14,753
Cash and cash equivalents	**2,479**	777
Total assets	**16,608**	15,530

Cullinan – Composition of asset portfolio

	2007	2006
	£m	£m
Asset class		
Structured finance		
Residential mortgage backed securities	**4,962**	6,058
Commercial mortgage backed securities	**1,866**	1,972
Collateralised debt obligations	**1,894**	1,569
Student loans	**1,109**	1,180
Home equity lines of credit	**640**	1,040
Motor vehicle loans	**157**	186
Credit loans	**27**	93
Other ABS	**2,238**	388
Total structured finance assets	**12,893**	12,486
Finance		
Commercial bank debt	**3,124**	2,593
Investment bank debt	**344**	280
Finance company debt	**247**	171
Total financial assets	**3,715**	3,044
	16,608	15,530

These assets included £991million (2006: £1,372 million) of exposure to US sub-prime mortgages.

Cullinan – Total assets by balance sheet classification

	2007
	£m
Derivative assets	**95**
Loans and advances to banks	**1,212**
Financial investments	**15,197**
Other assets	**104**
	16,608

Cullinan – Weighted-average maturity of assets

	Financial investments	**Cash and cash equivalents**
	£m	**£m**
2007		
0-6 months	**590**	**2,478**
6-12 months	**801**	–
Greater than 12 months	**12,739**	–
	14,130	**2,478**
2006		
0-6 months	48	777
6-12 months	449	–
Greater than 12 months	14,256	–
	14,753	777

The weighted average life of the portfolio at 31 December 2007 was 4 years (2006: 3.63 years).

Notes on the Financial Statements (continued)

Cullinan – Funding structure

	2007	
	Total	Provided by the group
2007	**£m**	**£m**
Capital notes	**478**	–
Commercial paper and medium term notes	**12,495**	**2,998**
Term repos executed	**3,541**	**3,627**
	16,514	**6,625**
2006		
Capital notes	946	–
Commercial paper and medium term notes	14,399	–
	15,345	–

The weighted average life of CP funding was 0.56 years (2006: 0.13 years) and the weighted average life of medium-term note funding was 1.13 years (2006: 0.64 years).

Asscher – Ratings analysis of assets

	2007 £m
S&P Ratings	
AAA	**3,059**
AA	**194**
A	**153**
Total investments	**3,406**
Cash and cash equivalents	**282**
Total assets	**3,688**

Asscher– Composition of asset portfolio

	2007 £m
Asset class	
Structured finance	
Residential mortgage backed securities	**1,492**
Commercial mortgage backed securities	**626**
Collateralised debt obligations	**544**
Student loans	**190**
Home equity lines of credit	**158**
Motor vehicle loans	**0**
Credit loans	**34**
Other ABS	**72**
Total structured finance assets	**3,116**
Finance	
Commercial bank debt	**483**
Inevstment bank debt	**58**
Finance company debt	**31**
Total financial assets	**572**
	3,688

These assets included £21 million of exposure to US sub-prime mortgages.

Asscher – Total assets by balance sheet classification

	2007 £m
Derivative assets	37
Loans and advances to banks	371
Financial investments	3,265
Other assets	15
	3,688

Asscher – Weighted-average maturity of assets

	Financial investments £m	Cash and cash equivalents £m
2007		
0-6 months	98	282
6-12 months	289	–
Greater than 12 months	3,019	–
	3,406	282

The weighted average life of the portfolio at 31 December 2007 was 3.7 years.

Asscher – Funding structure

	2007	
	Total £m	Provided by the bank £m
Mezzanine notes	155	10
Commercial paper and medium term notes	2,760	746
Term repos executed	799	570
	3,714	1,326

The weighted average life of CP funding liabilities was 0.44 years and weighted average life of medium-term note funding liabilities was 1.03 years.

Money market funds

The group has established and manages a number of money market funds which provide customers with tailored investment opportunities. These SPEs have narrow and well-defined objectives and typically the group does not have any holdings in the SPEs of sufficient size to represent the majority of the risks and rewards of ownership.

In aggregate, the group had established money market funds which had total assets of £21 billion at 31 December 2007 (2006: £17 billion).

Within the money market funds, there were three main categories:

- £5 billion (2006: £1 billion) in Constant Net Asset Value ('CNAV') funds, which invest in shorter-dated and highly-rated money market securities with the objective of providing investors with a highly liquid and secure investment;
- £4 billion (2006: £4 billion) in French domiciled *dynamique* ('dynamic') funds termed Enhanced Variable Net Asset Value ('Enhanced VNAV') funds, which invest in longer-dated money market securities to provide investors with a higher return than traditional money market funds; and
- £12 billion (2006: £12 billion) in various other money market funds, Variable Net Asset Value ('VNAV') funds domiciled in France, Germany and Turkey.

These money market funds invest in a diverse portfolio of highly-rated debt instruments, including limited holdings of instruments issued by SIVs. As at 31 December 2007, these funds' exposure to SIVs was £401 million (2006: £55 million).

Notes on the Financial Statements (continued)

CNAV Funds

CNAV funds price their assets on an amortised cost basis, subject to the amortised book value of the portfolio being within 50 basis points of its market value. This enables CNAV funds to create and liquidate shares in the fund at a constant price. If the amortised value of the portfolio were to vary by more than 50 basis points from its market value, the CNAV fund would be required to price its assets at market value, and consequently would no longer be able to create or liquidate shares at a constant price. This is popularly known as 'breaking the buck'. In the event that a CNAV fund breaks the buck, the group would be under no legal obligation to offer financial support.

The group's CNAV funds hold senior notes issued by a number of SIVs and, due to current market liquidity conditions and consequential actions of the rating agencies, the market value for this SIV paper has deteriorated. This has caused the CNAV funds to record unrealised losses on their SIV investments. While the majority of these SIVs are bank-sponsored, and are not judged to be impaired, there are holdings in three independent SIVs which have experienced greater difficulties; two of these, in which the group's CNAV funds have invested £20 million, were placed in enforcement in early 2008, the process by which the winding down of the independent SIVs and repaying secured creditors begins.

The deterioration in the market value of holdings of SIV paper raised the possibility that certain CNAV funds would be forced to realise liquid assets to meet potential redemptions. In order to address this potential impact, on 24 December 2007, HSBC provided a letter of limited indemnity, capped at £4 million, in relation to certain holdings of SIV assets of one of its CNAV funds with total assets under management ('AUM') at 31 December 2007 of £3 billion.

The group has continued to create and liquidate shares in all its CNAV funds at a constant price.

Enhanced VNAV funds

Enhanced VNAV funds price their assets on a fair value basis and consequently prices change from one day to the next. These funds pursue an 'enhanced' investment strategy, as part of which investors accept greater credit and duration risk in the expectation of higher returns.

Money market activities are highly developed in France due to the historical restriction on the payment of interest on current accounts, and the search for enhanced yields has resulted in sophisticated money market funds which are essentially used as an alternative to cash. However, since July 2007, French dynamic money market funds have experienced unprecedented redemption requests caused by the market's lack of confidence in funds containing exposure to primarily US sub-prime assets. In August 2007, a decision by two French institutions to suspend withdrawals from certain asset-backed securities funds caused a general acceleration of redemptions on dynamic money market funds.

In the third quarter of 2007, the group acquired underlying assets and shares in two of its dynamic money market funds of €1.2 billion (£880 million) and €590 million (£396 million) respectively to fund asset redemptions. No additional shares were acquired in the fourth quarter. The group's aggregate holding in these funds at 31 December 2007 was €896 million (£657 million). The total AUM of these two funds at 31 December 2007 was €2.1 billion (£1.5 billion). These funds were not consolidated by the group at 31 December 2007 because the acquisition of additional shares in these funds did not expose the group to the majority of risks and rewards of ownership. However, post year end one of the funds has been consolidated by the group as a result of continued redemptions by unit holders which caused the group's percentage holding in the funds to increase to a level where the group would be exposed to the majority of risks and rewards of ownership.

Total assets of the group's money market funds

	2007	2006
	£m	£m
Size of holding		
CNAV funds	**5,213**	955
Enhanced VNAV funds	**3,900**	3,717
VNAV funds	**11,627**	12,074
	20,740	16,746

The majority of the group's money market funds are off-balance sheet. The group's financial investments in these off balance sheet funds at 31 December 2007 amounted to £0.7 billion (2006: £83 million). These financial investments

have been recognised in the group's balance sheet at fair value. Total assets of the group's money market funds which are on balance sheet at 31 December 2007 amount to £2.5 billion (2006:£ 1.1 billion). These assets have been measured at fair value.

Non-money market investment funds

The group has also established a large number of non-money market funds to enable customers to invest in a range of assets, typically equities and debt securities. At the launch of a fund the group, as fund manager typically provides a limited amount of capital known as 'seed capital to enable the fund to start purchasing assets. These holdings are normally redeemed over time. The majority of these funds are off-balance sheet because, in view of the group's limited economic interest, the group does not have the majority of the risks and rewards of ownership.

Total assets of the group's non-money market funds

	2007 £m	2006 £m
Assets under management		
Specialist funds	**30,556**	31,144
Local Investment Management funds	**31,864**	28,299
Multi-manager	**2,167**	724
	64,587	60,167

Total assets of the group's non-money market funds, which are on-balance sheet

	2007 £m	2006 £m
Specialist funds	**71**	53
Local Investment Management funds	**19**	18
	90	71

All of the above on-balance sheet assets are classified as financial investments.

The group's holdings in non-money market funds, which are off-balance sheet

	2007 £m	2006 £m
Specialist funds	**30,485**	31,091
Local Investment Management funds	**31,845**	28,281
Multi-manager	**2,167**	724
	64,497	60,096

The group's financial investments in off-balance sheet money market funds at 31 December 2007 amounted to £263 million (2006; £257 million). These financial investments have been recognised in the group's balance sheet at fair value.

Conduits

The group sponsors and manages SPEs that have been established for the purpose of providing alternative sources of financing to the group's customers through the use of multi-seller conduits, for example, in respect of motor vehicle finance receivables or for the purpose of providing a tailored investment opportunity for investors by way of a securities investment conduit.

The multi-seller conduits purchase interests in a diversified pool of third party originated assets for example, loans and advances using finance provided by third party investors, usually by the issue of CP. The cash flows received by the conduits on the pools of assets are used to service the finance provided by investors. The group administers these arrangements, which facilitate diversification of funding sources for the third party originators and allow the debt issuance of the conduits to be divided into differing risk classes in order to attract a wide range of investors with varying risk appetites. The group also typically provides programme wide credit enhancements, for example, letters of credit, and liquidity facilities to the Multi-seller conduits. The group's multi-seller conduits are Regency Assets Limited ('Regency') and Bryant Park Funding LLC ('Bryant Park'). The group provided 100 per cent liquidity facilities to Regency and Bryant Park.

Notes on the Financial Statements (continued)

Securities investment conduits, such as Solitaire Funding Ltd ('Solitaire') operate in a similar way, except that it purchases AAA rated asset-backed securities from third party market participants instead of loans. In this respect it is more akin to a SIV than the multi-seller conduit. Unlike Cullinan and Asscher, the group provided Solitaire a letter of credit and 100 per cent liquidity line.

Solitaire – Ratings by class of asset

	2007	2006
	£m	£m
S&P Ratings		
AAA	**10,772**	10,368
Total investments	**10,500**	10,289
Other assets	**276**	79
Total assets	**10,772**	10,368

Solitaire – Total assets by balance sheet classification

	2007	2006
	£m	£m
Financial instruments designated at fair value	**50**	50
Derivative assets	**30**	10
Loans and advances to banks	**125**	–
Financial investments	**10,291**	10,229
Other assets	**276**	79
	10,772	10,368

Solitaire's financial investments have been recognised in the group's balance sheet at fair value.

Solitaire – Funding structure

	Total	**Provided by the bank**
	£m	**£m**
2007		
Commercial paper	**11,452**	**3,869**
2006		
Commercial paper	10,309	–

The group consolidated these conduits from inception because it is exposed to the majority of risks and rewards.

Securitisations

The group uses SPEs to securitise customer loans and advances it has originated in order to diversify its sources of funding, and where this source of funding is cost-effective and capital efficient. The SPEs have been consolidated except for one small securitisation where the SPE is not consolidated because the group does not have the majority of risks and rewards of ownership. Credit enhancements are used to obtain investment grade ratings on the senior debt issued by the SPE.

The group also established term securitisation programmes in Germany where third party loans are securitised. The majority of these vehicles are not consolidated by the group as it is not exposed to the risks and rewards of ownership in the SPEs.

Other

The group also establishes, in the normal course of business, SPEs to facilitate, for example, structured credit transactions for customers and to provide finance to public and private sector infrastructure projects, asset and structured finance transactions. These off-balance sheet vehicles are not consolidated by the group as it does not have the majority of risks and rewards of ownership in these SPEs.

The group has not given guarantees or indemnities in respect of these vehicles nor provided support.

Included within the 'Other' SPE category are the following types of SPEs:

Structured credit transactions

The group provides structured credit transactions to third party professional and institutional investors who wish to obtain exposure, sometimes on a leveraged basis, to a reference portfolio of debt instruments. The investors obtain the risks and rewards of the relevant reference portfolios by purchasing notes issued by the SPEs. The SPEs enter into contracts with the group, generally in the form of derivatives, in order to pass the risks and rewards of the reference portfolios to the SPEs. The group's risk in relation to the derivative contracts with the SPEs is managed within the group's trading market risk framework. See Market Risk Management on page [ ].

The transactions are facilitated through SPEs in order that the notes issued to the investors can be rated. The SPEs are not consolidated by the group because the investors bear substantially all the risks and rewards of ownership through the notes, except where the group itself holds a majority of the notes in particular SPEs.

Public and private sector infrastructure projects

The group participates in 'Public-Private Partnerships' to provide financial support for infrastructure projects initiated by government authorities. The funding structure is commonly achieved through the use of SPEs. The group consolidates the SPEs where it is exposed to the majority of risks and rewards of the vehicles.

Asset finance transactions

The group's Asset and Structured Finance ('ASF') business specialises in leasing and arranging finance for aircraft and other physical assets, which it is customary to ring-fence through the use of SPEs, and in structured loans and deposits where SPEs introduce cost efficiencies. The group consolidates these SPEs where the substance of the relationship indicates that the group controls the SPE.

Third party sponsored SPEs

The group's exposure to third party sponsored SIVs, conduits and securitisations have arisen through normal banking arrangements on standard market terms. The group did not provide any credit enhancement to third party SIVs, conduits and securitisations.

Other off-balance sheet arrangements

Financial guarantees, letters of credit and similar undertakings

Note 39 describes various types of guarantees and discloses the maximum potential future payments under such arrangements. Credit risk associated with all forms of guarantees is assessed in the same manner as for on-balance sheet credit advances and, where necessary, provisions for assessed impairment are included in 'Other provisions'.

Commitments to lend

Undrawn credit lines are disclosed in Note 39 on page 178. The majority by value of undrawn credit lines arise from 'open to buy' lines on personal credit cards, cheques issued to potential customers offering them a pre-approved loan, advised overdraft limits, and mortgage offers awaiting customer acceptance.

The group generally has the right to change or terminate any conditions of a personal customer's overdraft, credit card or other credit line upon notification to the customer. In respect of corporate commitments to lend, in most contracts the group's position will be protected through restrictions on access to funding in the event of material adverse change.

Leveraged finance transactions

Loan commitments in respect of leveraged finance transactions are accounted for as derivatives where it is the group's intention to sell the loan after origination. As at 31 December 2007, the group's commitments in respect of leveraged finance transactions were £2.9 billion, of which £2.0 billion were funded and £0.9 billion were unfunded. During 2007, losses of £55 million were recognised in trading income relating to transactions priced prior to the market turmoil. The remainder of the transactions have been priced subsequent to the widening of credit spreads and are valued at par.

Notes on the Financial Statements (continued)

39 Contingent liabilities, contractual commitments and guarantees

Contingent liabilities and commitments

	The group		The bank	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Contract amounts				
Contingent liabilities				
Guarantees and irrevocable letters of credit pledged as collateral security	**18,972**	23,698	**10,816**	16,723
Other contingent liabilities	**75**	59	**–**	–
	19,047	23,757	**10,816**	16,723
Commitments				
Documentary credits and short-term trade-related transactions	**1,621**	1,414	**447**	532
Forward asset purchases and forward forward deposits placed	**38**	54	**–**	–
Undrawn note issuing and revolving underwriting facilities	**19**	32	**–**	–
Undrawn formal standby facilities, credit lines and other commitments to lend[1]:				
– one year and under	**108,149**	100,248	**78,934**	74,111
– over one year	**36,192**	29,604	**22,945**	19,693
	146,019	131,352	**102,326**	94,336

1 *Based on original contractual maturity.*

The above table discloses the nominal principal amounts of contingent liabilities, commitments and guarantees. They are mainly credit-related instruments which include both financial and non-financial guarantees and commitments to extend credit. Nominal principal amounts represent the amounts at risk should contracts be fully drawn upon and clients default. 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.

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 2007 were as follows:

The group

	At 31 December 2007		At 31 December 2006	
	Guarantees in favour of third parties	**Guarantees by the group in favour of other HSBC group entities**	Guarantees in favour of third parties	Guarantees by the group in favour of other HSBC group entities
	£m	**£m**	£m	£m
Guarantee type				
Financial guarantees[1]	**8,957**	**1,266**	8,925	729
Standby letters of credit which are financial guarantees[2]	**752**	**68**	32	–
Other direct credit substitutes[3]	**191**	**6**	846	19
Performance bonds[4]	**1,751**	**29**	505	19
Bid bonds[4]	**129**	**4**	82	4
Standby letters of credit related to particular transactions[4]	**412**	**–**	320	–
Other transaction-related guarantees[4]	**5,215**	**71**	12,156	48
Other items	**196**	**–**	72	–
Total	**17,603**	**1,444**	22,938	819

The bank

	At 31 December 2007		At 31 December 2006	
	Guarantees in favour of third parties	**Guarantees by the group in favour of other HSBC group entities**	Guarantees in favour of third parties	Guarantees by the group in favour of other HSBC group entities
	£m	**£m**	£m	£m
Guarantee type				
Financial guarantee contracts[1]	**6,382**	**1,069**	6,786	557
Standby letters of credit which are financial guarantee contracts[2]	**–**	**–**	–	–
Other direct credit substitutes[3]	**1**	**–**	6	–
Performance bonds[4]	**648**	**22**	495	19
Bid bonds[4]	**19**	**3**	30	3
Standby letters of credit related to particular transactions[4]	**74**	**–**	90	–
Other transaction-related guarantees[4]	**2,461**	**16**	8,713	15
Other items	**121**	**–**	9	–
Total	**9,706**	**1,110**	16,129	594

1 *Financial guarantees are contracts that require the issuer to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. The amounts in the above table are nominal principal amounts.*

2 *Standby letters of credit which are financial guarantee contracts are irrevocable obligations on the part of HSBC 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 obligation on the group to make payment depends on the outcome of a future event.*

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.

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.

Notes on the Financial Statements (continued)

Provisions in respect of the group's obligations under outstanding guarantees

	2007 £m	2006 £m
Guarantees and items pledged as collateral security	**5**	14
Other items	**5**	4

At 31 December 2007, 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 £282 million (2006: £330 million).

In relation to joint ventures and associates, the group had no contingent liabilities or commitments, incurred jointly or otherwise.

40 Lease commitments

Finance lease commitments

	2007			2006		
	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	**13**	**(12)**	**1**	15	(14)	1
Later than one year and no later than five years	**51**	**(51)**	**–**	66	(63)	3
Later than five years	**415**	**(87)**	**328**	356	(32)	324
	479	**(150)**	**329**	437	(109)	328

Future minimum sublease payments of £232 million (2006: £83 million) were expected to be received under non-cancellable subleases at 31 December 2007.

Operating lease commitments

At 31 December 2007, 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	
	2007 £m	2006 £m
Future minimum lease payments under non-cancellable operating leases expiring:		
– no later than one year	**110**	94
– later than one year and no later than five years	**367**	307
– later than five years	**540**	361
	1,017	762

At 31 December 2007, future minimum sublease payments of nil (2006: nil) were expected to be received under non-cancellable subleases.

In 2007, £117 million (2006: £100 million) was charged to 'General and administrative expenses' in respect of lease and sublease agreements, all of which related to minimum lease payments.

Finance lease receivables

	2007			2006		
	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	**729**	**(141)**	**588**	486	(87)	399
– later than one year and no later than five years	**2,222**	**(493)**	**1,729**	2,049	(380)	1,669
– later than five years	**3,502**	**(1,146)**	**2,356**	3,535	(1,169)	2,366
	6,453	**(1,780)**	**4,673**	6,070	(1,636)	4,434

At 31 December 2007, unguaranteed residual values of £85 million (2006: £77 million) had been accrued, and the accumulated allowance for uncollectible minimum lease payments receivable amounted to nil (2006: £9 million).

In 2007, nil (2006: £25 million) was received as contingent rents and recognised in 'Other operating income'.

Operating lease receivables

	Equipment	
	2007 £m	2006 £m
Future minimum lease payments under non-cancellable operating leases expiring:		
– no later than one year	**237**	228
– later than one year and no later than five years	**670**	737
– later than five years	**199**	292
	1,106	1,257

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.

41 Litigation

On 27th July 2007, the UK Office of Fair Trading ("OFT") issued High Court legal proceedings against a number of UK financial institutions, including the bank, to determine the legal status and enforceability of certain of the charges applied to their personal customers in relation to unauthorised overdrafts (the "charges"). Certain preliminary issues in these proceedings were heard in a trial in the Commercial Division of the High Court on 17th January 2008. This trial concluded on 8th February 2008 and judgement, on the preliminary issues tested, is awaited.

The proceedings remain at a very early stage and may, if appeals on the preliminary issues (or, subsequently on substantive issues) are pursued, take a number of years to conclude. A wide range of outcomes is possible, depending, initially, upon whether the Court finds that some, all or none of the charges should be tested for fairness and/ or tested as common law penalties and, if it does find that some or all of the charges should be so tested, upon the Court's subsequent assessment of each charge across the period under review. Since July 2001, there have been a variety of charges applied by the bank across different charging periods under the then current contractual arrangements. The bank considers the charges to be and to have been valid and enforceable, and intends strongly to defend its position.

If, contrary to the bank's current assessment, the Court should ultimately (after appeals) reach a decision adverse to the bank that results in a liability for it, a large number of different outcomes is possible, each of which would have a different financial impact. Based on the facts currently available, and a number of assumptions, the bank estimates that the financial impact could be approximately £300 million. To make an estimate of the potential financial impact at this stage with any precision is extremely difficult, owing to (among other things) the complexity of the issues, the number of permutations of possible outcome, and the early stage of the proceedings. In addition, the assumptions made by the bank may prove to be incorrect.

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.

42 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 Group Managing Directors of HSBC Holdings plc.

	2007			2006		
	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	**110**	**379,869**	**271,991**	54	158,512	103,069
Credit cards	**47**	**635**	**267**	47	681	443
Guarantees	**17**	**14,811**	**13,224**	3	5,911	5,202

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.

	2007		2006	
	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	**12**	**11,038**	17	8,369
Credit cards	**20**	**68**	18	92
Guarantees	**1**	**12**	1	12
Officers				
Loans	**19**	**7,018**	32	7,003
Credit cards	**21**	**108**	20	113
Guarantees	**-**	**–**	–	–

	2007		2006	
	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	**12**	**11,038**	17	8,369
Credit cards	**20**	**68**	18	92
Guarantees	**1**	**12**	1	12
Officers				
Loans	**19**	**7,018**	32	7,003
Credit cards	**21**	**108**	20	113
Guarantees	**-**	**–**	–	–

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.

Compensation to the Key Management Personnel of the group under IAS 24

	2007 £000	2006 £000
Short-term employee benefits	**6,665**	5,534
Post-employment benefits	**395**	400
Share-based payment	**4,432**	3,081
	11,492	9,015

Directors' and Other Key Management Personnel shareholdings and options

	Balance at 31 December 2007	Balance at 31 December 2006
Number of share options from equity participation plans held by Directors and other key management personnel (and their connected persons)	**904,327**	1,571,328
Number of shares held by Directors and other key management personnel (and their connected persons)	**7,297,558**	3,900,008

Transactions with other related parties

Associates and joint ventures

The group

	2007		2006	
	Highest balance during the year[1] £m	**Balance at 31 December 2007[1] £m**	Highest balance during the year[1] £m	Balance at 31 December 2006[1] £m
Amounts due from joint ventures				
– subordinated	**–**	**–**	–	–
– unsubordinated	**216**	**202**	342	24
Amounts due from associates				
– subordinated	**19**	**–**	19	19
– unsubordinated	**33**	**–**	54	33
Amounts due to joint ventures	**20**	**20**	804	12
Amounts due to associates	**166**	**1**	166	166

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)

The bank

	2007		2006	
	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	**161**	**161**	342	–
Amounts due from associates				
– subordinated	**–**	**–**	–	–
– unsubordinated	**1**	**–**	18	1
Amounts due to joint ventures	**4**	**4**	763	–
Amounts due to associates	**29**	**1**	47	29

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.

	2007		2006	
	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	**37**	**7**	159	9
Financial assets designated at fair value	**15**	**15**	–	–
Derivatives	**–**	**–**	–	–
Loans and advances to banks	**–**	**–**	–	–
Loans and advances to customers	**60**	**33**	35	35
Financial investments	**1**	**1**	1	1
Other assets	**–**	**–**	–	–

	2007		2006	
	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	**13**	**12**	2,561	13
Deposits by banks	**–**	**–**	–	–
Customer accounts	**3,308**	**2,931**	2,287	2,287
Derivatives	**–**	**–**	–	–
Guarantees	**–**	**–**	–	–

	For the year ended 31 December 2007 £m	For the year ended 31 December 2006 £m
Income Statement		
Interest income	**–**	–
Interest expense	**111**	123
Dividend income	**14**	10
Fee income	**–**	–
Fee expense	**–**	–
Trading income	**–**	–
Other operating income	**–**	–
General and administrative expenses	**48**	50

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.*

Transactions detailed below include amounts due to/from fellow subsidiaries of HSBC Holdings plc

	2007		2006	
	Highest balance during the year[1] £m	**Balance at the year end[1] £m**	Highest balance during the year[1] £m	Balance at the year end[1] £m
Assets				
Trading assets	**9,895**	**7,453**	2,859	2,314
Derivatives	**24,494**	**7,445**	12,981	4,061
Loans and advances to banks	**5,968**	**5,968**	5,441	3,685
Loans and advances to customers	**1,646**	**1,102**	2,626	625
Financial investments	**5,829**	**5,829**	6,341	5,493
Other assets	**1,983**	**716**	2,996	370

	2007		2006	
	Highest balance during the year[1] £m	**Balance at the year end[1] £m**	Highest balance during the year[1] £m	Balance at the year end[1] £m
Liabilities				
Trading liabilities	**19,563**	**17,345**	2,780	2,780
Deposits by banks	**6,962**	**6,095**	7,837	4,345
Customer accounts	**2,131**	**1,429**	2,758	1,537
Derivatives	**26,536**	**8,966**	14,564	5,722
Guarantees	**151**	**116**	137	137

	For the year ended 31 December 2007 £m	For the year ended 31 December 2006 £m
Income Statement		
Interest income	**556**	491
Interest expense	**379**	322
Dividend income	**–**	–
Fee income	**99**	102
Fee expense	**135**	111
Trading income	**316**	120
Other operating income	**27**	30
General and administrative expenses	**120**	33

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)

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.

	2007		2006	
	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	**40,138**	**40,138**	6,706	4,961
Derivatives	**8,341**	**8,341**	4,612	4,612
Loans and advances to banks	**5,026**	**3,798**	9,667	3,521
Loans and advances to customers	**7,930**	**7,594**	8,930	6,546
Financial investments	**–**	**–**	–	–
Other assets	**–**	**–**	–	–
Liabilities				
Trading liabilities	**16,153**	**13,567**	5,523	2,991
Deposits by banks	**12,695**	**10,827**	12,557	8,345
Customer accounts	**11,470**	**11,470**	10,144	10,144
Derivatives	**8,056**	**8,056**	4,487	4,020
Guarantees	**998**	**998**	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.*

Transactions detailed below include amounts due to/from HSBC Bank plc and HSBC Holdings plc

	2007		2006	
	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	**37**	**7**	86	9
Derivatives	**–**	**–**	–	–
Loans and advances to banks	**–**	**–**	–	–
Loans and advances to customers	**60**	**33**	35	35
Financial investments	**–**	**–**	–	–
Other assets	**–**	**–**	–	–
Liabilities				
Trading liabilities	**13**	**12**	2,554	13
Deposits by banks	**–**	**–**	–	–
Customer accounts	**3,289**	**2,919**	2,273	2,273
Derivatives	**–**	**–**	–	–
Guarantees	**–**	**–**	–	–

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.*

Transactions detailed below include amounts due to/from HSBC Bank plc and fellow subsidiaries of HSBC Holdings plc

	2007		2006	
	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	**8,803**	**6,634**	2,863	2,195
Derivatives	**5,335**	**5,255**	2,602	2,366
Loans and advances to banks	**4,890**	**4,329**	5,122	3,075
Loans and advances to customers	**982**	**982**	2,425	509
Financial investments	**–**	**–**	–	–
Other assets	**204**	**36**	232	98

	2007		2006	
	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	**19,497**	**16,272**	2,720	2,720
Deposits by banks	**4,323**	**4,200**	4,317	2,105
Customer accounts	**1,850**	**1,147**	2,318	1,289
Derivatives	**5,826**	**5,826**	3,667	3,667
Guarantees	**113**	**70**	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 2007, fees of £1.6 million (2006: £1.6 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 £215 million (2006: £143 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 2007, the gross notional value of the swaps was £14,994 million (2006: £7,390 million), the swaps had a negative fair value of £124 million to the bank (2006: positive fair value to the bank of £139 million) and the bank had delivered collateral of £378 million (2006: £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.

43 Events after the balance sheet date

There have been no material events after the balance sheet date which would require disclosure or adjustment to the 31 December 2007 financial statements.

On 29 February 2008, HSBC France, a wholly-owned subsidiary of the bank , received a firm offer from Banque Fédérale des Banques Populaires of €2.1 billion (£1.5 billion) for its seven French regional banking subsidiaries. On the basis of this offer, HSBC France has entered into exclusive discussions with Banque Fédérale des Banques Populaires. HSBC France will now commence consultations with representatives of the relevant employee representative bodies before making any final decision. Any transaction will be subject to regulatory approvals in France.

At 31 December 2007, the aggregate total assets attributable to the seven French regional banking subsidiaries were €8.4 billion (£6.2 billion), and they generated net profits after tax of €100 million (£71 million) for the year ended 31 December 2007.

On 3 March 2008, the Board of Directors authorised the financial statements for issue.

HSBC Bank plc
8 Canada Square, London E14 5HQ, United Kingdom
Telephone: 44 020 7991 8888 Facsimile: 44 020 7991 4888
www.hsbc.co.uk