Company No. 14259

2012

Interim Report

HSBC Bank plc

Interim Report 2012

Contents

Presentation of Information

This document comprises the Interim Report 2012 for HSBC Bank plc ('the bank') and its subsidiary undertakings (together 'the group'). It contains the Interim Management Report and Condensed Financial Statements, together with the Auditor's review report, as required by the Financial Services Authority's ('FSA') Disclosure and Transparency Rules ('DTR'). References to 'HSBC' or 'the Group' within this document mean HSBC Holdings plc together with its subsidiaries.

Within the Interim Management Report, the group has presented income statement figures for the three most recent 6 month periods to illustrate the current performance compared to recent periods. This compares to the Condensed Financial Statements and related notes, prepared in accordance with IAS 34, which include income statement year on year comparatives.

Cautionary Statement Regarding Forward-Looking Statements

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

Certain statements that are not historical facts, including statements about the group'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 subsequent 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.

Interim Management Report: Financial Highlights

Reported profit before tax of £757 million was 60 per cent lower than the first half of 2011 and 37 per cent lower than the second half of 2011. The results reflect the impact of the ongoing challenging operating environment across Europe together with a higher level of provisions in respect of customer redress and non-recurrence of the benefits of the pensions accounting gain which arose in the first half of 2011.

Excluding the change in own credit spread on long-term debt, profit before tax was 35 per cent lower than the first half of 2011 and 247 per cent higher than the second half of 2011.

Net operating income before impairments of £6,813 million was 5 per cent lower than the same period in 2011, and broadly in line with that in the second half of 2011. Despite strong growth in mortgage and term lending, Retail Banking revenues were partially offset by lower margins. Global Banking and Markets benefited from tightening spreads on eurozone bonds in the first quarter, which led to higher revenues in the Rates business, together with higher gains on the sale of available-for-sale debt securities arising from Balance Sheet Management’s interest rate risk management activities.

Loan impairments and other credit risk provisions of £674 million were 8 per cent and 24 per cent lower than the first and second halves of 2011, respectively. The falls reflected improved delinquency trends resulting in lower charges in Retail Banking, offset partially by higher levels of specific impairments in Global Banking and Markets.

Total operating expenses of £5,378 million, impacted by restructuring costs as well as a number of other notable items[1], increased by 20 per cent and 12 per cent in the first and second halves of 2011 respectively. After adjusting for these items, operating expenses were broadly in line with both halves of 2011.

The group continued its focus on improving cost efficiency and organisational effectiveness, announcing a restructuring programme targeted at implementing consistent business models across businesses and support functions. The group announced an exit from operations in Slovakia and has entered into an agreement to sell its equities broking business in Greece and non-core insurance businesses in Ireland.

1 *These items comprise £819 million of provisions relating to customer redress programmes in the first half of 2012, compared to £332 million in the first half of 2011, an accounting gain in the UK of £360 million resulting from legislative change in the inflation measure used to calculate the indexation of certain pension liabilities in May 2011, and restructuring costs of £132 million in the first half of 2012 compared to £56 million in the first half of 2011.*

Financial Highlights of the group

	Half-year to		
	30 June 2012	30 June 2011	31 December 2011
For the period (£m)			
Profit before tax	**757**	1,908	1,203
Total operating income	**8,186**	8,685	7,520
Net operating income before loan impairment charges and other credit risk provisions	**6,813**	7,139	6,884
Profit attributable to shareholders of the parent company	**762**	1,407	922
At period end (£m)			
Total equity attributable to shareholders of the parent company	**32,347**	31,984	31,090
Risk weighted assets	**216,366**	201,865	227,679
Loans and advances to customers (net of impairment allowances)	**291,804**	311,290	288,014
Customer accounts	**364,568**	371,527	346,129
Ratio of customer advances to customer accounts	**80.0**	83.8	83.2
Capital ratios[2]			
Core Tier 1 ratio	**9.9**	10.5	9.1
Tier 1 ratio	**10.8**	11.4	10.0
Total capital ratio	**15.3**	16.0	14.4
Performance and efficiency ratios (annualised %)			
Return on average shareholders’ funds (equity) of the parent company	**4.8**	9.0	5.9
Cost efficiency ratio	**78.9**	63.0	69.6

2 *Includes externally verified profits for the period to 30 June 2012. Does not include the interim dividend of £575 million declared by the Board of Directors after 30 June 2012.*

Interim Management Report: Operating and Financial Review (continued)

Financial summary

Summary consolidated income statement

	Half year to		
	30 June 2012	30 June 2011	31 December 2011
	£m	£m	£m
Net interest income	**3,450**	3,622	3,601
Net fee income	**1,913**	1,966	1,934
Net trading income	**1,374**	1,379	157
Net (expense)/income from financial instruments designated at fair value	**(61)**	(70)	503
Gains less losses from financial investments	**295**	128	164
Net earned insurance premiums	**1,180**	1,479	1,101
Other operating income	**35**	181	60
Total operating income	**8,186**	8,685	7,520
Net insurance claims incurred and movements in liabilities to policy holders	**(1,373)**	(1,546)	(636)
Net operating income before impairment charges and other credit risk provisions	**6,813**	7,139	6,884
Loan impairment charges and credit risk provisions	**(674)**	(731)	(892)
Net operating income	**6,139**	6,408	5,992
Total operating expenses	**(5,378)**	(4,495)	(4,793)
Operating profit	**761**	1,913	1,199
Share of profit of associates and joint ventures	**(4)**	(5)	4
Profit before tax	**757**	1,908	1,203
Tax credit/(expense)	**29**	(473)	(261)
Profit for the period	**786**	1,435	942
Profit attributable to shareholders of the parent company	**762**	1,407	922
Profit attributable to non-controlling interests	**24**	28	20

Economic briefing

The UK economy remained weak in the first half of 2012. In the second quarter, the level of real Gross Domestic Product (‘GDP’) contracted by 0.7 per cent, the third consecutive quarterly contraction. Despite this, the unemployment rate fell slightly to 8.1 per cent in the three months to May, from 8.4 per cent at the end of 2011, although much of the job creation was in part-time work. Consumer Prices Index (‘CPI’) inflation fell sharply from 4.2 per cent in December 2011 to 2.4 per cent in June, in part reflecting the removal of last year's rise in VAT from the annual comparison. The Bank of England left interest rates unchanged at 0.5 per cent but loosened monetary policy by extending its programme of asset purchases by £50 billion to £325 billion. Strains in the banking system arising from the Eurozone sovereign crisis contributed to a tightening in credit conditions for both households and firms, prompting the UK authorities to announce more direct measures aimed at boosting the flow of credit.

The eurozone economy continued to face stresses related to the sovereign debt crisis in the first half of 2012. While the economy as a whole stagnated in the first quarter, divergences between countries in the north of the region and those in the south continued to widen. Concerns surrounding the health of the financial sector led the European Central Bank (‘ECB’) to provide greater liquidity through a Long-Term Refinancing Operation (‘LTRO’) in February 2012. As oil prices eased, eurozone inflation began to moderate towards the ECB’s price stability target, allowing it to maintain the refinancing rate at 1.0 per cent in the period. Worries over the sovereign bond market and the banking sector intensified over the first half of 2012, and up to EUR 100 billion of emergency financial aid was approved from the temporary euro bailout fund, the European Financial Security Facility, to recapitalise the Spanish banking sector.

Review of business performance

Profit before tax of £757 million was £1,151 million or 60 per cent lower than the first half of 2011, and £446 million lower than the second half of 2011. UK Retail Banking recorded a decrease in profit before tax when compared with both the first and second halves of 2011. Continental Europe Retail Banking and Private Banking recorded a decrease in profit before tax when compared with the first half of 2011 but an increase when compared with the second half of 2011. Global Banking and Markets profit before tax was higher than both the first and second halves of 2011.

Net interest income fell by 5 per cent, due primarily to lower Balance Sheet Management revenues in Global Banking and Markets as yield curves continued to flatten and interest rates remained low. An increase in UK Retail Banking net interest income was offset by falls in the other business segments. UK Retail Banking benefited from growth in mortgage balances and commercial lending as a result of targeted campaigns. This was partially offset by margin compression as customers continued to repay unsecured loans. In Continental Europe, Commercial Banking net interest income increased as a result of widening margins and growth in lending volumes. This was more than offset by lower asset margins in the Retail Banking and Wealth Management business.

Net fee income decreased by 3 per cent, due to a fall in average assets under management in Private Banking owing to adverse movements in the financial markets, net new money outflows and a lower number of clients. This was partially offset in Continental Europe Retail Banking by lower commissions paid as a result of the winding down of the non-strategic insurance businesses in Ireland.

Net trading income was broadly in line with the first half of 2011 as increases in Rates and Foreign Exchange revenues were offset by adverse foreign exchange movements on trading assets held as economic hedges of foreign currency debt designated at fair value. These offset favourable foreign exchange movements on the foreign currency debt which are reported in '*Net expense from financial instruments designated at fair value*'.

Foreign Exchange revenue benefited from increased client revenues, driven in part by Global Banking & Markets' ongoing collaboration with Commercial Banking, coupled with a favourable trading environment for foreign exchange. Rates revenues also increased as spreads on eurozone bonds tightened, notably in the first quarter of 2012 following the announcement of the LTRO. However in the second quarter, political uncertainty and concerns about eurozone contagion returned to the markets resulting in adverse fair value movements on eurozone bonds, this partly offset the favourable performance in the first quarter.

In addition, there were adverse fair value movements on structured liabilities as credit spreads tightened at the beginning of 2012 compared with a reported release in the previous year. Lower Equities revenue reflected a less favourable trading environment. Net trading income from our legacy credit portfolio also declined as a result of losses on disposals made with the intention of reducing capital consumption.

Net expense from financial instruments designated at fair value was £9 million or 13 per cent lower than in the first half of 2011. The change in own credit spread on long term debt resulted in losses of £491 million in the first half of 2012 compared with losses of £11 million in the first half of 2011. This was offset by favourable foreign exchange movements in foreign currency debt designated at fair value, issued as part of our overall funding strategy, with an offset reported in '*Trading income*'.

In addition, net income arising from financial assets held to meet liabilities under insurance and investment contracts reflected higher net investment gains in 2012 from equity markets that were stronger than in the first half of 2011. This predominantly affected the value of assets held to support unit-linked contracts in the UK and investment contracts with discretionary participation features ('DPF') in France. The investment gains arising from equity markets resulted in a corresponding movement in liabilities to customers, reflecting the extent to which unit-linked policyholders, in particular, participate in the investment performance of the associated asset portfolio. Where these relate to assets held to back insurance contracts or investment contracts with DPF, the corresponding movement in liabilities to customers is recorded under *'Net insurance claims incurred and movement in liabilities to policyholders'*.

Gains less losses from financial investments were £167 million or 130 per cent higher than in the first half of 2011 due to significantly higher gains on the disposal of available-for-sale debt securities as part of portfolio management activities.

Net earned insurance premiums decreased by £299 million or 20 per cent, mainly due to lower levels of sales in France of investment contracts with DPF as a result of the adverse economic environment and increased product competition. In addition, there was a reduction in premiums from the decision taken in 2011 to discontinue certain businesses and transfer to third parties certain contracts in the group's Irish business.

Other operating income decreased by £146 million or 81 per cent. A net decrease in the present value of in-force ('PVIF') long-term insurance business reflected both the non-recurrence of the one-off accounting gain recognised in the first half of 2011, following refinement of the calculation of the PVIF asset, and the impact of experience and assumption updates.

Net insurance claims incurred and movement in liabilities to policyholders decreased by £173 million or 11 per cent. The policyholders' liability decrease reflected the lower levels of new business written, consistent with the fall in net earned insurance premiums. Partially offsetting the decrease were gains on the fair value of assets held to meet liabilities under insurance and investment products, in respect of which there was a corresponding increase in *'Net expense from financial assets designated at fair value'*.

Interim Management Report: Operating and Financial Review (continued)

Loan impairment charges and other credit risk provisions decreased by £57 million or 8 per cent. In the UK personal business, improved delinquency trends across both the secured and unsecured loan portfolios as the bank focused its lending on higher quality assets resulted in a decrease in the loan impairment charges. This was partially offset by an increase in Commercial Banking as specific provisions were raised against a small number of customer exposures. Global Banking and Markets saw an increase in loan impairment and other credit provisions because of a small number of significant individually assessed provisions. This was partially offset by lower levels of credit risk provisions on available-for-sale asset-backed securities. The non-recurrence of charges made in the first half of 2011, in respect of Greek sovereign debt, also contributed to the lower levels of impairments.

Total operating expenses increased by 20 per cent, driven mainly by a higher level of customer redress provisions in the UK and higher levels of restructuring costs as the cost efficiency programme continued to be implemented. The first half of 2011 included a £360 million one-off accounting gain relating to a legislative change in the indexation of certain UK pensions liabilities.

The first half of 2012 included additional provisions of £819 million in respect of customer redress provisions, primarily in the UK. These provisions relate mainly to the estimated redress for the possible mis-selling of Payment Protection Insurance (‘PPI’) and interest rate products sold to small businesses. The additional charge relating to PPI reflects the refinement of assumptions in light of recent experience. The bank is also working with customers and the Financial Services Authority (‘FSA’) to provide redress arising from the sale of interest rate products. There are many factors which affect the estimated liabilities and there remains a high degree of uncertainty as to the eventual costs of redress for these matters.

The review initiated in 2011 to improve cost efficiency and effectiveness continued during the period. Restructuring costs of £132 million (H1 2011: £56 million and H2 2011: £181 million) included the costs incurred with the initiative to improve operational efficiency. During 2012 the group announced the closure of its Slovakian business and disposal of non-strategic businesses in Greece and Ireland. Excluding customer redress, restructuring costs and the impact of the pension credit, operating expenses were broadly in line with those in the first and second halves of 2011. Investment in business platforms, improved process automation and revenue related performance costs were funded by sustainable cost savings made during the period.

Tax credit for the period was £29 million, compared to a tax expense of £473 million in the first half of 2011. The tax credit was driven by a combination of the lower level of profit before tax for the period and a tax credit in respect of previous periods relating to a number of open issues that have been assumed by HSBC Holdings plc. The resulting reported effective rate for the first half of 2012 was (3.8) per cent compared with 24.8 per cent in the first half of 2011.

Balance sheet commentary

	At 30 June 2012 £m	At 31 December 2011 £m
Total assets	**878,205**	827,970
Cash and balances at central banks	**70,332**	56,460
Trading assets	**161,606**	126,598
Financial assets designated at fair value	**15,856**	15,332
Derivative assets	**181,261**	176,993
Loans and advances to banks	**47,227**	44,603
Loans and advances to customers	**291,804**	288,014
Financial investments	**84,063**	93,112
Other	**26,056**	26,858
Total liabilities	**845,351**	796,366
Deposits by banks	**48,504**	41,032
Customer accounts	**364,568**	346,129
Trading liabilities	**134,800**	119,211
Financial liabilities designated at fair value	**32,403**	31,992
Derivative liabilities	**183,221**	178,121
Debt securities in issue	**42,280**	42,688
Liabilities under insurance contracts issued	**16,583**	16,347
Provisions	**1,379**	820
Other	**21,613**	20,026
Total equity	**32,854**	31,604
Total equity attributable to shareholders of the parent company	**32,347**	31,090
Non-controlling interests	**507**	514

Total assets amounted to £878 billion, 6 per cent higher than at 31 December 2011.

The group's conservative approach to managing its balance sheet and strong excess liquidity position, partly due to growth in deposits in the first half of 2012, has enabled it to continue to support its customers' borrowing requirements, leading to higher term lending and mortgage balances in the UK. In addition, the fair value of derivative contracts increased markedly, as the result of an increase in the fair value of interest rate and currency swap contracts. Growth in trading assets reflected the return to normal trading levels following the lower seasonal levels of activity during the Christmas period.

In April 2012, the bank issued the first international renminbi bond outside sovereign Chinese territory, mainly distributing to European investors.

The group maintained a strong and liquid balance sheet with the ratio of customer advances to customer accounts of 80.0 per cent (December 2011: 83.2 per cent).

The group's reported Core Tier 1 ratio stood at 9.9 per cent (December 2011: 9.1 per cent). Risk weighted assets amounted to £216 billion, 5 per cent lower than at 31 December 2011. The decrease in risk weighted assets reflected a reduction in positions and the tightening of credit default swap spreads, which reduced the value at risk ('VAR') components of market risk including stressed VAR.

Assets

Cash and balances at central banks increased by 25 per cent. Financial markets continued to be dominated by concerns about eurozone sovereign debt and possible contagion effects in the first half of 2012. As a result, the group maintained its conservative risk profile by placing a greater portion of its excess liquidity with central banks.

Trading assets increased by 28 per cent as client activity increased from the more subdued levels in December 2011. This resulted in higher reverse repo balances used to cover short positions, together with a rise in settlement account balances and increased levels of intragroup trading assets.

Financial assets designated at fair value were in line with the position at 31 December 2011. Following an increase in its holding in the first half of the year, the insurance business in France consolidated a fund which invests primarily in debt securities.

Interim Management Report: Operating and Financial Review (continued)

Derivative assets increased by 2 per cent, driven by fair value movements in interest rate contracts due to downward movements in the yield curves of major currencies reflecting the ongoing monetary response to the economic weakness and turmoil in the eurozone. The effect was partially offset by a decrease in the fair value of foreign exchange contracts.

Loans and advances to banks grew by 6 per cent, as a result of increased money market term deposits.

Loans and advances to customers increased by 1 per cent. Mortgage lending grew strongly over the period, reflecting the group's strong competitive positioning and successful marketing campaigns, particularly in the UK. There was also an increase in customer overdrafts, with a corresponding increase in customer accounts, for balances which did not meet the accounting netting criteria. These increases were partially offset by a fall in reverse repo transactions with non-bank counterparties and lower levels of unsecured customer balances as customers continued to reduce debt levels.

Financial investments decreased by 10 per cent, as the group redeployed the liquidity from the disposals of available-for-sale securities as part of portfolio management activities.

Liabilities

Deposits by banks increased by 18 per cent, as continued turmoil in sovereign debt markets led to a rise in placements with the group by other financial institutions.

Customer accounts increased by 5 per cent, mainly reflecting an increase in customer deposits which do not meet the accounting netting criteria.

Trading liabilities increased by 13 per cent due to an increase in settlement account balances which vary in proportion to the volume of trading activity. Repo balances increased, reflecting higher funding requirements as trading assets grew. Cash collateral posted by third parties also rose in line with the fair value of derivative assets.

Financial liabilities designated at fair value were in line with 31 December 2011.

Derivative liabilities increased by 3 per cent. The derivative businesses are managed within market risk limits and, as a consequence, the increase in the value of derivative liabilities broadly matched that of derivative assets.

Debt securities in issue were in line with 31 December 2011.

Liabilities under insurance contracts were in line with 31 December 2011.

Provisions increased by 68 per cent, reflecting the increase in provision held in respect of customer redress programmes.

Equity

Total shareholders' equity increased by 4 per cent as a result of profits generated during the period and fair value movements on available-for-sale assets. These positive movements were partially offset by a dividend paid to shareholders and adverse movements in the foreign exchange reserve.

Liquidity position

The group's liquidity and funding metrics improved over the first half of 2012 driven by an increase core customer deposits. As at 30 June 2012, the bank held significant buffers against all regulatory liquidity metrics.

HSBC Values

The role of HSBC Values in daily operating practice is significant in the context of the financial services sector and the wider economy. This is particularly important in the light of developments and changes in regulatory policy, investor confidence and society's view of the role of banks. The group expects its executives and employees to act with courageous integrity in the execution of their duties by being:

- dependable and doing the right thing;
- open to different ideas and cultures; and
- connected with our customers, communities, regulators and each other.

The group continues to enhance its value-led culture by embedding HSBC Values into how it conducts its business and through personal sponsorship by the Group Chief Executive and senior bank executives.

Challenges and uncertainties

As a provider of banking and financial services, risk is at the core of the group's day-to-day activities. The group's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or a combination of risks. The group's risk management framework is detailed in full in the *Annual Report and Accounts 2011* in 'Report of the Directors: Risk' on pages 27 to 74.

Challenges to business operations

Operational complexity has the potential to heighten all types of operational risk across the group's activities. This includes the risk of fraudulent and other criminal activities, process errors and system failures. Operational complexity can also increase operational costs.

The group is also subject to the risk of disruption to its business arising from events that are wholly or partially beyond its control. All operational risks also apply when the group relies on external suppliers or vendors to provide services to the group and its customers.

Challenges to governance and internal control systems

Information security and the management of an increasingly complex operating infrastructure remain two of the key emerging operational risks that the group faces. The reliability of the technology infrastructure and the security of the group's information are crucial. Critical system failures, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to the group's ability to serve its clients. This would also breach regulations under which it operates and cause long-term damage to its business.

Macro-economic and geopolitical

The group's earnings are affected by global and local economic and market conditions. The group's results are subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and changes in government policies on matters such as expropriation, authorisations, international ownership, interest-rate caps, foreign exchange transferability and tax in the jurisdictions in which it operates. The global economy will remain very volatile and subject to shocks and this could have an adverse effect on the group's results.

A number of mature economies are implementing austerity measures in order to reduce their deficits and public debt. While it is expected to help resolve the sovereign and banking crisis in the medium term, in the short term it is limiting growth, increasing unemployment and restricting taxation revenues severely.

The Eurozone has received increasing focus given the continued instability in the area and the potential for contagion from the peripheral to core eurozone countries, and beyond to trading partners. There is significant risk of one or more countries leaving the euro. This would place further pressure on banks within the core European countries through their exposures to banks in these countries. In the current context of very low growth this could further aggravate the economic crisis and could push European countries into a vicious circle of economic and sovereign debt defaults. The group's eurozone exposures are described in more detail on pages 10 to 12.

Macro-prudential and regulatory

Financial services providers face increasingly stringent and costly regulatory and supervisory requirements, particularly in the areas of capital and liquidity management, the conduct of business, the structure of operations and the integrity of financial services delivery. Increased government intervention and control over financial institutions, together with measures to reduce systemic risk, may significantly alter the competitive landscape.

Prudential measures aimed at increasing resilience in the financial system: In July 2011 the European Commission published proposals for a new Regulation and Directive, collectively known as 'CRD IV', to give effect to the *Basel III* framework in the EU. The proposals are expected to be passed into European law in 2012.

This Regulation additionally sets out provisions to harmonise regulatory and financial reporting in the EU. In December 2011, the European Banking Authority ('EBA') published a consultative document proposing measures to specify uniform formats, frequencies and dates of prudential reporting to the regulator. The new requirements are due to take effect on 1 January 2013.

Globally Systemically Important Banks (G-SIBs): HSBC has been classified by the Financial Stability Board ('FSB') as a G-SIB. G-SIBs will be subjected to what the FSB refers to as a 'multi-pronged and integrated set of policies'. The designated G-SIBs initially for those banks identified in November 2014 will be required to hold a minimum additional common equity tier 1 capital of between 1% and 2.5%. The requirements will be phased in from 1 January 2016, becoming fully effective on 1 January 2019. National regulators have discretion to introduce higher thresholds than these minima.

The European Commission is due to publish its *European resolution framework* in the second half of 2012. The proposal is expected to cover recovery and resolution plans and provide resolution authorities with a toolkit that will allow them to deal with banks in difficulty. One such tool is the debt write down tool or bail-in requirements, first published by the European Commission in April 2012 for discussion. The proposal requires a minimum bail-in requirement of 10% of eligible liabilities. HSBC continue to engage with the European Commission and industry as these proposals evolve.

The EU *financial transaction tax* (‘EU FTT’) is a proposal made by the European Commission in September 2011 to introduce a financial transaction tax. Whereas uniform implementation across Europe seems unlikely some countries, such as Germany or France, support implementation even if not all European countries participate.

UK Independent Commission on Banking: the UK government issued its White Paper in June 2012 setting out its proposed implementation of the recommendations of the Independent Commission on Banking (‘ICB’). It is likely that the group will be required to make major changes to its corporate structure and the business activities it conducts in the UK through HSBC Bank plc, as:

- at a minimum retail banking activities for most personal customers and smaller businesses currently carried out within the bank will have to be spun-off into a ring-fenced retail bank. These changes will take some time to implement with a significant effect on costs to both implement the changes and run the ongoing operations as restructured;
- significant banks, such as HSBC Bank plc, will be required to have core tier 1 capital of at least 10% of RWAs and over 3% of total assets (leverage ratio); and
- UK-incorporated banks will be required to hold primary loss absorbing capital (‘PLAC’) together with equity and debt capable of absorbing losses if the bank is non-viable, of at least 17% of RWAs.

The framework for defining products, services and customers which are either required to be within the ring-fenced bank or prohibited from it are subject to consultation, and will then be incorporated into draft legislation. Detailed rule making will also be required which will take place over an extended period, probably into 2015.

Regulatory investigations

Financial service providers are at risk of regulatory sanctions or fines related to conduct of business and financial crime. The incidence of regulatory and other adversarial proceedings against financial services firms is increasing. Various regulators and competitive and enforcement authorities are conducting investigations related to certain past submissions made by panel banks in connection with the setting of London interbank offered rates (‘LIBOR’) and other interbank offered rates. As certain group entities are members of such panels, the bank and/or its subsidiaries have been the subject of regulatory demands for information and are cooperating with their investigations.

Implementation risks of regulatory change

The extensive programme of regulatory change carries significant implementation risks for authorities and industry participants alike.

Disparities in implementation: Many official measures are proposals in development and negotiation, and have not yet been enacted into regional and national legislation. Linked to this, some regulators are adopting or considering changes in applying existing rules relating to capital requirements. These processes could result in differing, fragmented and overlapping implementation around the world, leading to risks of regulatory arbitrage, a far from level competitive playing-field and increased compliance costs.

Timetable and market expectations: While the Basel Committee has announced the timetable for its core proposals in Basel III, it remains uncertain how these and other measures will play out in practice. Meanwhile, market expectations will exert pressure on institutions to assess and effect compliance well in advance of official timetables.

Wider economic impact and unforeseen consequences: While the conclusions of official and industry studies have diverged, the measures proposed will clearly impact on financial and economic activity in ways that cannot yet be clearly foreseen. For example, higher capital requirements may seriously restrict the availability of funds for lending to support economic recovery.

Eurozone exposure

For the purpose of this disclosure, eurozone countries are members of the EU and part of the euro single currency bloc. The eurozone countries identified as peripheral exhibited during the period levels of market volatility which exceeded other eurozone countries and demonstrated fiscal or political uncertainty which may persist through the second half of 2012. In addition, certain of these countries exhibited high sovereign debt to GDP ratios, short to medium-term maturity concentration of their liabilities, or have sought bailout funding. They include Greece, Ireland, Italy, Portugal and Spain. In addition, on-balance sheet exposures for 'selected other eurozone' countries to which the group has material exposures are disclosed in a separate table below.

During the first half of 2012 exposures to the eurozone remained a key focus given the continued instability in the area and the potential for contagion spreading from the periphery to core eurozone countries. The unchanged high risk of sovereign defaults by the peripheral eurozone countries continues to place pressure on banks within the core European countries which are exposed to them. Although the group's exposure to the peripheral eurozone countries is relatively limited, exposure to counterparties in the core European countries can be impacted by any sovereign crisis.

The group regularly updates its assessment of higher risk countries and adjusts its risk appetite to reflect such changes. The group's exposure to the eurozone countries remained well diversified across asset classes, sectors and products.

Exposure to selected countries in the eurozone

The tables below summarise the group's exposures to governments and central banks of selected eurozone countries, and near/quasi-government agencies and banks domiciled in those countries. The category 'Held for trading' comprises trading assets. The category 'Not held for trading' comprises financial assets designated at fair value, derivatives, loans and advances to banks, loans and advances to customers and financial investments.

On-balance sheet exposure

	30 June 2012								
	Sovereign & Agencies			Banks			Total		
	Held for trading £bn	Not held for trading £bn	Total £bn	Held for Trading £bn	Not held for trading £bn	Total £bn	Held for trading £bn	Not held for trading £bn	Total £bn
Greece	-	-	-	-	0.1	0.1	-	0.1	0.1
Ireland	0.1	0.1	0.2	1.0	0.2	1.2	1.1	0.3	1.4
Italy	0.9	0.4	1.3	0.3	0.3	0.6	1.2	0.7	1.9
Portugal	0.3	-	0.3	-	0.3	0.3	0.3	0.3	0.6
Spain	(0.1)	0.3	0.2	1.1	0.3	1.4	1.0	0.6	1.6
Total	1.2	0.8	2.0	2.4	1.2	3.6	3.6	2.0	5.6

Off-balance sheet items

Off-balance sheet exposures mainly relate to the group's commitments to lend. In some instances limitations are imposed on a counterparty's ability to draw down on a facility. These limitations are governed by the legal documentation which differs from counterparty to counterparty. In the majority of cases the group is bound to fulfil commitments made to third parties.

Of the peripheral eurozone countries, the only material off-balance sheet exposure is a £0.6 billion exposure to Spain relating to commitments to sovereigns and agencies.

Summary of on-balance sheet exposures to selected other eurozone countries

	30 June 2012		
	Sovereign & Agencies £bn	Banks £bn	Total £bn
Germany	15.6	7.9	23.5
France	30.6	20.1	50.7
Netherlands	9.2	2.8	12.0
Total	55.4	30.8	86.2

Interim Management Report: Operating and Financial Review (continued)

Redenomination risk

As a result of the continuing distressed conditions experienced by the peripheral eurozone countries, there is an increased possibility of an exit of a member state from the eurozone. There is currently no established legal framework within the European treaties to facilitate such an event. Consequently, it is not possible to predict accurately the course of events and legal consequences that would ensue.

HSBC's current view is that there is a greater risk of HSBC being affected by an exit from the euro of Greece, Italy or Spain than from Ireland, Portugal or Cyprus, where the group's exposures are substantially lower.

Key risks associated with an exit by a eurozone member include:

Foreign exchange losses: Exit by a eurozone country from the euro would probably be accompanied by the passing of new laws establishing a new local currency and providing for a redenomination of euro-denominated assets into that new local currency.

The exit of a weaker eurozone country would result in an immediate devaluation of those assets and liabilities where the value of retranslated currency is less than their original euro carrying amount.

It is not possible to predict what the total consequential loss might be as it is uncertain which assets and liabilities would be legally re-denominated or by how much they would be devalued. However, in order to provide an indication of potential exposure based on balances as at 30 June 2012, the table below identifies assets and liabilities booked in the group's banking operations in Greece, Italy and Spain (described as 'in-country'). These assets and liabilities are predominantly comprised of loans and deposits arising from the group's commercial banking operations in these countries. The net assets represent the group's net funding exposure to those countries which the group considers most likely to be affected by a redenomination event.

In-country funding exposure as at 30 June 2012

	Denominated in:			
	Euros £bn	US Dollars £bn	Other Currencies £bn	Total £bn
Greece				
In-country assets	1.4	0.1	0.1	1.6
In-country liabilities	(0.9)	(0.5)	(0.1)	(1.5)
Net in-country funding	0.5	(0.4)	-	0.1
Off balance sheet exposure/hedging	(0.2)	0.2	0.1	0.1
Italy				
In-country assets	0.9	-	-	0.9
In-country liabilities[1]	(1.3)	-	-	(1.3)
Net in-country funding	(0.4)	-	-	(0.4)
Off balance sheet exposure	0.2	-	-	0.2
Spain				
In-country assets	2.1	0.5	-	2.6
In-country liabilities	(1.2)	(0.3)	-	(1.5)
Net in-country funding	0.9	0.2	-	1.1
Off balance sheet exposure	0.8	0.1	-	0.9

1 *In-country liabilities in Italy include liabilities issued under local law but booked outside the country.*

The table also identifies in-country off-balance sheet exposures as these are at risk of redenomination should they give rise to a balance sheet exposure in the future.

It is to be noted that this analysis can only be an indication as it does not include any exposures booked by the group outside the countries at risk which are connected with those countries (see 'external contracts' below).

External contracts redenomination risk: Contracts entered into between the group's businesses based outside a country exiting the euro with in-country counterparties, or with those otherwise closely connected with the relevant country, may be affected by redenomination. The effect is subject to a high level of uncertainty. Factors such as the country law under which the contract is documented, the group entity involved and the payment mechanism for settlement may all be relevant to this assessment. The consequences on external contracts of a disorderly exit or one sanctioned under EU law may also be very different.

The group has been identifying and monitoring potential redenomination risks and, where possible, taking steps with the potential to mitigate and/or reduce the group’s overall exposure to losses that might arise in the event of a redenomination. It should be emphasised, however, that a euro exit could take the form of a number of different scenarios giving rise to distinct legal consequences which could significantly alter the potential effectiveness of any steps taken, and it is accordingly not possible to predict with certainty how effective particular measures might be until they are tested against the precise circumstances of a redenomination event.

Risk management and contingency planning

The group has an established framework for dealing with counterparty and systemic crisis situations which is complimented by regular specific stress testing and scenario planning. The framework functions both at pre- and in-crisis situations and ensures that the group has detailed operational plans in case an adverse scenario materialises.

While the main focus continues to be Greece, the group also considers additional scenarios including contagion risk or the exit of a higher impact country. This includes the setting up of a Eurozone Major Incident Group which meets regularly, complemented by a regional Eurozone contingency plan covering all businesses and functions. The plan has been tested and considers payments, legal, client account, internal and external communication and regulatory and compliance issues associated with eurozone breakup.

In the course of 2012, the group has examined several scenarios reflecting developments in the eurozone. The group explored the potential first and second order impact from a range of eurozone scenarios. These scenarios increase in severity from an orderly Greece default and exit, to a scenario comprising default of several peripheral eurozone countries with the potential risk of further deterioration.

Management actions to mitigate the impact of such scenarios are kept under close review and if eurozone prospects continue to deteriorate, management will take action to reduce further the impact of such deterioration on its business.

Outlook

Sovereign yields in a number of eurozone countries remain elevated and without further concrete progress towards complementing the monetary union with fiscal union, financial strains and economic uncertainty will continue to weigh on economic activity. The group expects a contraction of GDP of 0.6 per cent in the eurozone in 2012.

UK economic activity has stagnated as the eurozone crisis and the ongoing fiscal austerity programmes in the UK contributed to weak consumption and restrained investment. The group expects the UK to grow by just 0.1 per cent in 2012 and the Bank of England to maintain interest rates at 0.5 per cent through the remainder of the year.

Interim Management Report: Operating and Financial Review (continued)

Business segment discussion

Profit before tax

	Half year to		
	30 June 2012	30 June 2011	31 December 2011
	£m	£m	£m
UK Retail Banking	**271**	843	704
Continental Europe Retail Banking	**228**	275	39
Global Banking and Markets	**626**	542	(636)
Private Banking	**260**	304	224
Other/Intersegment	**(628)**	(56)	872
	757	1,908	1,203

UK Retail Banking

	Half year to		
	30 June 2012	30 June 2011	31 December 2011
	£m	£m	£m
Net interest income	**1,835**	1,788	1,814
Net fee income	**890**	884	892
Net trading income	**39**	23	31
Other income	**53**	123	71
Net operating income before impairments and provisions	**2,817**	2,818	2,808
Loan impairment charges and credit risk provisions	**(301)**	(404)	(392)
Net operating income	**2,516**	2,414	2,416
Total operating expenses	**(2,246)**	(1,567)	(1,715)
Operating profit	**270**	847	701
Share of profit/(loss) of associates and joint ventures	**1**	(4)	3
Profit before tax	**271**	843	704

Overview

UK Retail Banking reported a profit before tax of £271 million, 68 per cent lower than the first half of 2011 and 62 per cent lower than the second half of 2011.

For UK Retail Banking, the following items are significant in comparison of the first half of 2012's results against 2011:

- provisions of £332 million in the first half of 2011 and £712 million in the first half of 2012, in respect of customer remediation programmes including the estimated redress for the possible mis-selling of PPI policies and interest rate protection products; and
- an accounting gain of £292 million resulting from legislative change in the inflation measure used to calculate the indexation of certain pension liabilities in May 2011.

Excluding the items above, UK Retail Banking profit before tax was £983 million, 11 per cent higher than the first half of 2011.

In Retail Banking and Wealth Management, progress continued on the strategy of building long-term sustainable relationships with target customers with particular focus on mortgage lending, customer service and innovation, such as further enhancements to the Global Investment Centre service in the period.

The group's share of new UK residential mortgage lending in the first half of 2012 was 11 per cent, above the group's total market share of 6 per cent and the 10 per cent share of new lending achieved in 2011. The average loan to value ratio of this new lending was 56 per cent. Mortgage balances increased by 7 per cent to £73 billion in the period. The group continued to support the UK housing market during the first half of 2012, advancing funds to allow 64,000 customers to purchase properties, including 15,000 first time buyers.

Interim Management Report: Operating and Financial Review (continued)

In Commercial Banking, further progress was made towards the business strategy of becoming the leading international trade and business bank. Trade business revenues increased 14 per cent as the value of import transactions remained broadly in line with the same period last year while export transactions grew by 19 per cent.

Commercial Banking continued to support UK businesses that trade or aspire to trade internationally during the period by launching the 'Global Connections' campaign and a £4 billion International SME fund, £2.7 billion of which was made available to customers in the first half of 2012. Since June 2011, Commercial Banking has grown its deposit base by 17 per cent and total net lending to UK businesses by 7 per cent.

Financial performance

The commentary that follows does not adjust for the significant items detailed above.

Net interest income increased by £47 million or 3 per cent, driven by continued growth in mortgages and commercial lending combined with the impact of wider asset margins. This was partially offset by the impact of lower unsecured loan balances as customers continued to pay-down debt.

Net fee income was broadly in line with the first half of 2011. Growth in fee income in Commercial Banking from Trade and Receivables Finance and Global Markets business was offset by lower fee income from wealth management and general insurance. In addition, as a result of having brought the provision of travel money services in-house, revenue previously reported as fee income is now recognised as trading income.

Trading income increased by £16 million, reflecting the impact of bringing the provision of travel money services in-house in June 2011.

Other income decreased by £70 million or 57 per cent primarily within wealth management due to the impact of the one-off gain arising from the change in methodology used in the recognition of insurance revenues in the first half of 2011. In addition, income was also impacted by lower levels of wealth insurance products sold in the period.

Loan impairment charges and other credit risk provisions decreased by £103 million or 25 per cent. In Retail Banking and Wealth Management, loan impairment charges decreased by £117 million or 53 per cent due to lower levels of delinquencies across both the secured and unsecured portfolios resulting from the continued focus on improving collections and the high quality of new business booked over the past four years. In Commercial Banking, loan impairment charges were £14 million or 8 per cent higher than the comparative period in 2011, due to specific impairments raised in respect of a small number of customers.

Given the weakened financial state of some commercial and personal customers, a continuation in the positive impairment trends remains sensitive to general economic activity. The potential impact from the eurozone crisis, interest rate rises, employment levels and a weakening in commercial real estate values and house prices could all have an impact on future impairment levels.

Total operating expenses increased by £679 million or 43 per cent. Excluding the £292 million accounting gain arising from changes in indexation of certain pension liabilities recognised in the first half of 2011, customer redress provisions of £712 million and £332 million in the first halves of 2012 and 2011 respectively and restructuring costs, operating expenses were broadly in line with the prior period. The strategic investment in people and infrastructure was funded by sustainable cost savings delivered through re-engineering business processes.

Continental Europe Retail Banking

	Half year to		
	30 June 2012 £m	30 June 2011 £m	31 December 2011 £m
Net interest income	**849**	886	889
Net fee income	**399**	383	383
Net trading income	**(8)**	15	(17)
Other income	**(74)**	11	(101)
Net operating income before impairments and provisions	**1,166**	1,295	1,154
Loan impairment charges and credit risk provisions	**(99)**	(73)	(139)
Net operating income	**1,067**	1,222	1,015
Total operating expenses	**(838)**	(947)	(976)
Operating profit	**229**	275	39
Share of (loss) of associates and joint ventures	**(1)**	-	-
Profit before tax	**228**	275	39

Profit before tax - by country

	30 June 2012 £m	30 June 2011 £m	31 December 2011 £m
France	**91**	155	8
Germany	**28**	38	30
Turkey	**54**	55	38
Malta	**33**	40	24
Russia	**3**	(29)	(2)
Other	**19**	16	(59)
Profit before tax	**228**	275	39

Overview

Continental Europe Retail reported a profit before tax of £228 million, 17 per cent lower than the first half of 2011 and 485 per cent higher than the second half of 2011. Performance in the first half of 2012 was impacted by the deterioration in Greece's credit environment and reduction in revenues relating to insurance present value in-force and non-qualifying hedges on France’s mortgage portfolio, owing to adverse movements in the financial markets.

In Retail Banking and Wealth Management performance was impacted by unfavourable fair value movements on non-qualifying hedges and insurance in France, and restructuring costs incurred after the exit from non-strategic markets in the second half of 2011. The group has completed the process of rationalising the business portfolio and exited from underperforming businesses with the closure of the Retail Banking and Wealth Management operations in Russia, Georgia, Hungary and Poland. In France and Malta, the franchises are being leveraged to accelerate growth in the Wealth Management business, while in Turkey, both asset and deposit balances and margins have grown through the acquisition of new Premier customers.

Commercial Banking continued to focus on international and intra-HSBC connectivity, particularly with Global Banking & Markets. Growth was delivered in Trade and Receivables Finance and Payments and Cash Management as the group continued to support customers who aspire to expand their businesses, particularly internationally. Commercial Banking commenced a process to position the business for sustainable growth through the re-alignment of customer portfolios and participation models across the region.

Financial performance

Net interest income decreased by £37 million or 4 per cent. In Retail Banking and Wealth Management net interest income was lower as asset margins in France were negatively impacted. This was partly compensated by the growth in both assets and liability balances and margins in Turkey following a sustained drive to attract Premier customers. Commercial Banking liability balances grew by 15 per cent compared to the same period last year.

Net fee income increased by £16 million or 4 per cent primarily due to lower commissions paid following the winding down of the insurance business in Ireland, partially offset by lower fees in France.

Interim Management Report: Operating and Financial Review (continued)

Trading income decreased by £23 million, primarily due to a negative fair value adjustment on a non-qualifying hedge on France's mortgage portfolio.

Other income was £85 million lower than the first half of 2011, mainly due to a reduction in insurance revenues as a result of PVIF adjustments and the winding down of the non-strategic insurance businesses in Ireland.

Loan impairment charges and other credit risk provisions increased by £26 million or 36 per cent compared with the first half of 2011, partly due to growth in Turkey's asset book but also as a result of the higher level of recoveries in the first half of 2011. The Commercial Banking increase was due to a number of individually assessed provisions in Turkey and Greece due to deterioration in the eurozone.

Total operating expenses decreased by £109 million or 12 per cent in the first half of 2012 primarily due to the restructuring costs incurred in exiting non-strategic markets during 2011 and reductions generated through sustainable cost saves.

Global Banking and Markets

	Half year to		
	30 June 2012 £m	30 June 2011 £m	31 December 2011 £m
Net interest income[1]	**464**	692	631
Net fee income	**256**	316	282
Net trading income	**1,182**	1,166	(83)
Other income	**574**	3	264
Net operating income before impairments and provisions	**2,476**	2,177	1,094
Loan impairment charges and credit risk provisions	**(269)**	(234)	(309)
Net operating income	**2,207**	1,943	785
Total operating expenses	**(1,578)**	(1,400)	(1,422)
Operating profit	**629**	543	(637)
Share of profit of associates and joint ventures	**(3)**	(1)	1
Profit before tax	**626**	542	(636)

Profit before tax - by country	**30 June 2012 £m**	30 June 2011 £m	31 December 2011 £m
UK	**200**	216	(521)
France	**213**	172	(286)
Germany	**79**	56	36
Turkey	**39**	27	44
Other	**95**	71	91
Profit before tax	**626**	542	(636)

1 *The bank's Balance Sheet Management business, reported within Global Banking and Markets, provides funding to the trading businesses. To report Global Banking and Markets trading income on a fully funded basis, net interest income and net trading income are grossed up to reflect internal funding transactions prior to their elimination in the Inter Segment column on Page 19.*

Overview

Global Banking and Markets reported a pre-tax profit of £626 million, 15 per cent higher than the first half of 2011 and 198 per cent higher than the second half of 2011.

Despite the continued turmoil in eurozone sovereign debt markets, performance in Rates improved as spreads on eurozone bonds tightened, notably in the first quarter following the ECB's announcement of the LTRO. In addition, Balance Sheet Management revenues in the UK benefited from higher gains on disposals resulting from structural interest rate risk management activities. Performance in Foreign Exchange was also stronger in the UK as a result of increased client flows, in part due to enhanced collaboration with Commercial Banking, and higher market volatility which led to an improved trading environment.

These movements were partly offset by unfavourable fair value movements on structured liabilities as spreads tightened, along with lower revenues from the legacy credit portfolio.

Interim Management Report: Operating and Financial Review (continued)

Financial performance

Net interest income decreased by £228 million or 33 per cent compared to the first half of 2011, mainly due to the decline in Balance Sheet Management revenues as yield curves continued to flatten and interest rates remained low, together with a reduction in the available-for-sale debt security portfolio as a result of disposals. Revenues were also lower in Credit and Lending as clients sought long-term funding from debt capital markets, and on the legacy credit portfolio as a reduction in portfolio size resulted in lower effective yields.

Net fee income decreased by £60 million or 19 per cent compared to the first half of 2011. Primary revenues in the Rates business declined as a result of a fall in market volumes of new covered debt issuances, while revenue in Equity Capital Markets also fell following a decline in transaction and market volumes in a challenging economic environment.

Trading income was £16 million or 1 per cent higher than the first half of 2011. Rates' trading revenues increased as spreads on eurozone bonds tightened, notably in the first quarter of 2012 following the ECB's announcement of the LTRO. Excluding Legacy credit, Credit trading revenues increased as credit spreads tightened resulting in gains on corporate bonds. Foreign Exchange revenues benefited from strong growth, driven by a rise in customer activity, in part due to enhanced collaboration with Commercial Banking, and higher market volatility which created a more favourable trading environment compared with the first half of 2011.

The above movements were partly offset by unfavourable fair value movements on structured liabilities mainly in Rates, along with lower revenues on the legacy credit portfolio primarily resulting from writedowns compared with releases in the first half of 2011. In Equities, lower trading revenues reflected a less favourable trading environment.

Other income increased by £571 million. Balance Sheet Management reported significantly higher gains on the disposal of available-for-sale debt securities as part of structural interest rate risk management activities. This was partly offset by higher impairment charges and lower realised gains on available-for-sale equity investments, and reported losses on the disposal of specific bond positions in the legacy credit portfolio.

Loan impairment charges and other credit risk provisions increased by £35 million or 15 per cent due to a small number of significant individually assessed provisions, together with a rise in loan impairment charges in the legacy credit business. This was partly offset by lower impairments on available-for-sale ABSs as losses arising in the underlying collateral pools generated lower charges and lower charges on Greek sovereign debt.

Total operating expenses in the first half of 2011 included a credit of £68 million resulting from a change in the inflation measure used to calculate the defined benefit obligation for deferred pensions in the UK. Excluding this, expenses increased by £110 million or 8 per cent driven by a customer redress provision relating to interest rate protection products and higher performance costs reflecting the increase in net operating income in the first half of 2012.

Private Banking

	Half year to		
	30 June 2012 £m	30 June 2011 £m	31 December 2011 £m
Net interest income	**347**	379	371
Net fee income	**340**	355	345
Net trading income	**156**	115	135
Other income	**11**	16	6
Net operating income before impairments and provisions	**854**	865	857
Loan impairment charges and credit risk provisions	**(4)**	(20)	(52)
Net operating income	**850**	845	805
Total operating expenses	**(589)**	(541)	(581)
Operating profit	**261**	304	224
Share of (loss) of associates and joint ventures	**(1)**	-	-
Profit before tax	**260**	304	224

Overview

Private Banking reported pre-tax profit of £260 million, 14 per cent lower than the first half of 2011 and 16 per cent higher than the second half of 2011. While revenues were broadly in line with those periods, expenses incurred in the first half of 2012 were higher due to customer redress provisions. This was partly countered by decreased loan impairment charges and credit risk provisions.

Private Banking has started to implement a new target operating model designed to enable it to manage the business globally, better service the needs of clients through the offering of an integrated global platform, and improve risk and compliance standards.

Financial performance

Net interest income decreased by £32 million or 8 per cent compared with the first half of 2011. While income benefited from improved spreads following the re-pricing of the loan book in the UK, revenues were impacted by the maturity of higher yielding investments amid the low interest rate environment. However this was largely offset in net trading income through arbitrage opportunities on funding swaps.

Net fee income decreased by £15 million or 4 per cent compared with the first half of 2011 following a fall in average assets under management, owing to adverse movements in the financial markets, net new money outflows and a lower number of clients.

Net trading income increased by £41 million or 36 per cent in the first half of 2012, from higher volumes of funding swap positions.

Other income was in line with the comparative period in 2011.

Loan impairment charges and other credit risk provisions decreased by £16 million compared with the first half of 2011, following the part release of an impairment charge made in the first half of 2011 in relation to Greek available-for-sale debt securities.

Total operating expenses increased by £48 million or 9 per cent compared with the first half of 2011, largely due to customer redress provisions of £32 million, and restructuring costs incurred to improve operational efficiencies.

Other

	Half year to		
	30 June 2012	30 June 2011	31 December 2011
	£m	£m	£m
Net interest (expense)/income	**(45)**	(49)	(44)
Net fee income/(expense)	**28**	28	32
Net trading (expense)/income	**(2)**	(23)	16
Change in credit spread on long-term debt	**(491)**	(11)	843
Other income	**59**	46	186
Net operating (expense)/income	**(451)**	(9)	1,033
Loan impairment charges and credit risk provisions	**-**	-	-
Net operating (expense)/income	**(451)**	(9)	1,033
Total operating expenses	**(177)**	(47)	(161)
Operating (loss)/profit	**(628)**	(56)	872
Share of loss of associates and joint ventures	**-**	-	-
(Loss)/profit before tax	**(628)**	(56)	872

Reported loss before tax in Other was £628 million, compared with a loss of £56 million in the first half of 2011 and a profit of £872 million in the second half of 2011.

Other includes:

- the change in own credit spread on long-term debt which resulted in a £491 million loss in the first half of 2012 compared with a loss of £11 million for the first half of 2011 and a profit of £843 million in the second half of 2011; and
- other operating income and operating expenses increased as a result of higher intra-group recharges in line with the increase in costs from centralised operational and migrated activities.

Interim Management Report: Operating and Financial Review (continued)

Overall segmental analysis

	UK Retail £m	Continental Europe Retail £m	Global Banking and Markets £m	Private Banking £m	Other £m	Inter Segment £m	Total £m
Net Operating Income							
Half year to:							
30 June 2012	**2,516**	**1,067**	**2,207**	**850**	**(451)**	**(50)**	**6,139**
30 June 2011	2,414	1,222	1,943	845	(9)	(7)	6,408
31 December 2011	2,416	1,015	785	805	1,033	(62)	5,992
Profit before tax							
Half year to:							
30 June 2012	**271**	**228**	**626**	**260**	**(628)**	**-**	**757**
30 June 2011	843	275	542	304	(56)	-	1,908
31 December 2011	704	39	(636)	224	872	-	1,203

Statement of Directors' Responsibilities

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 and bank have the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on the going concern basis.

We confirm that to the best of our knowledge:

- the condensed set of financial statements has been prepared in accordance with IAS 34 'Interim Financial Reporting' as adopted by the EU;
- the interim management report includes a fair review of the information required by:

  (a) DTR 4.2.7R of the Disclosure and Transparency Rules, being an indication of important events that have occurred during the first six months of the current financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the financial year; and

  (b) DTR 4.2.8R of the Disclosure and Transparency Rules, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the group during that period; and any changes in the related party transactions described in the last annual report that could do so.

A A Flockhart (Chairman); B Robertson (Chief Executive); P Antika (Non-Executive Director); P W Boyles (Director); J D Garner (Director); Dame Denise Holt (Independent Non-Executive Director); S W Leathes (Independent Non-Executive Director); J W Leng (Non-Executive Director); Dame Mary Marsh (Independent Non-Executive Director); R E S Martin (Independent Non-Executive Director); A R D Monro-Davies (Independent Non-Executive Director); T B Moulonguet (Independent Non-Executive Director); P M Shawyer (Independent Non-Executive Director); A P Simoes (Director); J F Trueman (Independent Non-Executive Director).

On behalf of the Board, B Robertson (Chief Executive) 30 July 2012

Condensed Financial Statements (unaudited)

Consolidated income statement for the half-year to 30 June 2012

		Half-year to	
	Notes	**30 June 2012 £m**	30 June 2011 £m
Interest income		**5,475**	5,524
Interest expense		**(2,025)**	(1,902)
Net interest income		**3,450**	3,622
Fee income		**2,597**	2,657
Fee expense		**(684)**	(691)
Net fee income		**1,913**	1,966
Trading income excluding net interest income		**894**	885
Net interest income on trading activities		**480**	494
Net trading income		**1,374**	1,379
Net expense from financial instruments designated at fair value		**(61)**	(70)
Gains less losses from financial investments		**295**	128
Dividend income		**9**	10
Net earned insurance premiums		**1,180**	1,479
Other operating income		**26**	171
Total operating income		**8,186**	8,685
Net insurance claims incurred and movement in liabilities to policyholders		**(1,373)**	(1,546)
Net operating income before loan impairment charges and other credit risk provisions		**6,813**	7,139
Loan impairment charges and other credit risk provisions	*4*	**(674)**	(731)
Net operating income		**6,139**	6,408
Employee compensation and benefits	*5*	**(2,649)**	(2,165)
General and administrative expenses		**(2,476)**	(2,047)
Depreciation and impairment of property, plant and equipment		**(168)**	(182)
Amortisation and impairment of intangible assets		**(85)**	(101)
Total operating expenses		**(5,378)**	(4,495)
Operating profit		**761**	1,913
Share of loss in associates and joint ventures		**(4)**	(5)
Profit before tax		**757**	1,908
Tax credit/(expense)		**29**	(473)
Profit for the period		**786**	1,435
Profit attributable to shareholders of the parent company		**762**	1,407
Profit attributable to non-controlling interests		**24**	28

Condensed Financial Statements (unaudited) (continued)

Consolidated statement of comprehensive income for the half-year to 30 June 2012

	Half-year to	
	30 June 2012	30 June 2011
	£m	£m
Profit for the period	**786**	1,435
Other comprehensive income		
Available-for-sale investments:		
– fair value gains	**1,168**	512
– fair value gains transferred to the income statement on disposal	**(231)**	(74)
– amounts transferred to the income statement in respect of impairment losses	**284**	176
– income taxes	**(45)**	72
Cash flow hedges:		
– fair value gains	**136**	80
– fair value gains transferred to the income statement	**(83)**	(163)
– income taxes	**(12)**	30
Actuarial (losses)/gains on defined benefit plans		
– before income taxes	**(98)**	71
– income taxes	**22**	(34)
Exchange differences and other	**(415)**	768
Other comprehensive income for the period, net of tax	**726**	1,438
Total comprehensive income for the period	**1,512**	2,873
Total comprehensive income for the period attributable to:		
– shareholders of the parent company	**1,504**	2,836
– non-controlling interests	**8**	37
	1,512	2,873

Condensed Financial Statements (unaudited) (continued)

Consolidated statement of financial position at 30 June 2012

	Notes	At 30 June 2012 £m	At 31 December 2011 £m
ASSETS			
Cash and balances at central banks		**70,332**	56,460
Items in the course of collection from other banks		**2,143**	1,663
Trading assets	*6*	**161,606**	126,598
Financial assets designated at fair value	*6*	**15,856**	15,332
Derivatives	*6*	**181,261**	176,993
Loans and advances to banks	*4,6*	**47,227**	44,603
Loans and advances to customers	*4,6*	**291,804**	288,014
Financial investments	*6*	**84,063**	93,112
Other assets		**6,178**	7,137
Current tax assets		**559**	262
Prepayments and accrued income		**2,706**	2,937
Interests in associates and joint ventures		**71**	76
Goodwill and intangible assets		**10,741**	10,995
Property, plant and equipment		**2,163**	2,204
Deferred tax assets		**81**	140
Retirement benefit assets		**1,414**	1,444
Total assets		**878,205**	827,970
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	*6*	**48,504**	41,032
Customer accounts	*6*	**364,568**	346,129
Items in the course of transmission to other banks		**1,357**	1,154
Trading liabilities	*6*	**134,800**	119,211
Financial liabilities designated at fair value	*6*	**32,403**	31,992
Derivatives	*6*	**183,221**	178,121
Debt securities in issue	*6*	**42,280**	42,688
Other liabilities		**5,975**	4,570
Current tax liabilities		**139**	131
Liabilities under insurance contracts issued		**16,583**	16,347
Accruals and deferred income		**3,218**	3,509
Provisions	*7*	**1,379**	820
Deferred tax liabilities		**283**	266
Retirement benefit liabilities		**432**	398
Subordinated liabilities	*6*	**10,209**	9,998
Total liabilities		**845,351**	796,366
Equity			
Called up share capital		**797**	797
Share premium account		**20,025**	20,025
Other reserves		**275**	(537)
Retained earnings		**11,250**	10,805
Total equity attributable to shareholders of the parent company		**32,347**	31,090
Non-controlling interests		**507**	514
Total equity		**32,854**	31,604
Total equity and liabilities		**878,205**	827,970

Condensed Financial Statements (unaudited) (continued)

Consolidated statement of cash flows for the half-year to 30 June 2012

	Half-year to	
	30 June 2012 £m	30 June 2011 £m
Cash flows from operating activities		
Profit before tax	**757**	1,908
Adjustments for:		
– non-cash items included in profit before tax	**2,341**	1,296
– change in operating assets	**(21,994)**	(27,390)
– change in operating liabilities	**27,216**	29,739
– elimination of exchange differences[1]	**3,312**	(1,531)
– net gain from investing activities	**(315)**	(144)
– share of losses in associates and joint ventures	**4**	5
– contributions paid to defined benefit pension plans	**(95)**	(90)
– tax paid	**(206)**	(402)
Net cash generated from operating activities	**11,020**	3,391
Cash flows used in investing activities		
Purchase of financial investments	**(21,129)**	(41,207)
Proceeds from the sale and maturity of financial investments	**30,243**	39,643
Purchase of property, plant and equipment	**(162)**	(160)
Proceeds from the sale of property, plant and equipment	**34**	25
Purchase of intangible assets	**(117)**	(138)
Proceeds from the sale of intangible assets	**–**	2
Net cash outflow from acquisition of associates	**–**	(2)
Proceeds from disposal of associates	**–**	13
Purchase of HSBC Holdings plc shares to satisfy share-based payment transactions	**–**	(27)
Net cash used in investing activities	**8,869**	(1,851)
Cash flows used in financing activities		
Subordinated liabilities issued, net of perpetual subordinated debt classified as equity repaid	**350**	1,226
Subordinated liabilities repaid	**(350)**	(1,407)
Net cash outflow from change in stake of subsidiaries	**(2)**	–
Dividends paid to shareholders of the parent company	**(200)**	(974)
Dividends paid to non-controlling interests	**(15)**	(25)
Net cash used in financing activities	**(217)**	(1,180)
Net increase in cash and cash equivalents	**19,672**	360
Cash and cash equivalents at 1 January	**108,440**	86,005
Exchange differences in respect of cash and cash equivalents	**(2,560)**	2,175
Cash and cash equivalents at 30 June	**125,552**	88,540

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

Consolidated statement of changes in equity for the half-year to 30 June 2012

	Half-year to 30 June 2012									
					Other reserves					
	Called up share capital £m	Share premium £m	Other equity instruments £m	Retained earnings £m	Available-for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Total share-holders' equity £m	Non-controlling interests £m	Total equity £m
At 1 January 2012	797	20,025	–	10,805	(2,793)	236	2,020	31,090	514	31,604
Profit for the period	–	–	–	762	–	–	–	762	24	786
Other comprehensive income (net of tax)	–	–	–	(70)	1,170	41	(399)	742	(16)	726
Available-for-sale investments	–	–	–	–	1,170	–	–	1,170	6	1,176
Cash flow hedges	–	–	–	–	–	41	–	41	–	41
Actuarial (losses)/gains on defined benefit plans	–	–	–	(70)	–	–	–	(70)	(6)	(76)
Exchange differences and other	–	–	–	–	–	–	(399)	(399)	(16)	(415)
Total comprehensive income for the period	–	–	–	692	1,170	41	(399)	1,504	8	1,512
Dividends to shareholders	–	–	–	(200)	–	–	–	(200)	(15)	(215)
Net impact of equity-settled share-based payments	–	–	–	(52)	–	–	–	(52)	–	(52)
Other movements	–	–	–	5	–	–	–	5	–	5
Tax on items taken directly to equity	–	–	–	–	–	–	–	–	–	–
At 30 June 2012	797	20,025	–	11,250	(1,623)	277	1,621	32,347	507	32,854

	Called up share capital £m	Share premium £m	Other equity instruments £m	Retained earnings £m	Available-for-sale fair value reserve £m	Cash flow hedging reserve £m	Foreign exchange reserve £m	Total share-holders' equity £m	Non-controlling interests £m	Total equity £m
	Half-year to 30 June 2011									
					Other reserves					
At 1 January 2011	797	20,025	1,750	9,473	(2,949)	190	2,539	31,825	532	32,357
Profit for the period	–	–	–	1,407	–	–	–	1,407	28	1,435
Other comprehensive income (net of tax)	–	–	–	38	689	(53)	755	1,429	9	1,438
Available-for-sale investments	–	–	–	–	689	–	–	689	(3)	686
Cash flow hedges	–	–	–	–	–	(53)	–	(53)	–	(53)
Actuarial gains/(losses) on defined benefit plans	–	–	–	38	–	–	–	38	(1)	37
Exchange differences and other	–	–	–	–	–	–	755	755	13	768
Total comprehensive income for the period	–	–	–	1,445	689	(53)	755	2,836	37	2,873
Dividends to shareholders	–	–	–	(974)	–	–	–	(974)	(25)	(999)
Net impact of equity-settled share-based payments	–	–	–	38	–	–	–	38	–	38
Repayment of capital securities[1]	–	–	(1,750)	(6)	–	–	–	(1,756)	–	(1,756)
Other movements	–	–	–	(7)	3	–	3	(1)	–	(1)
Tax on items taken directly to equity	–	–	–	16	–	–	–	16	–	16
At 30 June 2011	797	20,025	–	9,985	(2,257)	137	3,297	31,984	544	32,528

1 *In March 2011, the bank repaid to HSBC Holdings plc £1,750 million of perpetual subordinated debt. At the same time, the bank issued US dollar denominated perpetual subordinated debt of $2,862 million to HSBC Holdings plc, which is included in 'Subordinated liabilities'.*

Notes on the Condensed Financial Statements (unaudited)

1 Basis of preparation

(a) Compliance with International Financial Reporting Standards

The interim consolidated financial statements of the group have been prepared in accordance with the Disclosure Rules and Transparency Rules of the Financial Services Authority and IAS 34 'Interim Financial Reporting' ('IAS 34') as issued by the International Accounting Standards Board ('IASB') and as endorsed by the European Union ('EU').

The consolidated financial statements of the group at 31 December 2011 were prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the IASB and as endorsed by the EU. EU-endorsed IFRSs may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2011, there were no unendorsed standards effective for the year ended 31 December 2011 affecting the consolidated financial statements at that date, 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 2011 were prepared in accordance with IFRSs as issued by the IASB.

At 30 June 2012, there were no unendorsed standards effective for the period ended 30 June 2012 affecting these interim consolidated 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.

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

During the period ended 30 June 2012, the group adopted a number of interpretations and amendments to standards which had an insignificant effect on these interim consolidated financial statements.

(b) Comparative information

These interim consolidated financial statements include comparative information as required by IAS 34 and the UK Disclosure and Transparency Rules.

(c) Use of estimates and assumptions

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates; actual results in the future may differ from those reported. Management believes that the group's critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances, goodwill impairment, the valuation of financial instruments, the impairment of available-for-sale financial assets and pensions. These critical accounting policies are described on pages 119 to 122 of the *Annual Report and Accounts 2011*.

(d) Consolidation

The interim consolidated financial statements of the group comprise the condensed financial statements of HSBC Bank plc and its subsidiaries. The method adopted by the group to consolidate its subsidiaries is described on pages 99 to 100 of the *Annual Report and Accounts 2011*.

(e) Future accounting developments

Future accounting developments are consistent with those described on pages 100 to 102 of the *Annual Report and Accounts 2011*, except that: (i) the amendments to IAS 19 'Employee Benefits' issued by the IASB in June 2011 were endorsed by the EU in the first half of 2012; (ii) based on the group's assessment to date, the group does not expect IFRS 10 'Consolidated Financial Instruments' and IFRS 11 'Joint Arrangements' to have a material effect on the group's financial statements; and (iii) the IASB re-opened the requirements for classification and measurement in IFRS 9 'Financial Instruments' in the first half of 2012 to address practice and other issues, with an exposure draft of revised proposals expected in the second half of 2012. Therefore, the group remains unable to provide a date by which it plans to apply IFRS 9 and it remains impracticable to quantify the effect of IFRS 9 as at the date of publication of these financial statements.

(f) Changes in composition of the group

There were no material changes in the composition of the group in the period.

Notes on the Condensed Financial Statements (unaudited) (continued)

2 Accounting policies

The accounting policies adopted by the group for these interim consolidated financial statements are consistent with those described on pages 102 to 119 of the *Annual Report and Accounts 2011,* except as discussed in Note 1, 'Basis of preparation'. The methods of computation applied by the group for these interim consolidated financial statements are consistent with those applied for the *Annual Report and Accounts 2011.*

3 Dividends

HSBC Bank plc dividends to shareholders of the parent company were as follows:

Dividends declared on ordinary shares

	Half-year to					
	30 June 2012		30 June 2011		31 December 2011	
	£ per share	**Total £m**	£ per share	Total £m	£ per share	Total £m
In respect of previous year:						
– second interim dividend	**0.25**	**200**	1.15	915	–	–
In respect of current year:						
– first interim dividend	**–**	**–**	–	–	1.00	800
	0.25	**200**	1.15	915	1.00	800

Dividends on preference shares classified as equity

In the first half of 2012 no dividend was paid on the HSBC Bank plc non-cumulative third dollar preference shares (first half of 2011: no dividend; second half of 2011: £1.17 per share, totalling £41 million).

4 Loan impairment charges and other credit risk provisions

	Half-year to	
	30 June 2012 £m	30 June 2011 £m
Total loans and advances		
– new allowances net of allowance releases	**659**	705
– recoveries of amounts previously written off	**(101)**	(173)
	558	532
Impairment charges on debt securities and other credit risk provisions	**116**	199
	674	731

Movement in impairment allowances on total loans and advances

	Individually assessed £m	**Collectively assessed £m**	**Total £m**
At 1 January 2012	**2,461**	**920**	**3,381**
Amounts written off	**(436)**	**(256)**	**(692)**
Recoveries of amounts previously written off	**14**	**87**	**101**
Charge to income statement	**411**	**147**	**558**
Foreign exchange and other movements	**(58)**	**20**	**(38)**
At 30 June 2012	**2,392**	**918**	**3,310**
At 1 January 2011	2,298	1,282	3,580
Amounts written off	(355)	(658)	(1,013)
Recoveries of amounts previously written off	15	158	173
Charge to income statement	279	253	532
Foreign exchange and other movements	19	(10)	9
At 30 June 2011	2,256	1,025	3,281

Notes on the Condensed Financial Statements (unaudited) (continued)

5 Post-employment benefits

Included within 'Employee compensation and benefits' are components of net periodic benefit cost related to the group's defined benefit pension plans and other post-employment benefits, as follows:

	Half-year to	
	30 June 2012	30 June 2011
	£m	£m
Current service cost	**97**	96
Interest cost	**385**	408
Expected return on plan assets	**(408)**	(430)
Other losses/(gains)	**2**	(358)
Total expense/(gain)	**76**	(284)

The group revalues its defined benefit post-employment plans each year at 31 December, in consultation with the plans' local actuaries. The assumptions underlying the calculations are used to determine the expected income statement charge for the following year.

At 30 June each year, the group revalues all plan assets to current market prices. The group also reviews the assumptions used to calculate the defined benefit obligations (the liabilities of the plans) and updates the carrying amount of the obligations if there have been significant changes as a consequence of changes in assumptions.

In the first half of 2012, there was a reduction in the average yields of high quality (AA rated or equivalent) debt instruments in the UK, together with a decrease in inflation expectations. The group has, therefore, revalued certain plan obligations where the impact has been significant. The change in these and other actuarial assumptions resulted in a £312 million decrease in the defined benefit obligation for the HSBC Bank (UK) Pension Scheme ('the Scheme'). This decrease was recognised directly in equity as an actuarial gain.

The actual return on plan assets of the Scheme was approximately £365 million below the expected return. This difference was recognised directly in equity as an actuarial loss.

Move to using the Consumer Prices Index

In May 2011, the Trustee communicated to Scheme members the impact on Scheme benefits of the UK government's intention to move to using the Consumer Prices Index ('CPI') rather than the Retail Prices Index ('RPI') as the inflation measure for determining the minimum pension increases to be applied to the statutory index-linked features of retirement benefits. At 30 June 2011, the bank used CPI in calculating the pension liability recognised, which resulted in a reduction of the Scheme's liabilities, in respect of deferred pensioners, of £360 million. A corresponding gain was recognised in the income statement, as a credit within 'Employee compensation and benefits'.

6 Fair values of financial instruments

Fair values are determined in accordance with the methodology set out in the *Annual Report and Accounts 2011* in the accounting policies on pages 102 to 122, and in Note 31 and Note 32 on pages 176 to 185.

Bases of valuing financial assets and liabilities measured at fair value

	Valuation techniques			
	Level 1 quoted market price	**Level 2 using observable inputs**	**Level 3 with significant unobservable inputs**	**Total**
	£m	**£m**	**£m**	**£m**
At 30 June 2012				
Assets				
Trading assets	**95,661**	**65,437**	**508**	**161,606**
Financial assets designated at fair value	**10,166**	**5,690**	**–**	**15,856**
Derivatives	**301**	**179,503**	**1,457**	**181,261**
Financial investments: available-for-sale	**53,799**	**24,417**	**2,171**	**80,387**
Liabilities				
Trading liabilities	**71,723**	**61,522**	**1,555**	**134,800**
Financial liabilities designated at fair value	**3,757**	**28,646**	**–**	**32,403**
Derivatives	**299**	**181,416**	**1,506**	**183,221**

Notes on the Condensed Financial Statements (unaudited) (continued)

	Valuation techniques			
	Level 1 quoted market price £m	Level 2 using observable inputs £m	Level 3 with significant unobservable inputs £m	Total £m
At 31 December 2011				
Assets				
Trading assets	72,839	52,981	778	126,598
Financial assets designated at fair value	9,126	6,206	-	15,332
Derivatives	383	175,055	1,555	176,993
Financial investments: available-for-sale	59,707	26,905	2,349	88,961
Liabilities				
Trading liabilities	48,435	69,072	1,704	119,211
Financial liabilities desingated at fair value	3,787	28,205	-	31,992
Derivatives	635	175,783	1,703	178,121

Level 3 trading assets include various asset-backed securities, leveraged loans underwritten by the group and corporate and mortgage loans held for securitisation.

Level 3 derivative products include certain types of correlation products, particularly equity and foreign exchange basket options and foreign exchange-interest rate hybrid transactions, long-dated option transactions, particularly equity options, interest rate and foreign exchange options and certain credit derivatives, including tranched credit default swap transactions and credit derivatives executed with certain monoline insurers.

Level 3 available-for-sale financial investments and financial assets designated at fair value include holdings of private equity and asset-backed securities.

Fair values of financial instruments not carried at fair value

	30 June 2012		31 December 2011	
	Carrying amount £m	**Fair Value £m**	Carrying amount £m	Fair Value £m
Assets				
Loans and advances to banks	**47,227**	**47,217**	44,603	44,588
Loans and advances to customers	**291,804**	**286,259**	288,014	282,813
Financial investments: debt securities	**3,676**	**3,794**	4,151	4,204
Liabilities				
Deposits by banks	**48,504**	**48,504**	41,032	41,032
Customer accounts	**364,568**	**364,612**	346,129	346,184
Debt securities in issue	**42,280**	**42,220**	42,688	42,661
Subordinated liabilities	**10,209**	**9,434**	9,998	9,266

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

7 Provisions

Provisions of £1,379 million (31 December 2011: £820 million) include £1,043 million (31 December 2011: £483 million) in respect of customer redress programmes. The most significant of these provisions are as follows:

(i) £601 million (31 December 2011: £262 million) for the group relating to the estimated liability for redress in respect of the possible mis-selling of Payment Protection Insurance ('PPI') policies in previous years. An increase in provisions of £571 million was recognised during the half-year ended 30 June 2012. Cumulative provisions made since the Judicial Review ruling in the first half of 2011 amount to £966 million of which £412 million has been paid.

The main assumptions are the number of customer complaints expected to be received, and for how long a period; the number of non-complainant customers who will have to be contacted if systemic issues are identified following root cause analysis; the response rate from customers who are contacted pro-actively; and the

Notes on the Condensed Financial Statements (unaudited) (continued)

expected uphold rate for complaints and the amount of redress payable in upheld cases. The main assumptions are likely to evolve over time as root cause analysis is completed and more experience is available regarding actual complaint volumes received.

In addition to these factors and assumptions, the extent of the required redress will also depend on the facts and circumstances of each individual customer's case. For these reasons, there is currently a high degree of uncertainty as to the eventual costs of redress for this matter.

During the first half of 2012, the group increased the estimate of the total number of policies to be ultimately redressed, as the level of complaints received was higher in volume and for a longer period than previously assumed. This change in assumptions contributed approximately £0.4 billion to the increased provision during the half.

(ii) £150 million (31 December 2011: £nil) relating to the estimated liability for redress in respect of the possible mis-selling of interest rate derivatives in the UK.

Following a FSA review of the sale of interest rate derivatives, the group agreed with the FSA to pay redress to customers where mis-selling of more complex derivatives has occurred. The group will contact customers who have been sold certain interest rate derivatives, explaining the scope of the contact exercise, and either advising that their product sale will be automatically reviewed, or seeking confirmation from the customer that they wish to have their derivative sale reviewed and requesting further details of the sale.

The extent to which the group is required to pay redress depends on the responses of contacted and other customers during the review period and the facts and circumstances of each individual case. For these reasons, there is currently a high degree of uncertainty as to the eventual costs of redress related to this programme.

8 Credit quality of financial instruments

The five credit quality classifications set out and defined on pages 43 to 44 of the *Annual Report and Accounts 2011* describe the credit quality of the group's lending, debt securities portfolios and derivatives. These classifications each encompass a range of more granular, internal credit rating grades assigned to wholesale and retail lending businesses, as well as the external ratings attributed by external agencies to debt securities. There is no direct correlation between internal and external ratings at granular level, except to the extent each falls within a single quality classification.

The following tables set out the group's distribution of financial instruments by measures of credit quality.

Notes on the Condensed Financial Statements (unaudited) (continued)

	30 June 2012							
	Neither past due nor impaired							
		Medium						
	Strong £m	Good £m	Satisfactory £m	Sub-standard £m	Past due not impaired £m	Impaired £m	Impairment allowances £m	Total £m
Cash and balances at central banks	**70,332**	**–**	**–**	**–**	**–**	**–**	**–**	**70,332**
Items in the course of collection from other banks	**2,143**	**–**	**–**	**–**	**–**	**–**	**–**	**2,143**
Trading assets	**106,105**	**19,855**	**18,744**	**189**	**–**	**–**	**–**	**144,893**
– treasury and other eligible bills	**1,465**	**488**	**337**	**–**	**–**	**–**	**–**	**2,290**
– debt securities	**38,703**	**6,350**	**5,083**	**131**	**–**	**–**	**–**	**50,267**
– loans and advances to banks	**28,714**	**7,271**	**4,529**	**53**	**–**	**–**	**–**	**40,567**
– loans and advances to customers	**37,223**	**5,746**	**8,795**	**5**	**–**	**–**	**–**	**51,769**
Financial assets designated at fair value	**4,011**	**406**	**4,467**	**9**	**–**	**–**	**–**	**8,893**
– treasury and other eligible bills	**3**	**–**	**1**	**–**	**–**	**–**	**–**	**4**
– debt securities	**3,976**	**406**	**4,443**	**9**	**–**	**–**	**–**	**8,834**
– loans and advances to banks	**32**	**–**	**23**	**–**	**–**	**–**	**–**	**55**
– loans and advances to customers	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Derivatives	**141,957**	**22,978**	**14,996**	**1,330**	**–**	**–**	**–**	**181,261**
Loans and advances held at amortised cost	**185,438**	**70,802**	**69,362**	**8,419**	**1,395**	**6,925**	**(3,310)**	**339,031**
– loans and advances to banks	**39,565**	**5,018**	**2,494**	**138**	**–**	**37**	**(25)**	**47,227**
– loans and advances to customers	**145,873**	**65,784**	**66,868**	**8,281**	**1,395**	**6,888**	**(3,285)**	**291,804**
Financial investments	**71,699**	**4,149**	**3,909**	**1,784**	**–**	**1,388**	**–**	**82,929**
– treasury and other similar bills	**4,107**	**410**	**644**	**–**	**–**	**–**	**–**	**5,161**
– debt securities	**67,592**	**3,739**	**3,265**	**1,784**	**–**	**1,388**	**–**	**77,768**
Other assets	**4,610**	**358**	**1,908**	**335**	**16**	**15**	**–**	**7,242**
– endorsements and acceptances	**441**	**22**	**365**	**–**	**–**	**–**	**–**	**828**
– accrued income and other	**4,169**	**336**	**1,543**	**335**	**16**	**15**	**–**	**6,414**

Notes on the Condensed Financial Statements (unaudited) (continued)

	31 December 2011							
	Neither past due nor impaired							
		Medium						
	Strong	Good	Satisfactory	Sub-standard	Past due not impaired	Impaired	Impairment allowances	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Cash and balances at central banks	56,460	–	–	–	–	–	–	56,460
Items in the course of collection from other banks	1,663	–	–	–	–	–	–	1,663
Trading assets	95,586	9,538	8,839	694	–	–	–	114,657
– treasury and other eligible bills	1,205	12	79	5	–	–	–	1,301
– debt securities	45,633	1,769	3,573	311	–	–	–	51,286
– loans and advances to banks	21,108	6,209	2,640	378	–	–	–	30,335
– loans and advances to customers	27,640	1,548	2,547	–	–	–	–	31,735
Financial assets designated at fair value	3,206	119	4,529	2	–	–	–	7,856
– treasury and other eligible bills	5	–	–	–	–	–	–	5
– debt securities	2,669	119	4,495	2	–	–	–	7,285
– loans and advances to banks	36	–	34	–	–	–	–	70
– loans and advances to customers	496	–	–	–	–	–	–	496
Derivatives	147,277	19,776	9,108	832	–	–	–	176,993
Loans and advances held at amortised cost	190,059	66,882	61,372	8,946	1,225	7,514	(3,381)	332,617
– loans and advances to banks	40,747	2,729	1,077	35	–	47	(32)	44,603
– loans and advances to customers	149,312	64,153	60,295	8,911	1,225	7,467	(3,349)	288,014
Financial investments	81,868	3,690	3,128	1,776	–	1,426	–	91,888
– treasury and other similar bills	6,156	485	74	22	–	–	–	6,737
– debt securities	75,712	3,205	3,054	1,754	–	1,426	–	85,151
Other assets	5,313	336	2,456	350	20	19	–	8,494
– endorsements and acceptances	384	15	331	–	–	–	–	730
– accrued income and other	4,929	321	2,125	350	20	19	–	7,764

Notes on the Condensed Financial Statements (unaudited) (continued)

9 Contingent liabilities, contractual commitments and guarantees

	At 30 June 2012 £m	At 31 December 2011 £m
Guarantees and other contingent liabilities		
Guarantees	**17,798**	17,510
Other contingent liabilities	**83**	88
	17,881	17,598
Commitments		
Documentary credits and short-term trade-related transactions	**2,540**	2,436
Forward asset purchases and forward deposits placed	**18**	21
Undrawn formal standby facilities, credit lines and other commitments to lend	**115,641**	118,424
	118,199	120,881

The above table discloses the nominal principal amounts of commitments, guarantees and other contingent liabilities. 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. As a significant proportion of guarantees and commitments is expected to expire without being drawn upon, the total of the nominal principal amounts is not representative of future liquidity requirements. Contingent liabilities arising from legal proceedings and regulatory matters are disclosed in Note 11.

Financial Services Compensation Scheme

The UK Financial Services Compensation Scheme ('FSCS') has provided compensation to consumers following the collapse of a number of deposit takers. The financial impact on the bank, the basis for estimating costs, and the uncertainties involved in estimating the ultimate FSCS levy to the industry, remain consistent with those disclosed on page 192 of the *Annual Report and Accounts 2011*.

Guarantees and other commitments

The principal types of guarantees generally provided in the normal course of the group's banking business, and other contractual commitments, are consistent with those detailed on page 193 of the *Annual Report & Accounts 2011*.

10 Related party transactions

Pension scheme swap transactions

The HSBC Bank (UK) Pension Scheme ('the Scheme') enters into swap transactions with the bank to manage the inflation and interest rate sensitivity of the liabilities. At 30 June 2012, the gross notional value of the swaps was £17,826 million (31 December 2011: £16,056 million), the swaps had a negative fair value of £3,122 million to the bank (31 December 2011: negative fair value £3,591 million) and the bank had delivered collateral of £4,100 million (31 December 2011: £4,451 million) to the Scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid/offer spreads.

11 Legal proceedings, investigations and regulatory matters

The group is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of its normal business operations. Apart from the matters described below, the group considers that none of these matters is material, either individually or in the aggregate. The group recognises a provision for a liability in relation to these matters when it is probable that an outflow of economic benefits will be required to settle an obligation which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation. While the outcome of these matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made in respect of legal proceedings as at 30 June 2012.

Notes on the Condensed Financial Statements (unaudited) (continued)

Bernard L. Madoff Investment Securities LLC

In December 2008, Bernard L. Madoff ('Madoff') was arrested for running a Ponzi scheme and a trustee was appointed for the liquidation of his firm, Bernard L. Madoff Investment Securities LLC ('Madoff Securities'), an SEC-registered broker-dealer and investment adviser. Since his appointment, the trustee has been recovering assets and processing claims of Madoff Securities customers. Madoff subsequently pleaded guilty to various charges and is serving a 150 year prison sentence. He has acknowledged, in essence, that while purporting to invest his customers' money in securities and, upon request, return their profits and principal, he in fact never invested in securities and used other customers' money to fulfil requests for the return of profits and principal. The relevant US authorities are continuing their investigations into his fraud, and have brought charges against others, including certain former employees and the former auditor of Madoff Securities.

Various non-US HSBC companies provided custodial, administration and similar services to a number of funds incorporated outside the US whose assets were invested with Madoff Securities. Based on information provided by Madoff Securities, as at 30 November 2008, the purported aggregate value of these funds was US$8.4bn, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC to date, we estimate that the funds' actual transfers to Madoff Securities minus their actual withdrawals from Madoff Securities during the time that HSBC serviced the funds totalled approximately US$4bn.

Plaintiffs (including funds, fund investors, and the Madoff Securities trustee) have commenced Madoff-related proceedings against numerous defendants in a multitude of jurisdictions. Various HSBC companies have been named as defendants in suits in the US, Ireland, Luxembourg, and other jurisdictions. Certain suits (which include US putative class actions) allege that the HSBC defendants knew or should have known of Madoff's fraud and breached various duties to the funds and fund investors.

In November 2011, the US District Court Judge overseeing three related putative class actions in the Southern District of New York dismissed all claims against the HSBC defendants on *forum non conveniens* grounds, but temporarily stayed this ruling as to one of the actions against the HSBC defendants – the claims of investors in Thema International Fund plc – in light of a proposed amended settlement agreement, pursuant to which, subject to various conditions, the HSBC defendants had agreed to pay from US$52.5m up to a maximum of US$62.5m. In December 2011, the court lifted this temporary stay and dismissed all remaining claims against the HSBC defendants, and declined to consider preliminary approval of the settlement. In light of the court's decisions, HSBC terminated the settlement agreement. The Thema plaintiff contests HSBC's right to terminate. Plaintiffs in all three actions filed notices of appeal to the US Court of Appeals for the Second Circuit. Plaintiffs' opening briefs were filed in April 2012 and HSBC filed responses in July 2012.

One of the individual claims that have been commenced by investors in Thema International Fund plc against HSBC in the Irish High Court has been listed for trial in November 2012.

In December 2010, the Madoff Securities trustee commenced suits against various HSBC companies in the US Bankruptcy Court and in the English High Court. The US action (which also names certain funds, investment managers, and other entities and individuals) sought US$9bn in damages and additional recoveries from HSBC and the various co-defendants. It sought damages against HSBC for allegedly aiding and abetting Madoff's fraud and breach of fiduciary duty. In July 2011, after withdrawing the case from the Bankruptcy Court in order to decide certain threshold issues, the US District Court Judge dismissed the trustee's various common law claims on the grounds that the trustee lacks standing to assert them. In December 2011, the trustee filed a notice of appeal to the US Court of Appeals for the Second Circuit. Briefing in that appeal was completed in April 2012; oral argument is expected later this year.

The District Court returned the remaining claims to the US Bankruptcy Court for further proceedings. Those claims seek, pursuant to US bankruptcy law, recovery of unspecified amounts received by HSBC from funds invested with Madoff, including amounts that HSBC received when it redeemed units HSBC held in the various funds. HSBC acquired those fund units in connection with financing transactions HSBC had entered into with various clients. The trustee's US bankruptcy law claims also seek recovery of fees earned by HSBC for providing custodial, administration and similar services to the funds. Between September 2011 and April 2012, the HSBC defendants and certain other defendants moved again to withdraw the case from the Bankruptcy Court. The District Court granted those withdrawal motions as to certain issues and is considering the motions as to other issues. Briefing on the merits of the withdrawn issues is ongoing.

Notes on the Condensed Financial Statements (unaudited) (continued)

The trustee's English action seeks recovery of unspecified transfers of money from Madoff Securities to or through HSBC, on the ground that the HSBC defendants actually or constructively knew of Madoff's fraud. HSBC has not been served with the trustee's English action.

Between October 2009 and April 2012, Fairfield Sentry Limited, Fairfield Sigma Limited, and Fairfield Lambda Limited ('Fairfield'), funds whose assets were directly or indirectly invested with Madoff Securities, commenced multiple suits in the British Virgin Islands ('BVI') and the US against numerous fund shareholders, including various HSBC companies that acted as nominees for clients of HSBC's private banking business and other clients who invested in the Fairfield funds. The Fairfield actions seek restitution of amounts paid to the defendants in connection with share redemptions, on the ground that such payments were made by mistake, based on inflated values resulting from Madoff's fraud, and some actions also seek recovery of the share redemptions under BVI insolvency law. The actions in the BVI have been dismissed, and those dismissals affirmed on appeal. The actions in the United States are currently stayed in the Bankruptcy Court pending developments in related appellate litigation in the BVI.

There are many factors which may affect the range of possible outcomes, and the resulting financial impact, of the various Madoff-related proceedings, including but not limited to the circumstances of the fraud, the multiple jurisdictions in which the proceedings have been brought and the number of different plaintiffs and defendants in such proceedings. For these reasons, among others, it is not practicable at this time for HSBC to estimate reliably the aggregate liabilities, or ranges of liabilities, that might arise as a result of all such claims but they could be significant. In any event, HSBC considers that it has good defences to these claims and will continue to defend them vigorously.

Investigations into the setting of London interbank offered rates, European interbank offered rates and other interest rates

Various regulators and competition and enforcement authorities around the world including in the UK, the US, Canada, the EU, Switzerland and Asia, are conducting investigations related to certain past submissions made by panel banks in connection with the setting of London interbank offered rates ('LIBOR'), European interbank offered rates ('EURIBOR') and other interest rates. As certain HSBC entities are members of such panels, HSBC and/or its subsidiaries have been the subject of regulatory demands for information and are cooperating with their investigations. In addition, HSBC and other panel banks have been named as defendants in private lawsuits filed in the US with respect to the setting of LIBOR and EURIBOR, including putative class action lawsuits which have been consolidated before the US District Court for the Southern District of New York. The complaints in those actions assert claims against HSBC and other panel banks under various US laws including US antitrust laws, the US Commodities Exchange Act, and state law. Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these regulatory investigations or private lawsuits, including the timing and potential impact, if any, on HSBC.

US Regulatory Investigations

Various HSBC Group companies are co-operating in ongoing investigations by the US Department of Justice ('DoJ') and the US Internal Revenue Service regarding whether certain Group companies acted appropriately in relation to certain customers who had US tax reporting requirements. HSBC continues to cooperate in ongoing investigations by the US Securities and Exchange Commission in relation to compliance with securities laws.

HSBC continues to cooperate in ongoing investigations by the DoJ, the New York County District Attorney's Office, the Office of Foreign Assets Control ('OFAC'), the Federal Reserve and the Office of the Comptroller of the Currency regarding historical transactions involving Iranian parties and other parties subject to OFAC economic sanctions.

In July 2012, the US Senate Permanent Subcommittee on Investigations held a hearing and released a report that was critical of, among other things, HSBC's anti-money laundering ('AML')/ US Bank Secrecy Act ('BSA') compliance and compliance with OFAC sanctions.

Based on the facts currently known, it is not practicable at this time to determine the terms on which the ongoing investigations will be resolved with the group or the timing of such resolution or for the group to estimate reliably the amounts, or range of possible amounts, of any fines and/or penalties which could be significant.

Notes on the Condensed Financial Statements (unaudited) (continued)

12 Event after the balance sheet date

A first interim dividend for the financial year ending 31 December 2012 of £575 million was declared by the Directors after 30 June 2012.

13 Interim Report 2012 and statutory accounts

The information in this *Interim Report 2012* is unaudited and does not constitute statutory accounts within the meaning of section 434(3) of the Companies Act 2006. The *Interim Report 2012* was approved by the Board of Directors on 30 July 2012. The statutory accounts for the year ended 31 December 2011 have been delivered to the Registrar of Companies in England and Wales in accordance with section 446 of the Companies Act 2006. The auditor has reported on those accounts. Its report was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498(2) or (3) of the Companies Act 2006.

Independent Review Report by KPMG Audit Plc to HSBC Bank plc

Introduction

We have been engaged by HSBC Bank plc (‘the bank’) to review the condensed set of financial statements in the half-yearly interim report for the six months ended 30 June 2012 which comprises the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of financial position, consolidated statement of changes in equity, consolidated cash flow statement and the related explanatory notes. We have read the other information contained in the *Interim Report 2012* and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the bank in accordance with the terms of our engagement to assist the bank in meeting the requirements of the Disclosure and Transparency Rules (‘the DTR’) of the UK's Financial Services Authority (‘the UK FSA’). Our review has been undertaken so that we might state to the bank those matters we are required to state to it in this 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 for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The *Interim Report 2012* is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the *Interim Report 2012* in accordance with the DTR of the UK FSA.

As disclosed in note 1, the annual financial statements of the bank are prepared in accordance with IFRSs as adopted by the European Union (‘EU’). The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with IAS 34 *Interim Financial Reporting* as adopted by the EU.

Our responsibility

Our responsibility is to express to the bank a conclusion on the condensed set of financial statements in the *Interim Report 2012* based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the *Interim Report 2012* for the six months ended 30 June 2012 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FSA.

P McIntyre
For and on behalf of KPMG Audit Plc
Chartered Accountants
London, England

30 July 2012

HSBC Bank plc
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