Company No. 14259

# 2013

# Interim Report

# HSBC Bank plc

# Interim Report 2013

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## Presentation of Information

This document is the Interim Report 2013 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 Conduct Authority's ('FCA') 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.

In November 2012, the group sold HSBC Private Banking Holdings (Suisse) SA ('PBSU') to HSBC Holdings plc, with the exception of HSBC Private Bank (UK) Limited which remains part of the group. The consolidated income statement and consolidated statement of comprehensive income have been re-presented to show the discontinued operations separately from continuing operations. The commentaries included in the Business Review have been prepared on a continuing operations basis. In June 2013 the bank acquired the assets and liabilities of HFC Bank Limited.

With effect from 1 January 2013, the group's operating segments have been revised to reflect internal changes made to the management structure. The revised segments are consistent with those reported to the bank's Executive Committee, the identified Chief Operating Decision Maker under IFRS 8. Further details are provided in *Note 1 'Basis of Preparation'* on page 24. All comparatives have been adjusted accordingly.

## 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

| | Half-year to | | |
|---|---|---|---|
| | **30 June 2013** | 30 June 2012 | 31 December 2012 |
| **For the period (£m)** | | | |
| Profit on ordinary activities before tax | **2,273** | 757 | 247 |
| Total operating income | **8,377** | 8,186 | 7,221 |
| Net operating income before loan impairment charges and other credit risk provisions | **6,925** | 6,813 | 5,675 |
| Profit attributable to shareholders of the parent company | **1,681** | 762 | 1,622 |
| **At period end (£m)** | | | |
| Total equity attributable to shareholders of the parent company | **31,911** | 32,347 | 31,675 |
| Risk-weighted assets | **200,368** | 216,366 | 193,402 |
| Loans and advances to customers (net of impairment allowances) | **282,498** | 291,804 | 282,685 |
| Customer accounts | **355,373** | 364,568 | 324,886 |
| **Capital ratios[1] (%)** | | | |
| Core Tier 1 ratio | **11.1** | 9.9 | 11.4 |
| Tier 1 ratio | **12.0** | 10.8 | 12.4 |
| Total capital ratio | **16.9** | 15.3 | 17.3 |
| **Performance and efficiency ratios (annualised %)** | | | |
| Return on average shareholders' funds (equity) of the parent company | **10.6** | 4.8 | 2.2 |
| Pre-tax return on average risk-weighted assets | **2.3** | 0.7 | 0.2 |
| Cost efficiency ratio | **59.2** | 78.9 | 85.6 |
| **Financial ratios (%)** | | | |
| Ratio of customer advances to customer accounts | **79.5** | 80.0 | 87.0 |
| Average total shareholders' equity to average total assets[2] | **3.7** | 3.3 | 3.4 |

1 *Includes profits for the period to 30 June 2013. Does not include the interim dividend of £570 million declared by the Board of Directors after 30 June 2013.*
2 *This ratio differs from the calculation of the Basel III leverage ratio. The leverage ratio is based on regulatory Tier 1 capital to total exposure (also including off-balance sheet items and adjustments for derivatives and netting).*

## Financial Highlights of the group

HSBC Bank plc and its subsidiaries reported a profit before tax of £2,273 million in the first half of 2013, compared with profits of £757 million and £247 million in the first and second halves of 2012 respectively. On a continuing operations basis, adjusting the 2012 results to exclude the contribution made by PBSU, profit before tax increased by £1,720 million compared with the first half of 2012. The increase was largely due to significantly lower operating expenses driven by a decrease in provisions relating to customer redress programmes, together with higher Global Banking and Markets ('GB&M') revenue, which included a favourable debit valuation adjustment on derivative contracts, and a decline in loan impairment charges.

All operating business segments reported an increase in profit before tax when compared to both halves of 2012.

In Retail Banking and Wealth Management ('RBWM'), the group continued to support the UK housing market during the first half of 2013, approving £7.1 billion of new mortgage lending funds to over 68,000 customers. This included £2.0 billion to over 16,000 first time buyers. The loan-to-value ratio on new lending was 59 per cent compared with an average of 51 per cent for the total mortgage portfolio. In Turkey, the business continued to target the mass affluent market and expand the strong credit card business.

In Commercial Banking ('CMB'), the group launched a further International SME fund of £5 billion supporting UK businesses that trade, or aspire to trade, internationally, with approved lending through the fund of £2.4 billion in the first half of 2013. Similarly, in France, an SME fund of €1 billion was launched, targeted at international trade customers, with approved lending of €0.7 billion in the first half of 2013.

In GB&M, Payments and Cash Management and Foreign Exchange businesses launched 'Global Disbursements' and 'FlexRate Payway', which provide clients with the ability to make multi-currency payments more efficiently with foreign exchange rates being guaranteed for an agreed period. In Credit, primary issuances increased reflecting demand for financing from debt capital markets resulting in leading positions and increased market share in both the Euro and Sterling markets.

# Interim Management Report: Business Review

## HSBC Values and Global Standards

The role of HSBC Values in daily operating practice is fundamental to the group's culture 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. HSBC expects its executives and employees to act with courageous integrity by being:

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

HSBC continues to enhance its values-led culture by embedding HSBC Values into how it conducts its business and in the selection, assessment, recognition and learning provided to staff.

In line with HSBC's ambition to be the world's leading international bank, it aspires to lead the industry in standards of conduct. As international markets become more interconnected and complex and as threats to the global financial system grow, the group is further strengthening the policies and practices which govern how and with whom it does business.

HSBC greatly values its reputation and its success over the years is due in no small part to its reputation for trustworthiness and integrity. HSBC is committed to adopting and enforcing the highest compliance standards across the group.

Under the supervision of the Group's Global Standards Steering Meetings of the Group Management Board, HSBC is strengthening policies in a number of important areas. HSBC is also reinforcing the status of compliance and standards as an important element of how it assesses and rewards senior executives, and rolling out communication, training and assurance programmes to ensure that all staff understand and meet their responsibilities.

HSBC has adopted the UK Code of Practice for the Taxation of Banks and seeks to apply the spirit as well as the letter of the law in all countries in which it operates. The Group deals with tax authorities in an open and honest manner and are strengthening its policies and controls with the objective of ensuring its services are not used by clients seeking to evade their tax obligations.

A committee of the HSBC Holdings Board, the Financial System Vulnerabilities Committee, will provide governance, oversight and policy guidance over the framework of controls and procedures designed to identify areas where HSBC may become exposed and through that exposure, expose the financial system more broadly to financial crime or system abuse.

## Economic briefing

The UK economy recovered tentatively, with real Gross Domestic Product ('GDP') growing by 0.3 per cent in the first quarter and 0.6 per cent in the second quarter of 2013. The labour market was resilient and employment reached new highs, while unemployment was 7.8 per cent in the three months to May, down from 7.9 per cent in the previous quarter. Inflation, as measured by the Consumer Prices Index ('CPI') increased from 2.7 per cent in December 2012 to 2.9 per cent in June 2013. The Bank of England left its key interest rate at 0.5 per cent and its stock of asset purchases was unchanged at £375 billion.

The eurozone economy remained in recession in the first quarter of 2013 and GDP shrank by 0.2 per cent. This was the sixth consecutive quarter of contraction, despite a bounce in German consumer spending of 0.8 per cent. Unemployment rose from 11.9 per cent in December 2012 to 12.1 per cent in June 2013. Exports continued to fall although there were signs of stabilisation in the second quarter, even in the periphery with export orders in Spain and Italy recovering according to purchasing managers' surveys. Inflation fell from 2.5 per cent to 1.6 per cent in the first half of 2013, and the squeeze on real wages started to abate. In May, in view of the weakness in economic activity and falling inflation, the ECB cut their interest rate by 0.25 per cent to a record low of 0.5 per cent. The ECB's commitment to buy unlimited amounts of government bonds helped government bond spreads in the periphery continue to narrow until late April. Any effect on government bond spreads as a result of the Italian election result and the Cyprus refinancing deal were very short-lived. Following the US Federal Reserve's suggestion that it could soon start to taper the pace of its quantitative easing market interest rates rose during May and June.

## Interim Management Report: Business Review (continued)

## Financial summary

### Summary consolidated income statement

| | Half year to | | | | |
|---|---|---|---|---|---|
| | Continuing Operations | | | Reported | |
| | **30 June 2013** | 30 June 2012 | 31 December 2012 | 30 June 2012 | 31 December 2012 |
| | **£m** | £m | £m | £m | £m |
| Net interest income | **3,437** | 3,216 | 3,303 | 3,450 | 3,454 |
| Net fee income | **1,648** | 1,628 | 1,681 | 1,913 | 1,868 |
| Net trading income | **2,518** | 1,219 | 368 | 1,374 | 460 |
| Net (expense)/income from financial instruments designated at fair value | **(512)** | (61) | 179 | (61) | 179 |
| Gains less losses from financial investments | **123** | 294 | 41 | 295 | 41 |
| Net earned insurance premiums | **1,132** | 1,180 | 1,106 | 1,180 | 1,106 |
| Other operating income | **31** | 31 | 113 | 35 | 113 |
| Total operating income | **8,377** | 7,507 | 6,791 | 8,186 | 7,221 |
| Net insurance claims incurred and movements in liabilities to policy holders | **(1,452)** | (1,373) | (1,546) | (1,373) | (1,546) |
| Net operating income before impairment charges and other credit risk provisions | **6,925** | 6,134 | 5,245 | 6,813 | 5,675 |
| Loan impairment charges and credit risk provisions | **(550)** | (675) | (571) | (674) | (571) |
| **Net operating income** | **6,375** | 5,459 | 4,674 | 6,139 | 5,104 |
| Total operating expenses | **(4,103)** | (4,902) | (4,604) | (5,378) | (4,858) |
| **Operating profit** | **2,272** | 557 | 70 | 761 | 246 |
| Share of profit/ (loss) of associates and joint ventures | **1** | (4) | 1 | (4) | 1 |
| **Profit before tax** | **2,273** | 553 | 71 | 757 | 247 |
| Tax (expense)/ credit | **(567)** | 63 | 157 | 29 | 127 |
| **Profit for the period before discontinued operations** | **1,706** | 616 | 228 | 786 | 374 |
| Gain on sale of discontinued operations | **–** | – | – | – | 1,265 |
| **Profit for the period** | **1,706** | 616 | 228 | 786 | 1,639 |
| Profit attributable to shareholders of the parent company | **1,681** | 592 | 211 | 762 | 1,622 |
| Profit attributable to non-controlling interests | **25** | 24 | 17 | 24 | 17 |

### Review of business performance

HSBC Bank plc and its subsidiaries reported a profit before tax of £2,273 million in the first half of 2013, compared with profits of £757 million and £247 million in the first and second halves of 2012 respectively.

All group operating business segments reported an increase in profit before tax when compared to both halves of 2012.

The following commentary is on a continuing operations basis.

On a continuing operations basis, adjusting the 2012 results to exclude the contribution made by PBSU, profit before tax increased by £1,720 million compared with the first half of 2012.

*Net interest income* increased by £221 million compared with the first half of 2012. The rise in RBWM was driven by higher average lending balances, principally residential mortgages in the UK and to a lesser extent in France. In GB&M, net interest income was higher in the UK from wider margins in the Credit & Lending businesses as pricing increased and funding costs reduced. In CMB net interest income was also higher, mainly in the UK, driven by growth in term lending and higher new business margins.

*Net fee income* increased by £20 million compared with the first half of 2012. In CMB the growth in fee income reflected higher levels of lending in the UK. In GB&M, most notably in Germany, higher levels of fees were earned on primary issuances. In RBWM the growth in credit card and mortgage fees in Turkey was more than offset by lower general insurance revenues and higher fees paid under partnership agreements in the UK.

*Net trading income* increased by £1,299 million compared with the first half of 2012. Of this increase, £1 billion was due to favourable foreign exchange movements on trading assets held as economic hedges against foreign currency debt held at fair value compared with adverse movements reported in the first half of 2012. These offset adverse foreign exchange movements on the foreign currency debt reported in '*Net (expenses)/income from financial instruments designated at fair* *value'*. In addition, there was a favourable debit valuation adjustment ('DVA') of £198 million on derivative contracts reflecting a widening of spreads on the bank's credit default swaps and from further refinement of the calculation.

A rise in Credit trading revenue resulted from reserve releases, compared with charges in the prior year and revaluation gains in the legacy portfolio. An increase in Foreign Exchange trading revenue was due to higher client volumes which benefited from improved electronic pricing and distribution capabilities. Equities trading revenue also increased reflecting positive fair value movements on certain assets in Europe, together with lower adverse movements on structured liabilities.

These increases were partly offset by lower trading revenue in Global Markets, driven by a fall in Rates revenue. The Rates business benefited from a significant tightening of spreads on eurozone bonds in the first half of 2012 following the ECB's Long-Term Refinancing Operation ('LTRO'). Although performance in the first quarter of 2013 was resilient, reflecting improved investor sentiment, the second quarter was adversely affected by more volatile market conditions on the expectations that the scale of government repurchase schemes and quantitative easing measures may be reduced.

*Net expenses from financial assets designated at fair value* of £512 million compared with expenses of £61 million in the first half of 2012. This included an adverse foreign exchange movement of £757 million in the first half of the year (first half 2012: gain of £277 million) on foreign currency debt designated at fair value issued as part of the group's overall funding strategy. An offset, from trading assets held as economic hedges, of this amount is reported in *'Net trading income'*.

This was partially offset by a £477 million favourable movement due to the change in credit spreads on the group's own debt held at fair value. In addition, there were higher net investment gains recognised on the fair value of assets held to meet liabilities under insurance and investment contracts as market conditions improved.

*Gains less losses from financial investments* were £171 million or 58 per cent lower than the first half of 2012. Net gains on the disposal of debt securities fell as the first half of 2012 included significant gains on the sale of available-for-sale government debt securities, notably in the UK, as part of structural interest rate risk management of the balance sheet.

*Net earned insurance premiums* decreased by £48 million or 4 per cent mainly in RBWM in France. This was primarily due to lower life insurance sales in France reflecting the adverse economic environment and anticipation of customers of the impact of new regulations relating to the investment market. In addition, lower volumes following the run-off of business from independent financial advisor channels also impacted 2013 premiums.

*Other operating income* remained broadly in line with the first half of 2013.

*Net insurance claims incurred and movement in liabilities to policyholders* increased by £79 million. The increase in liabilities to policyholders was due to the increase in gains experienced on the financial assets designated at fair value held to support these insurance and investment contract liabilities. This was partially offset by a decrease in new business written, notably in France, explained under *'Net earned insurance premiums'*.

*Loan impairment charges and other credit risk provisions* decreased by £125 million or 19 per cent. This was mainly due to net releases on available-for-sale asset back securities within GB&M in the UK, compared with charges in the first half of 2012. RBWM in the UK saw a reduction in loan impairment charges as a result of improved delinquency rates and reductions in the size of its unsecured portfolio. This was partially offset by increases in collectively assessed provisions in Turkey mainly as a result of increased unsecured lending reflecting business expansion. In CMB loan impairment charges were higher as impairments were raised against a small number of specific exposures in Spain and the UK.

*Total operating expenses* decreased by £799 million or 16 per cent, due primarily to lower UK customer redress provisions of £267 million. This included a charge for additional estimated redress for possible mis-selling in previous years of PPI policies of £238 million (H1 2012: £571 million) which took the balance sheet provision for the UK customer redress programmes at 30 June 2013 to £1.2 billion. Restructuring costs of £65 million were £67 million lower than the comparable period in 2012.

Following a consultation process on various employee benefit proposals, the bank announced to employees in the UK that the future service accrual for defined benefit members would cease from 1 July 2015. As part of these amendments, the bank is changing the basis of delivering ill-health benefits to certain employees, resulting in the recognition of an accounting gain of £280 million. This credit, together with lower performance costs in GB&M reduced the level of staff costs compared to the first half of 2012.

During the first half of 2013 the group maintained its strict cost control discipline and benefited from the delivery from its organisational effectiveness programmes. Compared to the first half of 2012 full time equivalent staff numbers across the group have fallen by 10 per cent. Partially offsetting these savings was an increase in litigation costs primarily relating to the agreed settlement reached with Thema International Fund plc in respect to a Madoff related claim.

*Tax expense* totalled £567 million, compared to tax income of £63 million in the first half of 2012. The effective tax rate for the first half of 2013 was 24.9 per cent, compared to (11.4) per cent for the same period in 2012. The tax expense in the first half of 2013 is a result of the increased level of taxable profits.

## Review of business position

### Summary consolidated balance sheet

| | At 30 June 2013 £m | At 31 December 2012 £m |
|---|---|---|
| **Total assets** | **855,592** | 815,481 |
| Cash and balances at central banks | **59,438** | 51,613 |
| Trading assets | **188,724** | 161,516 |
| Financial assets designated at fair value | **16,293** | 15,387 |
| Derivative assets | **155,723** | 177,808 |
| Loans and advances to banks | **51,610** | 32,286 |
| Loans and advances to customers | **282,498** | 282,685 |
| Financial investments | **77,928** | 71,265 |
| Other | **23,378** | 22,921 |
| **Total liabilities** | **823,133** | 783,281 |
| Deposits by banks | **44,596** | 39,571 |
| Customer accounts | **355,373** | 324,886 |
| Trading liabilities | **150,252** | 122,896 |
| Financial liabilities designated at fair value | **34,466** | 32,918 |
| Derivative liabilities | **156,438** | 181,095 |
| Debt securities in issue | **38,895** | 40,358 |
| Liabilities under insurance contracts issued | **19,074** | 17,913 |
| Other | **24,039** | 23,644 |
| **Total equity** | **32,459** | 32,200 |
| Total equity attributable to shareholders of the parent company | **31,911** | 31,675 |
| Non-controlling interests | **548** | 525 |

Total assets amounted to £856 billion, 5 per cent higher than at 31 December 2012.

The group continued to attract customer deposits during the first half of 2013, further enhancing its strong liquidity position. This has enabled it to continue supporting its customers borrowing requirements, leading to higher mortgage balances in the UK and increased term lending in other markets. In addition, higher client activity led to a rise in trading balances. However, the value of derivatives fell as yield curves in major currencies trended upwards.

The group maintained a strong and liquid balance sheet with the ratio of customer advances to customer accounts of 79.5 per cent (December 2012: 87.0 per cent).

The group's reported Core Tier 1 ratio stood at 11.1 per cent (December 2012: 11.4 per cent). Risk-weighted assets of £200 billion were 4 per cent higher than at 31 December 2012.

#### Assets

*Cash and balances at central banks* increased by 15 per cent as surplus liquidity was placed with central banks, in line with the group's conservative risk profile.

*Trading assets* increased by 17 per cent primarily due to a rise in settlement accounts. Settlement account balances vary according to customer trading activity, which is typically lower at the end of the year. Equity securities, held as economic hedges of client positions, also increased as a result of business expansion. These movements were partly offset by a decline in reverse repo balances.

*Financial assets designated at fair value* increased by 6 per cent due to the investment of net premiums received during the period from insurance businesses and favourable equity market movements over the period.

# Interim Management Report: Business Review (continued)

*Derivative assets* decreased by 12 per cent. The upward movements in yield curves in major currencies led to a decline in the fair value of interest rate contracts.

*Loans and advances to banks* rose by 60 per cent from the relatively low levels seen at December 2012. This was due to higher customer demand for reverse repo funding.

*Loans and advances to customers* were broadly in line with December 2012. Declines in reverse repos with non-bank counterparties were offset by further increases in mortgage lending in the UK and term lending in Turkey, reflecting the group's focus on its core markets.

*Financial investments* rose by 9 per cent following net new purchases by Balance Sheet Management as it deployed surplus liquidity.

### Liabilities

*Deposits by banks* rose by 13 per cent from the low levels seen in December 2012. The repayment in early 2013 of the €5 billion of LTRO funding in France was more than offset by a rise in repo balances to fund the increase in reverse repo activity and higher placements by financial institutions in the UK.

*Customer accounts* grew by 9 per cent as the group continued to attract deposits from customers who, in the current environment, elected to hold liquid funds. Repo balances also rose as a result of a significant short-term placement at the end of the period.

*Trading liabilities* increased by 22 per cent due to a rise in settlement account balances, which vary according to customer trading activity. In addition, net short bond and equity positions rose as a result of an increase in client activity compared with the reduced activity typically seen at the end of the year.

*Financial liabilities* designated at fair value increased by 5 per cent as maturities were more than offset by new issuances.

The reduction in the value of *derivative liabilities* was in line with that of 'Derivative assets' as the underlying risk is broadly matched.

*Debt securities in issue* decreased by 4 per cent as maturing certificates of deposits and bonds were only partially offset by new issuances.

*Liabilities under insurance contracts* increased by 6 per cent as a result of reserves established for new business written and gains on unit-linked products from favourable equity market movements.

### Equity

*Total shareholders' equity* was in line with 31 December 2012.

### Liquidity position

The group's liquidity and funding metrics improved over the first half of 2013 driven by an increase in core customer deposits. As at 30 June 2013, the bank held sufficient buffers against all regulatory liquidity requirements.

## Risk

HSBC's global risk operating model supports adherence to globally consistent standards and risk management policies across the Group. The HSBC Bank plc Board, advised by the Risk Committee, approves the bank's risk appetite.

Balance sheet assets grew by 5 per cent and credit risk-weighted assets increased by 4 per cent during the period.

In the first six months of 2013, financial markets were dominated by concerns over sovereign debt default risk and its contagion effects, the Middle East and the perception that the world economic recovery remained fragile. This created volatility in financial markets. In the face of this changeable economic and financial environment, HSBC maintained its conservative risk profile by reducing exposure to the most likely areas of stress. Stress tests were run regularly to evaluate the potential impact of emerging scenarios and, where appropriate, the group adjusted its risk appetite accordingly.

The group continued to manage selectively its exposure to sovereign debt and bank counterparties, with the overall quality of the portfolio remaining strong. The group regularly updated its assessment of higher risk countries and adjusted its risk appetite and exposures to reflect these updates.

## Areas of special interest

### Compliance

In recent years, HSBC has experienced increasing levels of compliance risk as regulators and other agencies pursued investigations into historical activities. HSBC continued to work with regulators and these other agencies in relation to existing issues. This has included the matters giving rise to the Deferred Prosecution Agreements ('DPA') reached with US authorities in relation to investigations regarding inadequate compliance with anti-money laundering and sactions law, and the related undertaking with the FSA (now revised as directions from the Financial Conduct Authority ('FCA') following the UK regulatory restructuring in April 2013).

The bank has been involved in investigations into the mis-selling of certain products in the UK. This included sales of Payment Protection Insurance ('PPI') and interest rate derivative products to SMEs. As well as investigations and reviews related to certain past submissions made by panel banks and the process for making submissions in connection with the setting of Libor, Euribor and other benchmark interest and foreign exchange rates.

There has been a substantial increase in the volume of new regulation, much of which has some element of extra-territorial reach. The level of activity among regulators and law enforcement agencies in investigating possible breaches of regulations has also increased, and the direct and indirect costs of such breaches can be significant. As a result the group believes that the level of inherent compliance risk will continue to remain high for the foreseeable future.

### Commercial Real Estate ('CRE')

The group's CRE lending is concentrated in the UK, where many regions continued to be negatively affected by weak growth in the economy. London and the South East, where more than 50 per cent of the bank's UK CRE lending is based, continued to exhibit relative strength.

While there continues to be a prolonged concern regarding the sensitivity to risks of refinance, no deterioration in market conditions has been experienced in the first half of 2013. Refinance risk was discussed in the *Annual Report and Accounts 2012* (page 38).

There was a marginal reduction in UK CRE balances compared with the end of 2012 with no material changes in loan and advances due to be refinanced in the next 12 months.

### Exposure to countries in the eurozone

Eurozone countries are members of the European Union ('EU') and part of the euro single currency bloc. The eurozone countries identified as peripheral exhibited levels of market volatility which exceeded those of other eurozone countries and demonstrated fiscal or political uncertainty which may persist through the second half of 2013. Despite improvements through austerity and structural reforms, the peripheral eurozone countries of Greece, Ireland, Italy, Portugal, Spain and Cyprus continued to exhibit high sovereign debt to GDP ratios or short to medium-term maturity concentration of their liabilities.

In March 2013 Cyprus sought assistance from the Troika (the European Commission, European Central Bank and the International Monetary Fund) which ultimately agreed a bailout under conditions requiring a consolidation of banking assets and the 'bail in' of larger depositors' monies. Capital controls led to some minor disruption of payments from Cyprus. However, the group has limited exposure to the country and no impairments have been recorded as a result.

The framework for dealing with counterparty and systemic crisis situations was described on page 34 of the *Annual Report and Accounts 2012*. It continued to operate throughout the first half of 2013 to ensure that pre-crisis preparation remains apposite and robust. A Major Incident Group was effective in dealing with HSBC's response to the Cyprus sovereign debt crisis. The main focus of Eurozone Contingency Planning continues to be on Greece and Spain. Other scenarios including contagion risk to non-eurozone countries or the exit of a higher impact eurozone member remain under consideration.

At 30 June 2013, the group's net exposure to the peripheral eurozone countries was £21.1 billion, including net exposure to sovereign borrowers, agencies and banks of £6.2 billion. During the first half of 2013, there were marginal reductions in aggregate exposure to sovereigns and agencies of peripheral eurozone countries.

The group's businesses in peripheral eurozone countries are funded from a mix of local deposits, local wholesale funding and intra-group loans extended from HSBC operations with surplus funds. Intra-group funding carries the risk that a member country might exit the eurozone and redenominate its national currency, which could result in significant currency devaluation.

The group's exposure to selected eurozone countries is analysed in the tables below:

## Exposure to eurozone countries

*On- and off-balance sheet exposure*

| | At 30 June 2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Peripheral eurozone countries | | | | | | | |
| | **Greece** | **Ireland** | **Italy** | **Portugal** | **Spain** | **Germany** | **Netherlands** | **France** |
| | **£bn** | **£bn** | **£bn** | **£bn** | **£bn** | **£bn** | **£bn** | **£bn** |
| **Total** | | | | | | | | |
| On-balance sheet | 3.5 | 4.7 | 3.2 | 0.3 | 4.8 | 32.8 | 16.3 | 67.6 |
| Off-balance sheet | 0.5 | 0.7 | 1.5 | – | 1.9 | 7.2 | 2.3 | 18.1 |
| | **4.0** | **5.4** | **4.7** | **0.3** | **6.7** | **40.0** | **18.6** | **85.7** |
| **Sovereigns & agencies** | | | | | | | | |
| On-balance sheet | – | 0.2 | 1.1 | 0.2 | (0.1) | 20.2 | 7.6 | 13.8 |
| Off-balance sheet | – | – | – | – | – | 0.1 | – | 0.2 |
| | **–** | **0.2** | **1.1** | **0.2** | **(0.1)** | **20.3** | **7.6** | **14.0** |
| **Banks** | | | | | | | | |
| On-balance sheet | 1.2 | 0.9 | 0.6 | – | 2.1 | 6.2 | 1.7 | 28.8 |
| Off-balance sheet | – | – | – | – | – | – | – | 0.8 |
| | **1.2** | **0.9** | **0.6** | **–** | **2.1** | **6.2** | **1.7** | **29.6** |
| **Other financial institutions & corporates** | | | | | | | | |
| On-balance sheet | 2.3 | 3.6 | 1.5 | 0.1 | 2.8 | 6.4 | 7.0 | 25.0 |
| Off-balance sheet | 0.5 | 0.7 | 1.5 | – | 1.9 | 7.1 | 2.3 | 17.1 |
| | **2.8** | **4.3** | **3.0** | **0.1** | **4.7** | **13.5** | **9.3** | **42.1** |

| | At 31 December 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Peripheral eurozone countries | | | | | | | |
| | Greece | Ireland | Italy | Portugal | Spain | Germany | Netherlands | France |
| | £bn | £bn | £bn | £bn | £bn | £bn | £bn | £bn |
| Total | | | | | | | | |
| On-balance sheet | 2.6 | 4.4 | 3.5 | 0.5 | 5.0 | 28.3 | 14.2 | 57.3 |
| Off-balance sheet | 0.4 | 0.5 | 1.5 | 0.1 | 1.7 | 6.8 | 2.0 | 17.1 |
| | 3.0 | 4.9 | 5.0 | 0.6 | 6.7 | 35.1 | 16.2 | 74.4 |
| Sovereigns & agencies | | | | | | | | |
| On-balance sheet | 0.1 | 0.1 | 1.6 | 0.2 | 0.5 | 13.8 | 6.2 | 17.2 |
| Off-balance sheet | – | – | – | – | – | - | - | 0.2 |
| | 0.1 | 0.1 | 1.6 | 0.2 | 0.5 | 13.8 | 6.2 | 17.4 |
| Banks | | | | | | | | |
| On-balance sheet | 0.4 | 0.9 | 0.7 | 0.2 | 1.4 | 5.9 | 1.9 | 16.4 |
| Off-balance sheet | – | – | – | – | – | 0.2 | 0.2 | 1.6 |
| | 0.4 | 0.9 | 0.7 | 0.2 | 1.4 | 6.1 | 2.1 | 18.0 |
| Other financial institutions & corporates | | | | | | | | |
| On-balance sheet | 2.1 | 3.4 | 1.2 | 0.1 | 3.1 | 8.6 | 6.1 | 23.7 |
| Off-balance sheet | 0.4 | 0.5 | 1.5 | 0.1 | 1.7 | 6.6 | 1.8 | 15.3 |
| | 2.5 | 3.9 | 2.7 | 0.2 | 4.8 | 15.2 | 7.9 | 39.0 |

## Redenomination risk

As the peripheral eurozone countries of Greece, Ireland, Italy, Portugal, Spain and Cyprus continue to exhibit distress, there is continuing possibility of a member state exiting from the eurozone. There remains 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.

At 30 June 2013, the group's in-country funding exposures for peripheral eurozone countries had been reduced compared with 31 December 2012. The group's current view remains that the most likely impact would be from a euro exit of Greece, Italy or Spain. The in-country funding exposures to these three countries are disclosed in the table below.

*In-country funding exposure as at 30 June 2013*

| | Denominated in: | | | |
|---|---|---|---|---|
| | Euros £bn | US Dollars £bn | Other Currencies £bn | Total £bn |
| **Greece** | | | | |
| In-country assets | 1.1 | 0.1 | – | 1.2 |
| In-country liabilities | (1.1) | (0.4) | – | (1.5) |
| Net in-country funding | – | (0.3) | – | (0.3) |
| Off balance sheet exposure/hedging | (0.2) | – | 0.2 | – |
| **Italy** | | | | |
| In-country assets | 0.6 | – | – | 0.6 |
| In-country liabilities[1] | (1.2) | (0.1) | – | (1.3) |
| Net in-country funding | (0.6) | (0.1) | – | (0.7) |
| Off balance sheet exposure | 0.4 | – | – | 0.4 |
| **Spain** | | | | |
| In-country assets | 1.1 | 0.6 | – | 1.7 |
| In-country liabilities | (0.9) | (0.1) | – | (1.0) |
| Net in-country funding | 0.2 | 0.5 | – | 0.7 |
| Off balance sheet exposure | 0.5 | 0.1 | – | 0.6 |

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

## 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 fully detailed in the *Annual Report and Accounts 2012* in ‘Report of the Directors: Risk’ on pages 27 to 80.

### 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.

*Emerging markets slowdown*: World growth is slowing as demand in mature economies is subdued and credit availability and investment activity remain very limited. Growth in a number of emerging markets has decelerated during the first half of 2013 and advanced economies are depending on stronger trade growth in emerging markets to help them through tough economic times domestically.

A number of mature economies are continuing with austerity measures in order to reduce their deficits and public debt. This is expected to help resolve the sovereign and banking crisis in the medium term, but in the short term it is limiting growth, increasing unemployment and restricting taxation revenues severely. This is affecting the rest of the world through lower trade, reduced international financing as banks are deleveraging and potential disruption to capital flows.

Trade and capital flows may contract as a result of weaker economic growth in some emerging markets, banks deleveraging, the introduction of protectionist measures in certain markets, the emergence of geopolitical risks or increasing redenomination risk, which in turn might curtail profitability.

*Increased geopolitical risk and changes in the energy market*: Weak global economic growth is exacerbating the risk of protectionism and some countries may impose restrictions on trade or on capital flows to protect their domestic economies. Continuing political instability and unrest in the Middle East combined with developments in global energy extraction increase the risk of lower energy prices impacting the dynamics of natural gas markets and exposures. In emerging markets such as Turkey the population is increasingly critical of economic policies. Developments across all markets are closely watched to ensure the understanding is shared and appropriate action is taken as circumstances evolve. Actual conflict could put staff in harm’s way and bring physical damage to assets.

During the first half of 2013, the group increased its monitoring of the geopolitical and economic outlook, in particular in countries where it has material exposures and a physical presence. The internal credit risk ratings of sovereign counterparties are adjusted to reflect appetite and mitigate these risks as appropriate. These drive the group's appetite for conducting business in those countries.

*Disorderly exit from quantitative easing:* A prolonged period of low interest rates due to policy actions taken to address the economic crisis in mature economies still constrains the interest income the group earns from investing excess deposits through spread compression and low returns on assets. However, an excessively rapid exit from quantitative easing ('QE') and a swift rise in interest rates could prove to be as detrimental. Fears of such actions are already creating significant volatility in the markets. An increase in real interest rates while the economy remains weak could further limit the pace of recovery. A scaling back of QE could result in an adverse impact on global equity and bond prices, and create turbulence in global foreign exchange markets. The pace and timing of QE cessation could further exacerbate market instability.

### 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. These measures may be introduced as formal requirements in a supra-equivalent manner and to differing timetables across regulatory regimes.

*Regulatory developments affecting the business model and profitability*: Several regulatory changes are likely to affect the group's activities, the group as a whole, the bank and some or all of its principal subsidiaries.

These changes include:

- the introduction of Basel III measures in the EU through CRD IV and uncertainty on both the timing and final form of implementation given that certain areas, such as the operation of capital buffers, have yet to be finalised and the technical guidance from the European Banking Authority ('EBA') across numerous areas has yet to be published;
- a new regulatory structure within the UK comprising the Financial Policy Committee ('FPC'), Prudential Regulatory Authority ('PRA') and Financial Conduct Authority ('FCA') and, in particular, the effects of the ability of the FPC to seek additional capital for lending to sectors perceived as higher risk;
- The proposed legislation in the UK to give effect to the recommendations of the ICB in relation to 'ringfencing' of the UK retail banking from wholesale banking activities, the structural separation of other activities envisaged in legislative proposals in the EU following the Liikanen Group recommendations; and
- changes in the regime for the operation of capital markets and changing standards for the conduct of business.

There is also continued risk of further changes to regulation relating to remuneration and other taxes.

As the development and implementation of many of these various regulations are in their early stages, it is not possible to estimate the effect, if any, on the group's operations. The group are ensuring that its capital and liquidity plans take into account the potential effects of these changes. Capital allocation and liquidity management disciplines have been expanded to incorporate future increased capital and liquidity requirements and drive appropriate risk management and mitigating actions.

*Regulatory investigations and requirements relating to conduct of business*: Financial service providers are at risk of regulatory sanctions or fines related to conduct of business and financial crime. The incidence of regulatory proceedings and other proceedings against financial service firms is increasing.

In the UK, the FCA has continued to increase its focus on 'conduct risk' including attention to sales processes and incentives, product and investment suitability and conduct of business concerns more generally. These measures are concerned principally, but not exclusively, with the conduct of business with retail customers. In conjunction with this focus, the UK regulators are making increasing use of existing and new powers of intervention and enforcement. This includes powers to consider past business undertaken and implement customer compensation and redress schemes or other, potentially significant, remedial work. Additionally, the UK and other regulators increasingly take actions in response to customer complaints either specific to an institution or more generally in relation to a particular product. This may lead from time to time to significant direct costs or liabilities (including in relation to mis-selling) and changes in the practices of such businesses which benefit customers at a cost to shareholders. Further, decisions taken in the UK by the

Financial Ombudsman Service in relation to customer complaints could, if applied to a wider class or grouping of customers, have a material adverse effect on the operating results, financial condition and prospects of the group.

The group continues to be subject to a number of other regulatory proceedings, including investigations and reviews by various regulators and competition and enforcement authorities around the world, including in the UK, the US, Canada, the EU, Switzerland and Asia. These regulators and authorities are conducting investigations and reviews related to certain past submissions made by panel banks and the process for making submissions in connection with the setting of London interbank offered rates ('Libor'), European interbank offered rates ('Euribor') and other benchmark interest and foreign exchange rates. Further information can be found in Note 12 of this report.

### Challenges to operations, governance and control

*Regulatory commitments and consent orders including under the Deferred Prosecution Agreement:* There is a risk that HSBC fails to meet the deadlines or is judged to have material gaps in the plans or implementation compared with the requirements of the DPA and other orders. Details of this risk are provided on page 28 of the *Annual Report and Accounts 2012*. If, during the term of the DPA, HSBC is determined to have breached the DPA, the DoJ or the New York County District Attorney's Office may prosecute HSBC in relation to the matters which are the subject of the DPA. The FCA may, in similar vein, take enforcement action against the Group as a result of a breach of the DPA or of the related undertakings to the FCA.

*Data management:* HSBC has received feedback from external stakeholders that it needs a clear data strategy to meet the increasingly frequent regulatory reporting requirements as well as other internal or external information demands. Regulators are evaluating the industry on its ability to provide accurate information and may use the industry-developed Data Maturity Model to assess financial services firms. A HSBC-level Data Strategy Board has been established to define a data strategy to ensure consistent data management across the Group. Vision, governance and quality frameworks of the data strategy have been completed and the policy and standards are due for completion by the third quarter of 2013.

*Model risk:* More stringent regulatory requirements governing the development of parameters applied to and controls around models used for measuring risk can give rise to changes, including increases in capital requirements. Furthermore, the changing external economic and legislative environment and changes in customer behaviour can lead to the assumptions made in the models becoming invalid.

These model risks can result in a potentially increased and volatile capital requirement. The group continues to address these risks through enhanced model development, independent review and model oversight to ensure its models remain "fit for purpose".

## Regulation and supervision

The regulation and supervision of financial institutions continues to undergo significant change.

*New regulatory bodies:* In April 2013, the FSA was abolished and replaced with three new regulatory bodies. These new bodies comprise the Financial Policy Committee ('FPC') of the Bank of England, the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').

*CRD IV:* In June 2013, the European Commission published the final Regulation and Directive, known collectively as CRD IV, to give effect to the Basel III framework in the EU. The Regulation and Directive come into effect on 1 January 2014. However, the PRA are due to consult on the implementation in the UK in the second half of 2013, as the legislation contains significant scope for national discretion, particularly in respect of capital buffers. As such, uncertainty remains on the PRA's interpretation and the ultimate transposition of the rules in the UK. Furthermore, numerous technical guidance and implementation standards to be issued by the EBA are pending, lending further uncertainty on the precise requirements.

*Independent Commission on Banking ('ICB'):* In terms of the ICB, the UK Government responded to further comments and issued a revised Bill in February 2013. The Government intends to enact the legislation by the end of this parliament in 2015 and to have reforms in place by 2019.

## Outlook

Signs of stabilisation in the eurozone are emerging but the political and economic challenges remain considerable. In the eurozone periphery growth is still absent, unemployment rates are high and debt projections continue to be revised up.

## Interim Management Report: Business Review (continued)

Economic activity is expected to remain subdued. The group expects a contraction of GDP of 0.6 per cent in the eurozone in 2013.

In the first half of 2013 the UK economic data has improved. However, the recovery remains fragile as inflation continues to outpace wage growth meaning real-terms pay is falling, restraining consumer demand. The group expects the UK to grow by 0.8 per cent in 2013 which, while weak, is an improvement over 2012.

## Performance and Business Review

***Profit on ordinary activities before tax***

| | Half year to | | |
|---|---|---|---|
| | **30 June 2013 £m** | 30 June 2012 £m | 31 December 2012 £m |
| Retail Banking and Wealth Management | **680** | 1 | 410 |
| Commercial Banking | **704** | 492 | 274 |
| Global Banking and Markets | **973** | 616 | 26 |
| Global Private Banking[1] | **66** | 260 | 220 |
| Other/Intersegment | **(150)** | (612) | (683) |
| | **2,273** | 757 | 247 |

1 *The Global Private Banking comparatives are on a reported basis and include the results of HSBC Private Banking (Suisse) SA*

### Retail Banking and Wealth Management

| | Half year to | | |
|---|---|---|---|
| | **30 June 2013 £m** | 30 June 2012 £m | 31 December 2012 £m |
| Net interest income | **1,770** | 1,665 | 1,729 |
| Net fee income | **743** | 776 | 756 |
| Net trading income | **83** | 20 | 12 |
| Other income | **(84)** | (57) | 5 |
| Net operating income before impairments and provisions | **2,512** | 2,404 | 2,502 |
| Loan impairment charges and credit risk provisions | **(123)** | (138) | (110) |
| **Net operating income** | **2,389** | 2,266 | 2,392 |
| Total operating expenses | **(1,710)** | (2,265) | (1,983) |
| **Operating profit** | **679** | 1 | 409 |
| Share of profit/(loss) of associates and joint ventures | **1** | – | 1 |
| **Profit before tax** | **680** | 1 | 410 |

**Overview**

Retail Banking and Wealth Management reported a profit before tax of £680 million, significantly higher than in the first half of 2012 and 66 per cent higher than the second half of 2012. The increase reflected significantly lower operating expenses due to the combination of lower provisions relating to customer redress programmes and an accounting gain on changes to staff benefits recognised in 2013.

Retail Banking and Wealth Management continues to support the UK housing market, approving £7.1 billion of new mortgage lending to over 68,000 customers during the first half of 2013. This included £2 billion to over 16,000 first time buyers. The loan to value ratio on new lending was 59 per cent compared with the ratio of average mortgage portfolio 51 per cent. In Turkey, the business continued with its strategy of targeting the mass affluent market and growing its credit card business.

**Financial performance**

*Net interest income* increased by £105 million or 6 per cent. The rise in RBWM was driven by higher average lending balances, principally residential mortgages in the UK and to a lesser extent in France. In addition, lending margins improved on new business in the UK.

*Net fee income* decreased by £33 million or 4 per cent primarily in the UK due to lower general insurance revenues and a higher level of fees paid under partnership agreements. This was partly offset by growth in card revenue in Turkey.

# Interim Management Report: Business Review (continued)

*Net trading income* increased by £63 million, primarily due to favourable fair value adjustments on non-qualifying hedges on the French mortgage portfolio, as long-term interest rates rose. In addition, there were favourable market movements on derivatives used as economic hedges in the insurance business in France.

*Other income* decreased by £27 million or 47 per cent. Lower levels of net earned premiums and higher levels of claims on credit protection and term-lending policies more than offset the increase in net income from financial assets designated at fair value. In addition, the offset of the net trading gain on economic hedges noted in *'Net trading income'* also contributed to lower *'Other income'*.

*Loan impairment charges and other credit risk provisions* decreased by £15 million or 11 per cent. An increase in loan impairment charges in Turkey, reflecting growth in credit card volumes, was more than offset by a fall in the UK as a result of improved delinquency rates and recoveries of previously written off debt.

*Total operating expenses* decreased by £555 million or 25 per cent compared to the first half of 2012. The fall was due primarily to lower UK Customer redress provisions of £267 million (H1 2012: £637 million) and the recognition of the accounting gain of £123 million arising on the change in UK employee ill-health benefits. In spite of additional costs incurred in respect of new regulations and implementation of global standards, excluding the items noted above, operating expenses were 4 per cent lower than the first half of 2012. This was achieved through robust cost control and the benefits delivered by the re-engineering of processes.

## Commercial Banking

| | Half year to | | |
|---|---|---|---|
| | **30 June 2013 £m** | 30 June 2012 £m | 31 December 2012 £m |
| Net interest income | **1,062** | 1,019 | 1,018 |
| Net fee income | **547** | 513 | 534 |
| Net trading income | **20** | 11 | 15 |
| Other income | **18** | 36 | 34 |
| Net operating income before impairments and provisions | **1,647** | 1,579 | 1,601 |
| Loan impairment charges and credit risk provisions | **(323)** | (262) | (437) |
| **Net operating income** | **1,324** | 1,317 | 1,164 |
| Total operating expenses | **(620)** | (825) | (890) |
| **Operating profit** | **704** | 492 | 274 |
| Share of (loss) of associates and joint ventures | **–** | – | – |
| **Profit before tax** | **704** | 492 | 274 |

### Overview

Commercial Banking reported a profit before tax of £704 million, 43 per cent higher than the first half of 2012 and £430 million higher than the second half of 2012. The performance, excluding the impact of customer redress provisions and the accounting gain on staff benefits, reflected higher revenue growth in the home and priority markets and reduced costs delivered through the sustainable saves programme.

Following the success of the 2012 International SME fund, Commercial Banking launched a further £5 billion fund supporting UK businesses that trade or aspire to trade internationally with approved lending of £2.4 billion in the first half of 2013. Similarly, in France, the business launched an SME fund of £0.8 billion targeted at international trade customers, with approved lending of £0.6 billion in the first half of 2013.

### Financial performance

*Net interest income* increased by £43 million or 4 per cent, mainly in the UK due to growth in term lending balances and change in product mix to higher margin business.

*Net fee income* increased by £34 million or 7 per cent, due to an increase in lending fees in the UK and higher fee income from Credit and Lending businesses in Germany. There was also growth in Payments and Cash Management fees.

*Net trading income* was £9 million higher than the first half of 2012, mainly due to an increase in the fair value of derivative contracts held within insurance unit-linked funds. There is a corresponding offset reported in *'Other income'*.

*Other income* was £18 million lower than the first half of 2012. The fall reflected the loss arising on the sale of debt in Spain and write-down of an equity investment. This was also impacted by the offset on the gains on derivatives reported within *'Net trading income'*.

## Interim Management Report: Business Review (continued)

*Loan impairment charges and other credit risk provisions* increased by £61 million or 23 per cent compared with the first half of 2012, mainly due to higher individually assessed provisions for a small number of specific customers in the UK and Spain.

*Total operating expenses* decreased by £205 million or 25 per cent compared to the first half of 2012. The fall was due primarily to the absence of UK customer redress provisions in the first half of 2013 and the recognition of the accounting gain of £104 million arising on the change in UK employee ill-health benefits. Excluding these items, operating expenses were 3 per cent lower than the first half of 2012. This reflected the benefits being delivered through re-engineering of the business processes.

### Global Banking and Markets

| | Half year to | | |
|---|---|---|---|
| | **30 June 2013** | 30 June 2012 | 31 December 2012 |
| | **£m** | £m | £m |
| Net interest income[1] | **509** | 464 | 412 |
| Net fee income | **302** | 280 | 336 |
| Net trading income | **2,420** | 1,182 | 372 |
| Other income | **(555)** | 574 | 399 |
| Net operating income before impairments and provisions | **2,676** | 2,500 | 1,519 |
| Loan impairment charges and credit risk provisions | **(97)** | (269) | (11) |
| **Net operating income** | **2,579** | 2,231 | 1,508 |
| Total operating expenses | **(1,606)** | (1,612) | (1,481) |
| **Operating profit** | **973** | 619 | 27 |
| Share of profit of associates and joint ventures | **–** | (3) | (1) |
| **Profit before tax** | **973** | 616 | 26 |

*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 16.*

#### Overview

Global Banking and Markets reported a pre-tax profit of £973 million, £357 million and £947 million higher than the first and second halves of 2012 respectively. The profit before tax increase was due to a favourable debit valuation adjustment on derivative contracts, lower adverse fair value movements on structured liabilities and revenue growth within the Financing and Equity Capital Markets, Foreign Exchange and Credit businesses. These movements were partly offset by lower revenue from Rates and Balance Sheet Management.

In GB&M, Payments and Cash Management and Foreign Exchange businesses launched 'Global Disbursements' and 'FlexRate Payway', which provide clients with the ability to make multi-currency payments more efficiently with foreign exchange rates guaranteed for an agreed period. In Credit, primary issuances increased reflecting demand for financing from debt capital markets resulting in leading positions and increased market share in both the Euro and Sterling markets.

#### Financial performance

*Net interest income* increased by £45 million or 10 per cent compared to the first half of 2012, from higher Credit and Lending revenue in the UK due to improved margins as prices increased and funding costs reduced.

*Net fee income* was £22 million or 8 per cent higher compared to the first half of 2012, due to higher Financing and Equity Capital Markets revenues, most notably in the priority market of Germany.

*Net trading income* was £1,238 million higher than the first half of 2012. This was mainly due to favourable foreign exchange movements on trading assets held as economic hedges of foreign currency debt designated at fair value, compared with adverse movements in the first half of 2012. A corresponding offset is reported within *'Other Income'*.

In Global Markets, revenue increased as the result of a favourable debit valuation adjustment on derivative contracts as own credit default swap spreads widened. In addition, Foreign Exchange income benefited from higher client volumes, which in part benefited from improved electronic pricing and distribution capabilities. An improvement in legacy asset prices resulted in reserve releases, compared with charges in the first half of 2012, along with revaluation gains in the Legacy Credit portfolio. These factors were partly offset by lower Rates revenue as the prior year benefited from tightening spreads following the ECB's announcement of the LTRO. Lower adverse fair value movements from own credit spreads on structured liabilities partly offset the decline in Rates revenue.

*Other income* decreased by £1,129 million which includes the £1 billion offset of the favourable foreign exchange movements on trading assets held as economic hedges noted in *'Net trading income'* above. Lower gains from the disposal of available-for-sale debt securities in Balance Sheet Management were partly offset by higher disposal gains in Principal Investments. Other income also benefited from the non-recurrence of losses on syndicated loan sales in the Credit and Lending business.

*Loan impairment charges and other credit risk provisions* decreased by £172 million or 64 per cent. Other credit risk provisions declined following a release of impairments against available-for-sale asset-backed securities as underlying asset prices improved compared with a charge in the first half of 2012. Loan impairment charges were broadly in line with the comparable period in 2012.

*Total operating expenses* were slightly below those for the first half of 2012. Excluding the £53 million accounting gain relating to the change in the basis of delivering ill-health benefits and non-recurrence of customer redress provisions of £75 million recognised in the first half of 2012, operating expenses were 8 per cent higher. A reduction in performance costs reflecting lower revenues (excluding the DVA) were more than offset by higher litigation costs. The business actively sought to identify cost savings by simplifying its business model in the first half of 2013.

## Global Private Banking

| | Half year to | | | | |
|---|---|---|---|---|---|
| | **Continuing Operations** | | | Reported | |
| | **30 June 2013** | 30 June 2012 | 31 December 2012 | 30 June 2012 | 31 December 2012 |
| | **£m** | £m | £m | £m | £m |
| Net interest income | **104** | 113 | 99 | 347 | 250 |
| Net fee income | **55** | 55 | 56 | 340 | 243 |
| Net trading income | **7** | 1 | 6 | 156 | 98 |
| Other income | **2** | 6 | (3) | 11 | (3) |
| Net operating income before impairments and provisions | **168** | 175 | 158 | 854 | 588 |
| Loan impairment charges and credit risk provisions | **(7)** | (5) | (14) | (4) | (14) |
| **Net operating income** | **161** | 170 | 144 | 850 | 574 |
| Total operating expenses | **(95)** | (113) | (100) | (589) | (354) |
| **Operating profit** | **66** | 57 | 44 | 261 | 220 |
| Share of (loss) of associates and joint ventures | **–** | (1) | – | (1) | – |
| **Profit before tax** | **66** | 56 | 44 | 260 | 220 |

### Overview

Global Private Banking reported profit before tax in the first half of 2013 of £66 million, 75 per cent and 70 per cent lower than the reported profits in the first and second halves of 2012 respectively. On a continuing operations basis, which excludes the contribution from PBSU sold to HSBC Holdings plc in November 2012, profit before tax in the first half of 2013 was 18 per cent and 50 per cent higher than the first and second halves of 2012 respectively.

The commentary that follows is on a continuing operations basis.

### Financial performance

*All income lines* were broadly in line with the first half of 2012.

*Total operating expenses* decreased by £18 million or 16 per cent compared with the first half of 2012, largely due to the non-recurrence of restructuring costs incurred in 2012 to improve operational efficiencies. The improved efficiencies resulted in a reduction in average staff numbers in the UK.

# Interim Management Report: Business Review (continued)

## Other

| | Half year to | | |
|---|---|---|---|
| | **30 June 2013 £m** | 30 June 2012 £m | 31 December 2012 £m |
| Net interest (expense)/income | **(28)** | (45) | 2 |
| Net fee income/(expense) | **1** | 4 | (1) |
| Net trading (expense)/income | **(1)** | (2) | (7) |
| Change in credit spread on long-term debt | **(14)** | (491) | (564) |
| Other income | **2** | 59 | 59 |
| Net operating (expense)/income | **(40)** | (475) | (511) |
| Loan impairment charges and credit risk provisions | **–** | – | – |
| **Net operating (expense)/income** | **(40)** | (475) | (511) |
| Total operating expenses | **(110)** | (137) | (173) |
| **Operating (loss)/profit** | **(150)** | (612) | (684) |
| Share of loss of associates and joint ventures | **–** | – | 1 |
| **(Loss)/profit before tax** | **(150)** | (612) | (683) |

Reported loss before tax in Other was £150 million, compared with a loss of £612 million in the first half of 2012 and a loss of £683 million in the second half of 2012.

Other includes:

- the change in own credit spread on long-term debt which resulted in a £14 million loss in the first half of 2013 compared with a loss of £491 million for the first half of 2012 and a loss of £564 million in the second half of 2012;
- restructuring costs of £11 million in the first half of 2013 and £43 million and £14 million in the first and second halves of 2012 respectively.

## Profit before tax – by country

| | Half year to | | | | |
|---|---|---|---|---|---|
| | **Continuing Operations** | | | Reported | |
| | **30 June 2013 £m** | 30 June 2012 £m | 31 December 2012 £m | 30 June 2012 £m | 31 December 2012 £m |
| UK | **1,907** | 48 | (264) | 39 | (264) |
| France | **315** | 191 | 186 | 191 | 186 |
| Germany | **108** | 99 | 86 | 99 | 86 |
| Turkey | **84** | 93 | 59 | 93 | 59 |
| Malta | **45** | 44 | 34 | 44 | 34 |
| Switzerland | **1** | – | – | 213 | 176 |
| Other | **(187)** | 78 | (30) | 78 | (30) |
| **Profit before tax** | **2,273** | 553 | 71 | 757 | 247 |

## Overall segmental analysis

| | **Retail Banking and Wealth Management £m** | **Commercial Banking £m** | **Global Banking and Markets £m** | **Global Private Banking £m** | **Other £m** | **Inter Segment £m** | **Total £m** |
|---|---|---|---|---|---|---|---|
| **Net Operating Income** | | | | | | | |
| **Half year to:** | | | | | | | |
| **30 June 2013** | **2,389** | **1,324** | **2,579** | **161** | **(40)** | **(38)** | **6,375** |
| 30 June 2012 | 2,266 | 1,317 | 2,231 | 850 | (475) | (50) | 6,139 |
| 31 December 2012 | 2,392 | 1,164 | 1,508 | 574 | (511) | (23) | 5,104 |
| **Profit before tax** | | | | | | | |
| **Half year to:** | | | | | | | |
| **30 June 2013** | **680** | **704** | **973** | **66** | **(150)** | **–** | **2,273** |
| 30 June 2012 | 1 | 492 | 616 | 260 | (612) | – | 757 |
| 31 December 2012 | 410 | 274 | 26 | 220 | (683) | – | 247 |

## 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.

J W Leng (Chairman); B Robertson (Chief Executive); P Antika (Non-Executive Director);
S N Cooper (Non-Executive Director); Dame Denise Holt (Independent Non-Executive Director);
S W Leathes (Independent Non-Executive Director); Dame Mary Marsh (Independent Non-Executive Director);
R E S Martin (Independent Non-Executive Director); T B Moulonguet (Independent Non-Executive Director);
P M Shawyer (Independent Non-Executive Director); A P Simoes (Deputy Chief Executive and Head of UK Bank);
A M Thomson (Independent Non-Executive Director); J F Trueman (Independent Non-Executive Director).

On behalf of the Board
B Robertson, *Chief Executive* 5 August 2013

# Condensed Financial Statements (unaudited)

## Consolidated income statement for the half-year to 30 June 2013

| | | 30 June 2013 | 30 June 2012 | | |
|---|---|---|---|---|---|
| | | | Continuing operations | Discontinued operations | Total |
| | *Notes* | **£m** | £m | £m | £m |
| Interest income | | **5,030** | 5,196 | 279 | 5,475 |
| Interest expense | | **(1,593)** | (1,980) | (45) | (2,025) |
| Net interest income | | **3,437** | 3,216 | 234 | 3,450 |
| Fee income | | **2,386** | 2,276 | 321 | 2,597 |
| Fee expense | | **(738)** | (648) | (36) | (684) |
| Net fee income | | **1,648** | 1,628 | 285 | 1,913 |
| Trading income excluding net interest income | | **2,136** | 743 | 151 | 894 |
| Net interest income on trading activities | | **382** | 476 | 4 | 480 |
| Net trading income | | **2,518** | 1,219 | 155 | 1,374 |
| Net expense from financial instruments designated at fair value | | **(512)** | (61) | – | (61) |
| Gains less losses from financial investments | | **123** | 294 | 1 | 295 |
| Dividend income | | **9** | 8 | 1 | 9 |
| Net earned insurance premiums | | **1,132** | 1,180 | – | 1,180 |
| Other operating income | | **22** | 23 | 3 | 26 |
| **Total operating income** | | **8,377** | 7,507 | 679 | 8,186 |
| Net insurance claims incurred and movement in liabilities to policyholders | | **(1,452)** | (1,373) | – | (1,373) |
| **Net operating income before loan impairment charges and other credit risk provisions** | | **6,925** | 6,134 | 679 | 6,813 |
| Loan impairment charges and other credit risk provisions | *4* | **(550)** | (675) | 1 | (674) |
| **Net operating income** | | **6,375** | 5,459 | 680 | 6,139 |
| Employee compensation and benefits | *5* | **(1,842)** | (2,373) | (276) | (2,649) |
| General and administrative expenses | | **(1,995)** | (2,284) | (192) | (2,476) |
| Depreciation and impairment of property, plant and equipment | | **(163)** | (160) | (8) | (168) |
| Amortisation and impairment of intangible assets | | **(103)** | (85) | – | (85) |
| **Total operating expenses** | | **(4,103)** | (4,902) | (476) | (5,378) |
| **Operating profit** | | **2,272** | 557 | 204 | 761 |
| Share of profit/(loss) in associates and joint ventures | | **1** | (4) | – | (4) |
| **Profit before tax** | | **2,273** | 553 | 204 | 757 |
| Tax (expense)/credit | | **(567)** | 63 | (34) | 29 |
| **Profit for the period** | | **1,706** | 616 | 170 | 786 |
| Profit attributable to shareholders of the parent company | | **1,681** | 592 | 170 | 762 |
| Profit attributable to non-controlling interests | | **25** | 24 | – | 24 |

# Condensed Financial Statements (unaudited) (continued)

## Consolidated statement of comprehensive income for the half-year to 30 June 2013

| | 30 June 2013 | 30 June 2012 | | |
|---|---|---|---|---|
| | | Continuing operations | Discontinued operations | Total |
| | £m | £m | £m | £m |
| Profit for the period | **1,706** | 616 | 170 | 786 |
| **Other comprehensive income** | | | | |
| **Items that will be reclassified subsequently to profit or loss when specific conditions are met** | | | | |
| Available-for-sale investments: | | | | |
| – fair value gains | **300** | 1,106 | 62 | 1,168 |
| – fair value losses/(gains) transferred to the income statement on disposal | **107** | (286) | 55 | (231) |
| – amounts transferred to the income statement in respect of impairment losses | **123** | 284 | – | 284 |
| – income taxes | **23** | (30) | (15) | (45) |
| Cash flow hedges: | | | | |
| – fair value (losses)/gains | **(156)** | 129 | 7 | 136 |
| – fair value (gains) transferred to the income statement | **(149)** | (73) | (10) | (83) |
| – income taxes | **88** | (13) | 1 | (12) |
| Exchange differences and other | **522** | (265) | (150) | (415) |
| **Items that will not be reclassified subsequently to profit or loss** | | | | |
| Remeasurement of the defined benefit asset | | | | |
| – before income taxes | **(1,095)** | (98) | – | (98) |
| – income taxes | **254** | 22 | – | 22 |
| Other comprehensive income for the period, net of tax | **17** | 776 | (50) | 726 |
| Total comprehensive income for the period | **1,723** | 1,392 | 120 | 1,512 |
| Total comprehensive income for the period attributable to: | | | | |
| – shareholders of the parent company | **1,683** | 1,384 | 120 | 1,504 |
| – non-controlling interests | **40** | 8 | – | 8 |
| | **1,723** | 1,392 | 120 | 1,512 |

# Condensed Financial Statements (unaudited) (continued)

## Consolidated statement of financial position at 30 June 2013

| | Notes | 30 June 2013 £m | 31 December 2012 £m |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances at central banks | | **59,438** | 51,613 |
| Items in the course of collection from other banks | | **2,353** | 1,961 |
| Trading assets | *6* | **188,724** | 161,516 |
| Financial assets designated at fair value | *6* | **16,293** | 15,387 |
| Derivatives | *6,7* | **155,723** | 177,808 |
| Loans and advances to banks | *4,6* | **51,610** | 32,286 |
| Loans and advances to customers | *4,6* | **282,498** | 282,685 |
| Financial investments | *6* | **77,928** | 71,265 |
| Other assets | | **6,757** | 6,366 |
| Current tax assets | | **264** | 200 |
| Prepayments and accrued income | | **2,627** | 2,584 |
| Interests in associates and joint ventures | | **74** | 67 |
| Goodwill and intangible assets | | **8,094** | 7,826 |
| Property, plant and equipment | | **2,043** | 2,024 |
| Deferred tax assets | | **237** | 274 |
| Retirement benefit assets | | **929** | 1,619 |
| Total assets | | **855,592** | 815,481 |
| **LIABILITIES AND EQUITY** | | | |
| **Liabilities** | | | |
| Deposits by banks | *6* | **44,596** | 39,571 |
| Customer accounts | *6* | **355,373** | 324,886 |
| Items in the course of transmission to other banks | | **1,361** | 1,017 |
| Trading liabilities | *6* | **150,252** | 122,896 |
| Financial liabilities designated at fair value | *6* | **34,466** | 32,918 |
| Derivatives | *6* | **156,438** | 181,095 |
| Debt securities in issue | *6* | **38,895** | 40,358 |
| Other liabilities | | **6,717** | 6,846 |
| Current tax liabilities | | **198** | 122 |
| Liabilities under insurance contracts issued | | **19,074** | 17,913 |
| Accruals and deferred income | | **2,859** | 3,250 |
| Provisions | *8* | **1,798** | 1,641 |
| Deferred tax liabilities | | **26** | 99 |
| Retirement benefit liabilities | | **329** | 319 |
| Subordinated liabilities | *6* | **10,751** | 10,350 |
| Total liabilities | | **823,133** | 783,281 |
| **Equity** | | | |
| Called up share capital | | **797** | 797 |
| Share premium account | | **20,025** | 20,025 |
| Other reserves | | **1,231** | 394 |
| Retained earnings | | **9,858** | 10,459 |
| Total equity attributable to shareholders of the parent company | | **31,911** | 31,675 |
| Non-controlling interests | | **548** | 525 |
| Total equity | | **32,459** | 32,200 |
| Total equity and liabilities | | **855,592** | 815,481 |

# Condensed Financial Statements (unaudited) (continued)

## Consolidated statement of cash flows for the half-year to 30 June 2013

| | 30 June 2013 £m | 30 June 2012 £m |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit before tax | **2,273** | 757 |
| Adjustments for: | | |
| – non-cash items included in profit before tax | **1,208** | 2,341 |
| – change in operating assets | **(9,307)** | (21,994) |
| – change in operating liabilities | **34,682** | 27,216 |
| – elimination of exchange differences[1] | **(6,421)** | 3,312 |
| – net gain from investing activities | **(138)** | (315) |
| – share of (profit)/loss in associates and joint ventures | **(1)** | 4 |
| – contributions paid to defined benefit plans | **(175)** | (95) |
| – tax paid | **(124)** | (206) |
| Net cash generated from operating activities | **21,997** | 11,020 |
| **Cash flows from investing activities** | | |
| Purchase of financial investments | **(17,628)** | (21,129) |
| Proceeds from the sale and maturity of financial investments | **15,340** | 30,243 |
| Purchase of property, plant and equipment | **(162)** | (162) |
| Proceeds from the sale of property, plant and equipment | **14** | 34 |
| Purchase of intangible assets | **(92)** | (117) |
| Net cash inflow from acquisition of businesses | **305** | - |
| Proceeds from disposal of subsidiaries | **8** | - |
| Net cash (used in)/generated from investing activities | **(2,215)** | 8,869 |
| **Cash flows from financing activities** | | |
| Subordinated liabilities issued, net of perpetual subordinated debt classified as equity repaid | **–** | 350 |
| Subordinated loan capital repaid | **–** | (350) |
| Net cash outflow from increase in stake of subsidiaries | **–** | (2) |
| Dividends paid to shareholders | **(1,400)** | (200) |
| Dividends paid to non-controlling interests | **(16)** | (15) |
| Net cash used in financing activities | **(1,416)** | (217) |
| **Net increase in cash and cash equivalents** | **18,366** | 19,672 |
| Cash and cash equivalents at 1 January | **98,158** | 108,440 |
| Effect of exchange rate changes on cash and cash equivalents | **3,336** | (2,560) |
| Cash and cash equivalents at 30 June | **119,860** | 125,552 |

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 2013

| | Half year to 30 June 2013 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Other reserves | | | | | |
| | Called up share capital £m | Share premium £m | Retained earnings £m | Available-for-sale fair value reserve £m | Cash flow hedging reserve £m | Foreign exchange reserve £m | Total share-holders' equity £m | Non-controlling interests £m | Total equity £m |
| At 1 January 2013 | 797 | 20,025 | 10,459 | (131) | 259 | 266 | 31,675 | 525 | 32,200 |
| Profit for the period | – | – | 1,681 | – | – | – | 1,681 | 25 | 1,706 |
| Other comprehensive income (net of tax) | – | – | (841) | 557 | (217) | 503 | 2 | 15 | 17 |
| Available-for-sale investments | – | – | – | 557 | – | – | 557 | (4) | 553 |
| Cash flow hedges | – | – | – | – | (217) | – | (217) | – | (217) |
| Actuarial (losses)/gains on defined benefit plans | – | – | (841) | – | – | – | (841) | – | (841) |
| Exchange differences and other | – | – | – | – | – | 503 | 503 | 19 | 522 |
| Total comprehensive income for the period | – | – | 840 | 557 | (217) | 503 | 1,683 | 40 | 1,723 |
| Dividends to shareholders | – | – | (1,400) | – | – | – | (1,400) | (16) | (1,416) |
| Net impact of equity-settled share-based payments | – | – | (125) | – | – | – | (125) | – | (125) |
| Other movements | – | – | – | – | – | – | – | – | – |
| Acquisition and disposal of subsidiaries/businesses | – | – | 85 | (1) | (5) | – | 79 | (1) | 78 |
| Tax on items taken directly to equity | – | – | (1) | – | – | – | (1) | – | (1) |
| **At 30 June 2013** | 797 | 20,025 | 9,858 | 425 | 37 | 769 | 31,911 | 548 | 32,459 |

| | Half year to 30 June 2012 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Other reserves | | | | | |
| | Called up share capital £m | Share premium £m | Retained earnings £m | Available-for-sale fair value reserve £m | Cash flow hedging reserve £m | Foreign exchange reserve £m | 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 gains/(losses) 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) |
| Repayment of capital securities[1] | – | – | 5 | – | – | – | 5 | – | 5 |
| Other movements | – | – | – | – | – | – | – | – | – |
| 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 |

# 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 Conduct 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 2012 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 2012, there were no unendorsed standards effective for the year ended 31 December 2012 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 2012 were prepared in accordance with IFRSs as issued by the IASB.

**Standards adopted during the period ended 30 June 2013**

On 1 January 2013, the group adopted the following significant new standards and revisions to standards for which the financial effect is insignificant to these interim consolidated financial statements:

- IFRS 10 'Consolidated Financial Statements,' IFRS 11 'Joint Arrangements', IFRS 12 'Disclosure of Interests in Other Entities' and amendments to IFRS 10, IFRS 11 and IFRS 12 'Transition Guidance'. IFRS 10 and 11 are required to be applied retrospectively.
- Under IFRS 10, there is one approach for determining consolidation for all entities, based on the concept of power, variability of returns and their linkage. This replaces the approach which applied to previous financial statements which emphasised legal control or exposure to risks and rewards, depending on the nature of the entity. The group controls and consequently consolidates an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.
- IFRS 11 places more focus on the investors' rights and obligations than on the structure of the arrangement when determining the type of joint arrangement in which the group is involved, unlike the previous approach, and introduces the concept of a joint operation.
- IFRS 12 is a comprehensive standard on disclosure requirements for all forms of interests in other entities, including for unconsolidated structured entities.
- IFRS 13 'Fair Value Measurement' establishes a single framework for measuring fair value and introduces new requirements for disclosure of fair value measurements. IFRS 13 is required to be applied prospectively from the beginning of the first annual period in which it is applied. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application. New disclosures and enhancements to existing disclosures are provided in Note 6.
- Amendments to IFRS 7 'Disclosures – Offsetting Financial Assets and Financial Liabilities' which requires disclosure of the effect or potential effects of netting arrangements on an entity's financial position. The amendment requires disclosure of recognised financial instruments that are subject to enforceable master netting arrangements or similar agreements. The amendments have been applied retrospectively. New disclosures are provided in Note 7.
- Amendments to IAS 19 'Employee Benefits' ('IAS 19 revised'). IAS 19 revised is required to be applied retrospectively. IAS 19 revised replaces the interest cost on the plan liability and expected return on plan assets with a finance cost comprising the net interest on the net defined benefit liability or asset. This finance cost is determined by applying to the net defined benefit liability or asset the same discount rate used to measure the defined benefit obligation. The difference between the actual return on plan assets and the return included in the finance cost component reflected in the income statement is presented in other comprehensive income. The effect of this change is to increase or decrease the pension expense by the

difference between the current expected return on plan assets and the return calculated by applying the relevant discount rate.

At 30 June 2013, there were no unendorsed standards effective for the period ended 30 June 2013 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 2013, the group adopted an interpretation 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 125 to 128 of the *Annual Report and Accounts 2012*.

### (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 in *'Standards adopted during the period ended 30 June 2013'* above.

### (e) Operating Segments

In the 2012 Annual Report and Accounts, the group's segments reported under IFRS 8 Operating Segments were: UK Retail Banking, Continental Europe Retail Banking, Global Banking and Markets, Global Private Banking and Other. Following the sale of HSBC Private Banking (Suisse) SA in November 2012, which made up the majority of Global Private Banking, and a reorganisation of reporting lines, operating segments were reviewed for all reporting periods from 1 January 2013.

The group has revised its operating segments, to: Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets, Global Private Banking and Other. Global Private Banking includes HSBC Private Bank (UK) Ltd and Private Banking businesses in France.

The revised segments are consistent with those reported to the group's Executive Committee, the identified Chief Operating Decision Maker ('CODM') under IFRS 8.

### (f) Future accounting developments

In addition to the projects to complete financial instrument accounting, discussed below, the IASB is continuing to work on projects on insurance, revenue recognition and lease accounting which will represent significant changes to accounting requirements in the future.

**Amendments issued by the IASB and endorsed by the EU**

In December 2011, the IASB issued amendments to IAS 32 'Offsetting Financial Assets and Financial Liabilities' which clarified the requirements for offsetting financial instruments and addressed inconsistencies in current practice when applying the offsetting criteria in IAS 32 'Financial Instruments: Presentation'. The amendments are effective for annual periods beginning on or after 1 January 2014 with early adoption permitted and are required to be applied retrospectively.

Based on the assessment performed to date, HSBC do not expect the amendments to IAS 32 to have a material effect on HSBC's financial statements.

**Amendments issued by the IASB but not endorsed by the EU**

*Standards applicable in 2015*

In November 2009, the IASB issued IFRS 9 'Financial Instruments' which introduced new requirements for the classification and measurement of financial assets. In October 2010, the IASB issued an amendment to IFRS 9 incorporating requirements for financial liabilities. Together, these changes represent the first phase in the IASB's planned replacement of IAS 39 'Financial Instruments: Recognition and Measurement.'

The second and third phases in the IASB's project to replace IAS 39 will address the impairment of financial assets and general hedge accounting. Macro hedging is not included in the IFRS 9 project and will be addressed separately.

Following the IASB's decision in December 2011 to defer the effective date, the existing version of IFRS 9 is effective for annual periods beginning on or after 1 January 2015. IFRS 9 is required to be applied retrospectively but prior periods need not be restated. However, as a result of the IASB's decision that all phases of IFRS 9 will be applied from the same effective date and the fact that it now seems unlikely that the final standard will be issued in 2013, HSBC expect that the mandatory effective date of IFRS 9 will be deferred at least until 1 January 2016. Since the final requirements for classification and measurement are uncertain, it remains impracticable to quantify the effect of the existing IFRS 9 as at the date of the publication of these financial statements.

HSBC is currently assessing the impact of the general hedge accounting requirements.

### (g) Changes in composition of the group

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

## 2 Accounting policies

The accounting policies adopted by the group for these interim consolidated financial statements are consistent with those described on pages 108 to 125 of the *Annual Report and Accounts 2012*, 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 2012*.

## 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 2013** | | 30 June 2012 | | 31 December 2012 | |
| | **£ per share** | **Total £m** | £ per share | Total £m | £ per share | Total £m |
| In respect of previous year: | | | | | | |
| – third (2012: second) interim dividend | **1.76** | **1,400** | 0.25 | 200 | – | – |
| In respect of current year: | | | | | | |
| – first interim dividend | – | – | – | – | 0.72 | 575 |
| – second interim dividend | – | – | – | – | 2.51 | 2,000 |
| | **1.76** | **1,400** | 0.25 | 200 | 3.23 | 2,575 |

**Dividends on preference shares classified as equity**

In the first half of 2013 no dividend was paid on the HSBC Bank plc non-cumulative third dollar preference shares (first half of 2012: no dividend; second half of 2012: £1.17 per share, totalling £41 million).

## 4 Loan impairment charges and other credit risk provisions

| | Half-year to | |
|---|---|---|
| | **30 June 2013** | 30 June 2012 |
| | **£m** | £m |
| Total loans and advances | | |
| – new allowances net of allowance releases | **788** | 659 |
| – recoveries of amounts previously written off | **(177)** | (101) |
| | **611** | 558 |
| Impairment charges on debt securities and other credit risk provisions | **(61)** | 116 |
| | **550** | 674 |

*Movement in impairment allowances on total loans and advances*

| | Individually assessed £m | Collectively assessed £m | Total £m |
|---|---|---|---|
| At 1 January 2013 | **2,351** | **919** | **3,270** |
| Amounts written off | **(340)** | **(258)** | **(598)** |
| Recoveries of amounts previously written off | **14** | **163** | **177** |
| Charge to income statement | **462** | **149** | **611** |
| Foreign exchange and other movements | **52** | **5** | **57** |
| **At 30 June 2013** | **2,539** | **978** | **3,517** |
| | | | |
| 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 |

## 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, as follows:

| | Half-year to | |
|---|---|---|
| | **30 June 2013** | 30 June 2012 |
| | **£m** | £m |
| Current service cost | **92** | 97 |
| Net interest income on the net defined benefit asset | **(40)** | (23) |
| Other (gains)/losses | **(279)** | 2 |
| Total (gain)/expense | **(227)** | 76 |

In June 2013, following consultation on various employee benefit proposals, the group announced to employees in the UK that future service accrual for defined benefit members would cease from 1 July 2015. Under the proposals, defined benefit pensions based on service to 30 June 2013 will continue to be linked to final salary on retirement (underpinned by increases in CPI) but all active members of the Defined Benefit Section will become members of the Defined Contribution Section from 1 July 2015. As part of these amendments, the HSBC Bank (UK) Pension Scheme ('the Scheme') will cease to deliver part-discretionary ill-health benefits to certain employees and these benefits will, instead, be purely formulaic, consistent with other UK employees, and covered via insurance policies. This results in a reduction in the defined benefit obligation of the Scheme and a corresponding gain of £280 million, recorded in the income statement as a reduction to total employee compensation and benefits.

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

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.

Average yields of high quality (AA rated or equivalent) debt instruments in the UK remained broadly consistent during the first half of 2013, but there was a significant increase in Retail Price Index inflation expectations. These and other actuarial assumptions resulted in a £1.1 billion increase in the defined benefit obligation for the Scheme. This was recognised in the statement of comprehensive income as an actuarial loss.

## 6 Fair values of financial instruments

Fair values are determined in accordance with the methodology set out in the *Annual Report and Accounts 2012* in the accounting policies on pages 108 to 128, and in Note 32 and Note 33 on pages 181 to 190.

*Bases of valuing financial assets and liabilities measured at fair value*

| | **Valuation techniques** | | | |
|---|---|---|---|---|
| | **Level 1 quoted market price £m** | **Level 2 using observable inputs £m** | **Level 3 with significant unobservable inputs £m** | **Total £m** |
| **At 30 June 2013** | | | | |
| **Assets** | | | | |
| Trading assets | **123,335** | **64,998** | **391** | **188,724** |
| Financial assets designated at fair value | **10,473** | **5,820** | **–** | **16,293** |
| Derivatives | **244** | **154,275** | **1,204** | **155,723** |
| Financial investments: available-for-sale | **55,587** | **20,625** | **1,716** | **77,928** |
| **Liabilities** | | | | |
| Trading liabilities | **80,860** | **67,952** | **1,440** | **150,252** |
| Financial liabilities designated at fair value | **3,861** | **30,605** | **–** | **34,466** |
| Derivatives | **149** | **154,780** | **1,509** | **156,438** |

| | 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 2012 | | | | |
| Assets | | | | |
| Trading assets | 86,373 | 74,789 | 354 | 161,516 |
| Financial assets designated at fair value | 9,501 | 5,886 | – | 15,387 |
| Derivatives | 193 | 176,455 | 1,160 | 177,808 |
| Financial investments: available-for-sale | 49,035 | 20,159 | 2,071 | 71,265 |
| Liabilities | | | | |
| Trading liabilities | 57,282 | 64,097 | 1,517 | 122,896 |
| Financial liabilities desingated at fair value | 3,767 | 29,151 | – | 32,918 |
| Derivatives | 189 | 179,598 | 1,308 | 181,095 |

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.

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

*Financial instruments measured at fair value using a valuation technique with significant unobservable inputs – Level 3*

*The group*

| | Assets | | | | Liabilities | | |
|---|---|---|---|---|---|---|---|
| | Available-for-sale £m | Held for trading £m | Designated at fair value through profit or loss £m | Derivatives £m | Held for trading £m | Designated at fair value through profit or loss £m | Derivatives £m |
| **At 30 June 2013** | | | | | | | |
| Private equity investments | **607** | **55** | **–** | **–** | **–** | **–** | **–** |
| Asset-backed securities | **1,052** | **164** | **–** | **–** | **–** | **–** | **–** |
| Structured notes | **–** | **–** | **–** | **–** | **1,440** | **–** | **–** |
| Derivatives | **–** | **–** | **–** | **1,204** | **–** | **–** | **1,509** |
| Other portfolios | **57** | **172** | **–** | **–** | **–** | **–** | **–** |
| | **1,716** | **391** | **–** | **1,204** | **1,440** | **–** | **1,509** |
| At 31 December 2012 | | | | | | | |
| Private equity investments | 452 | 51 | – | – | – | – | – |
| Asset-backed securities | 1,409 | 137 | – | – | – | – | – |
| Leverage finance | – | – | – | – | – | – | 7 |
| Structured notes | – | 5 | – | – | 1,515 | – | – |
| Derivatives | – | – | – | 1,160 | 2 | – | 1,301 |
| Other portfolios | 210 | 161 | – | – | – | – | – |
| | 2,071 | 354 | – | 1,160 | 1,517 | – | 1,308 |

*Quantitative information about significant unobservable inputs in level 3 valuations*

| | Fair value | | | | Range of inputs | |
|---|---|---|---|---|---|---|
| | Assets £m | Liabilities £m | Valuation technique | Key unobservable inputs | Lower | Higher |
| **At 30 June 2013** | | | | | | |
| Private equity including strategic investments | **662** | **–** | See notes below | See notes below | n/a | n/a |
| Asset-backed securities | **1,216** | **–** | | | | |
| CLO/CDO[1] | **666** | **–** | Market proxy | Bid quotes | – | 101 |
| Other ABSs | **550** | **–** | | | | |
| Structured notes | **–** | **1,440** | | | | |
| Equity-linked notes | **–** | **722** | Model – Option model | Equity volatility | 7% | 81% |
| | | | Model – Option model | Equity correlation | 0.12 | 0.83 |
| Fund-linked notes | **–** | **324** | Model – Option model | Fund volatility | 21% | 23% |
| FX-linked notes | **–** | **280** | Model – Option model | FX volatility | 3% | 24% |
| Other | **–** | **114** | | | | |
| Derivatives | **1,204** | **1,509** | | | | |
| Interest rate derivatives: | | | | | | |
| – securitisation swaps | **137** | **828** | Model – Discounted cash flow | Prepayment rate | 2% | 25% |
| – long-dated swaptions | **351** | **190** | Model – Option model | IR volatility | 4% | 28% |
| – other | **151** | **91** | | | | |
| Foreign exchange derivatives: | | | | | | |
| – Foreign exchange options | **141** | **85** | Model – Option model | FX volatility | 0.05% | 24% |
| – other | **6** | **1** | | | | |
| Equity derivatives: | | | | | | |
| – long-dated single stock options | **284** | **224** | Model – Option model | Equity volatility | 7% | 81% |
| – other | **50** | **61** | | | | |
| Credit derivatives: | | | | | | |
| – derivatives with monolines | **52** | **–** | Model – Discounted cash flow | Credit spread | 3% | 26% |
| – other | **32** | **29** | | | | |
| Other portfolios | **229** | **–** | | | | |
| | **3,311** | **2,949** | | | | |

1 *Collateralised loan obligation/ collateralised debt obligation*

## Key unobservable inputs to Level 3 financial instruments

The table above lists key unobservable inputs to level 3 financial instruments, and provides the range of those inputs as at 30 June 2013. A further description of the categories of key unobservable inputs is given below.

**Private equity including strategic investments**

HSBC's private equity and strategic investments are generally classified as available for sale and are not traded in active markets. In the absence of an active market, an investment's fair value is estimated on the basis of an analysis of the investee's financial position and results, risk profile, prospects and other factors, as well as by reference to market valuations for similar entities quoted in an active market, or the price at which similar companies have changed ownership. Given the bespoke nature of the analysis in respect of each holding, it is not practical to quote a range of key unobservable inputs.

**Prepayment rates**

Prepayment rates are a measure of the anticipated future speed at which a loan portfolio will be repaid in advance of the due date. Prepayment rates are an important input into modelled values of asset-backed securities. A modelled price may be used where insufficient observable market prices exist to enable a market price to be determined directly. Prepayment rates are also an important input into the valuation of derivatives linked to securitisations. For example, so-called securitisation swaps have a notional value that is linked to the size of the outstanding loan portfolio in a securitisation, which may fall as prepayments occur. Prepayment rates vary according to the nature of the loan portfolio, and expectations of future market conditions. For example, prepayment rates will generally be anticipated to increase as interest rates rise. Prepayment rates may be estimated using a variety of evidence, such as prepayment rates implied from proxy observable security prices, current or historic prepayment rates, macro-economic modelling.

**Market proxy**

Market proxy pricing may be used for an instrument for which specific market pricing is not available, but evidence is available in respect of instruments that have some characteristics in common. In some cases it might be possible to identify a specific proxy, but more generally evidence across a wider range of instruments will be used to understand the factors that influence current market pricing and the manner of that influence. For example, in the collateralised loan obligation market it may be possible to establish that A-rated securities exhibit prices in a range, and to isolate key factors that influence position within the range. Application of this to a specific A-rated security within HSBC's portfolio allows assignment of a price.

The range of prices used as inputs into a market proxy pricing methodology may therefore be wide. This range is not indicative of the uncertainty associated with the price derived for an individual security.

**Volatility**

Volatility is a measure of the anticipated future variability of a market price. Volatility tends to increase in stressed market conditions, and decrease in calmer market conditions. Volatility is an important input in the pricing of options. In general, the higher the volatility, the more expensive the option will be. This reflects both the higher probability of an increased return from the option, and the potentially higher costs that HSBC may incur in hedging the risks associated with the option. If option prices become more expensive, this will increase the value of HSBC's long option positions (i.e. the positions in which HSBC has purchased options), while HSBC's short option positions (i.e. the positions in which HSBC has sold options) will suffer losses.

Volatility varies by underlying reference market price, and by strike and maturity of the option. Volatility also varies over time. As a result, it is difficult to make general statements regarding volatility levels. For example, while it is generally the case that foreign exchange volatilities are lower than equity volatilities, there may be examples in particular currency pairs or for particular equities where this is not the case.

Certain volatilities, typically those of a longer-dated nature, are unobservable. The unobservable volatility is then estimated from observable data. For example, longer-dated volatilities may be extrapolated from shorter-dated volatilities.

The range of unobservable volatilities quoted in the table reflects the wide variation in volatility inputs by reference market price. For example, FX volatilities for a pegged currency may be very low, whereas for non-managed currencies the FX volatility may be higher. As a further example, volatilities for deep-in-the-money or deep-out-of-the-money equity options may be significantly higher than at-the-money options as a result of 'volatility skew'. For

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

any single unobservable volatility, the uncertainty in the volatility determination is significantly less than the range quoted above.

**Correlation**

Correlation is a measure of the inter-relationship between two market prices. Correlation is a number between minus one and one. A positive correlation implies that the two market prices tend to move in the same direction, with a correlation of one implying that they always move in the same direction. A negative correlation implies that the two market prices tend to move in opposite directions, with a correlation of minus one implying that the two market prices always move in opposite directions.

Correlation is used to value more complex instruments where the payout is dependent upon more than one market price. For example, an equity basket option has a payout that is dependent upon the performance of a basket of single stocks, and the correlation between the price movements of those stocks will be an input to the valuation. This is referred to as equity-equity correlation. There are a wide range of instruments for which correlation is an input, and consequently a wide range of both same-asset correlations (e.g. equity-equity correlation) and cross-asset correlations (e.g. foreign exchange rate-interest rate correlation) used. In general, the range of same-asset correlations will be narrower than the range of cross-asset correlations.

Correlation may be unobservable. Unobservable correlations may be estimated based upon a range of evidence, including consensus pricing services, HSBC trade prices, proxy correlations and examination of historical price relationships.

The range of unobservable correlations quoted in the table reflects the wide variation in correlation inputs by market price pair. For any single unobservable correlation, the uncertainty in the correlation determination is likely to be less than the range quoted above.

**Credit spread**

Credit spread is the premium over a benchmark interest rate required by the market to accept a lower credit quality. In a discounted cash flow model, the credit spread increases the discount factors applied to future cash flows, thereby reducing the value of an asset. Credit spreads may be implied from market prices. Credit spreads may not be observable in more illiquid markets.

### Inter-relationships between key unobservable inputs

Key unobservable inputs to level 3 financial instruments may not be independent of each other. As described above, market variables may be correlated. This correlation typically reflects the manner in which different markets tend to react to macro-economic or other events. For example, improving economic conditions may lead to a 'risk on' market, in which prices of risky assets such as equities and high yield bonds will rise, while 'safe haven' assets such as gold and US Treasuries decline. Furthermore, the impact of changing market variables upon the HSBC portfolio will depend upon HSBC's net risk position in respect of each variable. For example, increasing high-yield bond prices will benefit long high-yield bond positions, but the value of any credit derivative protection held against those bonds will fall.

*Fair values of financial instruments not carried at fair value*

| | **30 June 2013** | | 31 December 2012 | |
|---|---|---|---|---|
| | **Carrying amount** | **Fair Value** | Carrying amount | Fair Value |
| | **£m** | **£m** | £m | £m |
| **Assets** | | | | |
| Loans and advances to banks | **51,610** | **51,610** | 32,286 | 32,285 |
| Loans and advances to customers | **282,498** | **276,765** | 282,685 | 276,397 |
| **Liabilities** | | | | |
| Deposits by banks | **44,596** | **44,596** | 39,571 | 39,571 |
| Customer accounts | **355,373** | **355,470** | 324,886 | 325,029 |
| Debt securities in issue | **38,895** | **38,924** | 40,358 | 40,401 |
| Subordinated liabilities | **10,751** | **10,789** | 10,350 | 10,013 |

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

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

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 Offsetting of financial assets and financial liabilities

*Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements*

| | Gross amounts of recognised financial assets | Gross amounts offset in the balance sheet | Amounts presented in the balance sheet | Amounts not offset in the balance sheet | | Net amount |
|---|---|---|---|---|---|---|
| | | | | Financial instruments | Cash collateral received | |
| | £m | £m | £m | £m | £m | £m |
| **At 30 June 2013** | | | | | | |
| Derivatives | **335,529** | **(179,806)** | **155,723** | **102,474** | **17,579** | **35,670** |
| Reverse repurchase, securities borrowing and similar agreements Classified as: | | | | | | |
| – trading assets | **61,222** | **(19,423)** | **41,799** | **41,374** | **406** | **19** |
| – loans and advances to banks at amortised cost | **32,054** | **(4,756)** | **27,298** | **27,242** | **56** | **–** |
| – loans and advances to customers at amortised cost | **32,555** | **(16,676)** | **15,879** | **15,801** | **74** | **4** |
| Loans and advances excluding reverse repos | | | | | | |
| – to banks | **–** | **–** | **–** | **–** | **–** | **–** |
| – to customers | **103,885** | **(54,551)** | **49,334** | **47,348** | **–** | **1,986** |
| | **565,245** | **(275,212)** | **290,033** | **234,239** | **18,115** | **37,679** |
| At 31 December 2012 | | | | | | |
| Derivatives | 395,797 | (217,989) | 177,808 | 122,169 | 18,992 | 36,647 |
| Reverse repurchase, securities borrowing and similar agreements Classified as: | | | | | | |
| – trading assets | 69,223 | (26,409) | 42,814 | 42,814 | – | – |
| – loans and advances to banks at amortised cost | 17,949 | (4,151) | 13,798 | 13,693 | 105 | – |
| – loans and advances to customers at amortised cost | 28,607 | (11,717) | 16,890 | 16,862 | 27 | 1 |
| Loans and advances excluding reverse repos | | | | | | |
| – to banks | – | – | – | – | – | – |
| – to customers | 105,227 | (53,797) | 51,430 | 48,009 | – | 3,421 |
| | 616,803 | (314,063) | 302,740 | 243,547 | 19,124 | 40,069 |

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

*Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements*

| | Gross amounts of recognised financial liabilities £m | Gross amounts offset in the balance sheet £m | Amounts presented in the balance sheet £m | Amounts not offset in the balance sheet: Financial instruments £m | Amounts not offset in the balance sheet: Cash collateral pledged £m | Net amount £m |
|---|---|---|---|---|---|---|
| **At 30 June 2013** | | | | | | |
| Derivatives | **336,244** | **(179,806)** | **156,438** | **102,471** | **19,225** | **34,742** |
| Repurchase, securities lending and similar agreements Classified as: | | | | | | |
| – trading liabilities | **68,381** | **(19,423)** | **48,958** | **48,938** | **–** | **20** |
| – deposits by banks | **14,997** | **(4,756)** | **10,241** | **9,825** | **70** | **346** |
| – customer accounts | **39,414** | **(16,676)** | **22,738** | **22,675** | **63** | **–** |
| Deposits by banks excluding repos | **1** | **–** | **1** | **–** | **–** | **1** |
| Customer accounts excluding repos | **111,823** | **(54,551)** | **57,272** | **47,348** | **–** | **9,924** |
| | **570,860** | **(275,212)** | **295,648** | **231,257** | **19,358** | **45,033** |
| At 31 December 2012 | | | | | | |
| Derivatives | 399,084 | (217,989) | 181,095 | 122,499 | 22,984 | 35,612 |
| Repurchase, securities lending and similar agreements Classified as: | | | | | | |
| – trading liabilities | 71,142 | (26,409) | 44,733 | 44,733 | – | – |
| – deposits by banks | 10,508 | (4,151) | 6,357 | 6,300 | 57 | – |
| – customer accounts | 23,924 | (11,717) | 12,207 | 12,205 | 1 | 1 |
| Deposits by banks excluding repos | 29 | – | 29 | – | – | 29 |
| Customer accounts excluding repos | 109,840 | (53,797) | 56,043 | 48,009 | – | 8,034 |
| | 614,527 | (314,063) | 300,464 | 233,746 | 23,042 | 43,676 |

## 8 Provisions

Provisions of £1,798 million (31 December 2012: £1,641 million) include £1,186 million (31 December 2012: £1,227 million) in respect to customer redress programmes and £287 million (31 December 2012: £103 million) in respect of litigation. The most significant of these provisions are as follows:

(i) £666 million (31 December 2012: £692 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 £238 million was recognised in the income statement during the half-year ended 30 June 2013. In addition, a further £99 million of provision was transferred to the group following the acquisition of the business assets and liabilities of HFC Bank Limited (‘HFC’), a member of the HSBC Group, in June 2013. Cumulative provisions made since the Judicial Review ruling in the first half of 2011 (including amounts before the transfer of the balances from HFC) amount to £1.8 billion of which £1.1 billion 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 expected uphold rate for complaints and the amount of redress payable in upheld cases. The main assumptions are likely to evolve over time as more experience becomes available regarding actual complaint volumes received and root cause analysis is completed.

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. It is possible the eventual outcome may differ from the current estimate and there is currently a high degree of uncertainty as to the eventual costs of redress for this matter.

In determining the level of additional provision in the first half of 2013, management noted the higher levels of response to outbound mailings than had been previously assumed, now that the outbound contact exercise implemented is reasonably mature for some brands, as well as the increased cost of cases referred to the

Financial Ombudsman Service. The group continued to review remediation processes (root cause analysis, customer contact, case reviews, decision making and redress calculations) across all brands and sales channels and align these to the highest common standard and industry best practice.

(ii) £333 million (31 December 2012: £375 million) relating to the estimated liability for redress in respect of the possible mis-selling of interest rate derivatives in the UK. During the first half of 2013, the group utilised £17 million of the provision.

The extent to which the group is required to pay redress depends largely on the responses of contacted customers and complaints received from other customers during the review period and the facts and circumstances of each individual case. It is possible the eventual outcome may differ from the current estimate and there is currently a high degree of uncertainty as to the eventual costs of redress related to this matter.

Further details of legal proceedings and regulatory matters are set out in Note 12. Legal proceedings include civil court, arbitration or tribunal proceedings brought against the group (whether by way of claim or counterclaim) or civil disputes that may, if not settled, result in court, arbitration or tribunal proceedings.

## 9 Credit quality of financial instruments

The five credit quality classifications set out and defined on page 47 of the *Annual Report and Accounts 2012* 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 2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | **59,438** | **–** | **–** | **–** | **–** | **–** | **–** | **59,438** |
| Items in the course of collection from other banks | **2,353** | **–** | **–** | **–** | **–** | **–** | **–** | **2,353** |
| Trading assets | **107,525** | **24,446** | **23,908** | **1,649** | **–** | **–** | **–** | **157,528** |
| – treasury and other eligible bills | **941** | **752** | **188** | **–** | **–** | **–** | **–** | **1,881** |
| – debt securities | **48,179** | **7,792** | **4,069** | **342** | **–** | **–** | **–** | **60,382** |
| – loans and advances to banks | **25,343** | **8,192** | **7,405** | **1,299** | **–** | **–** | **–** | **42,239** |
| – loans and advances to customers | **33,062** | **7,710** | **12,246** | **8** | **–** | **–** | **–** | **53,026** |
| Financial assets designated at fair value | **2,460** | **264** | **4,249** | **5** | **–** | **–** | **–** | **6,978** |
| – treasury and other eligible bills | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| – debt securities | **2,459** | **264** | **4,247** | **5** | **–** | **–** | **–** | **6,975** |
| – loans and advances to banks | **1** | **–** | **2** | **–** | **–** | | **–** | **3** |
| – loans and advances to customers | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **–** |
| Derivatives | **121,760** | **19,787** | **13,253** | **923** | **–** | **–** | **–** | **155,723** |
| Loans and advances held at amortised cost | **193,417** | **64,040** | **64,563** | **6,227** | **1,329** | **8,049** | **(3,517)** | **334,108** |
| – loans and advances to banks | **44,618** | **4,353** | **2,521** | **81** | **10** | **49** | **(22)** | **51,610** |
| – loans and advances to customers | **148,799** | **59,687** | **62,042** | **6,146** | **1,319** | **8,000** | **(3,495)** | **282,498** |
| Financial investments | **63,690** | **7,108** | **2,467** | **1,935** | **–** | **1,710** | **–** | **76,910** |
| – treasury and other similar bills | **3,963** | **1,215** | **433** | **–** | **–** | **4** | **–** | **5,615** |
| – debt securities | **59,727** | **5,893** | **2,034** | **1,935** | **–** | **1,706** | **–** | **71,295** |
| Other assets | **4,523** | **449** | **2,005** | **571** | **7** | **10** | **–** | **7,565** |
| – endorsements and acceptances | **289** | **18** | **418** | **–** | **–** | **–** | **–** | **725** |
| – accrued income and other | **4,234** | **431** | **1,587** | **571** | **7** | **10** | **–** | **6,840** |

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

| | 31 December 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Neither past due nor impaired | | | | | | | |
| | Strong £m | Good £m | Medium Satisfactory £m | Sub-standard £m | Past due not impaired £m | Impaired £m | Impairment allowances £m | Total £m |
| Cash and balances at central banks | 51,613 | – | – | – | – | – | – | 51,613 |
| Items in the course of collection from other banks | 1,961 | – | – | – | – | – | – | 1,961 |
| Trading assets | 99,766 | 21,027 | 17,140 | 691 | – | – | – | 138,624 |
| – treasury and other eligible bills | 931 | 797 | 527 | 3 | – | – | – | 2,258 |
| – debt securities | 41,991 | 8,017 | 4,320 | 248 | – | – | – | 54,576 |
| – loans and advances to banks | 22,123 | 5,829 | 4,269 | 434 | – | – | – | 32,655 |
| – loans and advances to customers | 34,721 | 6,384 | 8,024 | 6 | – | – | – | 49,135 |
| Financial assets designated at fair value | 2,465 | 243 | 4,416 | 27 | – | – | – | 7,151 |
| – treasury and other eligible bills | – | – | – | – | – | – | – | – |
| – debt securities | 2,438 | 243 | 4,414 | 27 | – | – | – | 7,122 |
| – loans and advances to banks | 27 | – | 2 | – | – | – | – | 29 |
| – loans and advances to customers | – | – | – | – | – | – | – | – |
| Derivatives | 145,481 | 18,758 | 12,537 | 1,032 | – | – | – | 177,808 |
| Loans and advances held at amortised cost | 174,617 | 66,580 | 62,145 | 6,678 | 1,403 | 6,818 | (3,270) | 314,971 |
| – loans and advances to banks | 25,104 | 4,845 | 2,185 | 136 | – | 40 | (24) | 32,286 |
| – loans and advances to customers | 149,513 | 61,735 | 59,960 | 6,542 | 1,403 | 6,778 | (3,246) | 282,685 |
| Financial investments | 58,038 | 4,730 | 3,956 | 1,954 | – | 1,559 | – | 70,237 |
| – treasury and other similar bills | 4,199 | 530 | 474 | – | – | – | – | 5,203 |
| – debt securities | 53,839 | 4,200 | 3,482 | 1,954 | – | 1,559 | – | 65,034 |
| Other assets | 3,740 | 353 | 1,883 | 707 | 4 | 17 | – | 6,704 |
| – endorsements and acceptances | 271 | 21 | 487 | – | – | – | – | 779 |
| – accrued income and other | 3,469 | 332 | 1,396 | 707 | 4 | 17 | – | 5,925 |

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

## 10 Contingent liabilities, contractual commitments and guarantees

| | At 30 June 2013 £m | At 31 December 2012 £m |
|---|---|---|
| **Guarantees and other contingent liabilities** | | |
| Guarantees | **15,436** | 14,829 |
| Other contingent liabilities | **72** | 55 |
| | **15,508** | 14,884 |
| **Commitments** | | |
| Documentary credits and short-term trade-related transactions | **3,359** | 2,729 |
| Forward asset purchases and forward deposits placed | **38** | 19 |
| Undrawn formal standby facilities, credit lines and other commitments to lend | **121,361** | 112,977 |
| | **124,758** | 115,725 |

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 12.

### 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 198 of the *Annual Report and Accounts 2012*.

### 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 pages 198 and 199 of the *Annual Report & Accounts 2012*.

## 11 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 2013, the gross notional value of the swaps was £19,297 million (31 December 2012: £18,998 million), the swaps had a negative fair value of £3,330 million to the bank (31 December 2012: negative fair value £3,233 million) and the bank had delivered collateral of £4,724 million (31 December 2012: £4,423 million) to the Scheme in respect of these swaps. All swaps were executed at prevailing market rates and within standard market bid/offer spreads.

## 12 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 2013.

## 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$8.4 billion, an amount that includes fictitious profits reported by Madoff. Based on information available to HSBC to date, the Group 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$4 billion.

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 April 2013, the US Court of Appeals for the Second Circuit heard oral argument on an appeal by investors in three related putative class actions from decisions by the US District Court for the Southern District of New York that dismissed all claims against the HSBC defendants on *forum non conveniens* grounds and in one of the actions involving claims of investors in Thema International Fund plc, also declined to consider preliminary approval of a proposed settlement pursuant to which, subject to various conditions, HSBC had agreed to pay from US$52.5 million up to a maximum of US$62.5 million. In light of the District Court's decisions, HSBC terminated the settlement agreement. The Thema plaintiff contests HSBC's right to terminate. A decision on appeal is expected in late 2013.

In July 2013, a settlement was reached for US$250 million plus a contribution of US$43 million towards costs in respect of a claim by Thema International Fund plc against HSBC Institutional Trust Services (Ireland) Limited in the Irish High Court. A provision was made for this matter as at 30 June 2013.

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$9 billion 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. The Second Circuit issued a decision upholding the District Court's dismissal of the common law claims in June 2013.

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 briefing and oral arguments on the merits of the withdrawn issues are now complete. The District Court has issued rulings on several of the withdrawn issues, but decisions with respect to all other issues are still pending and are expected in 2013.

## 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 US 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 the claims made against it and will continue to defend them vigorously.

### Anti-money laundering and sanctions-related investigations

In December 2012, HSBC Holdings plc ('HSBC Holdings'), the bank's ultimate parent company, HSBC Bank USA, N.A. ('HBUS'), and HSBC North America Holdings ('HNAH') entered into agreements to achieve a resolution with US and UK government agencies regarding past inadequate compliance with anti-money laundering ('AML'), US Bank Secrecy Act ('BSA') and sanctions laws. Among other agreements, HSBC Holdings and HBUS entered into a five-year Deferred Prosecution Agreement (the 'US DPA') with the US Department of Justice ('DOJ'), HSBC Holdings entered into a two-year Deferred Prosecution Agreement with the New York County District Attorney ('DANY'), and HSBC Holdings consented to a cease and desist order with the Federal Reserve Board ('FRB'). HSBC Holdings also entered into an Undertaking with the UK Financial Services Authority (now a Financial Conduct Authority ('FCA') Direction) to comply with certain forward-looking obligations with respect to anti-money laundering and sanctions requirements over a five-year term.

In addition, HBUS entered into a monetary penalty consent order with the US Department of the Treasury's Financial Crimes Enforcement Network ('FinCEN') and a separate monetary penalty order with the Office of the Comptroller of the Currency ('OCC'). HBUS also entered into a separate consent order with the OCC requiring it to correct the circumstances and conditions as noted in the OCC's then most recent report of examination, imposing certain restrictions on HBUS directly or indirectly acquiring control of, or holding an interest in, any new financial subsidiary, or commencing a new activity in its existing financial subsidiary, unless it receives prior approval from the OCC. HBUS entered into a separate consent order with the OCC requiring it to adopt an enterprise-wide compliance program.

Under these agreements, HSBC Holdings and HBUS will continue to cooperate fully with US and UK regulatory and law enforcement authorities and take further action to strengthen its compliance policies and procedures. Under its agreements with DOJ, the FCA, and the FRB, an independent corporate compliance monitor will evaluate the HSBC Group's progress in implementing its obligations under the relevant agreements. Michael Cherkasky has been selected as the independent monitor, and, on 1 July, 2013, the United States District Court for the Eastern District of New York approved the US DPA and retained authority to oversee implementation of the same.

If HSBC Holdings and HSBC Bank USA fulfil all of the requirements imposed by the US DPA, the DOJ's charges against those entities will be dismissed at the end of the five-year period of that agreement. Similarly, if HSBC Holdings fulfils all of the requirements imposed by the DANY DPA, DANY's charges against it will be dismissed at the end of the two-year period of that agreement. The DoJ may prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA if HSBC Holdings or HSBC Bank USA breaches the terms of the US DPA, and DANY may prosecute HSBC Holdings in relation to the matters which are subject of the DANY DPA if HSBC Holdings violates the terms of the DANY DPA.

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

Under these agreements, HSBC Holdings has certain obligations to ensure that entities in the HSBC Group, including the bank and its subsidiaries, comply with certain requirements. Steps continue to be taken to implement ongoing obligations under the US DPA, FCA direction, and other settlement agreements.

The settlement with US and UK authorities does not preclude private litigation relating to, among other things, the HSBC Group's compliance with applicable AML/ BSA and sanctions laws or other regulatory or law enforcement actions for AML/BSA or sanctions matters not covered by the various agreements.

## Investigations and reviews into the setting of London interbank offered rates, European interbank offered rates and other benchmark interest and foreign exchange 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 and reviews related to certain past submissions made by panel banks and the processes for making submissions in connection with the setting of London interbank offered rates ('Libor'), European interbank offered rates ('Euribor') and other benchmark interest and foreign exchange 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 those investigations and reviews.

Based on the facts currently known in respect of each of these investigations, there is a high degree of uncertainty as to the terms on which the on-going investigations will be resolved and the timing of such resolution, including the amounts of fines and/or penalties. As matters progress, it is possible that fines and penalties could ultimately be significant.

In addition, HSBC and other panel banks have been named as defendants in a number of private lawsuits filed in the US with respect to the setting of US dollar Libor. These lawsuits include individual and putative class actions, most of which have been transferred and/or consolidated for pre-trial purposes before the US District Court for the Southern District of New York. The complaints in those actions assert claims against HSBC and other US dollar Libor panel banks under various US laws including US antitrust and racketeering laws, the US Commodity Exchange Act ('CEA'), and state law.

In March 2013, the US District Court Judge overseeing the consolidated proceeding that encompasses a number of pending actions related to US dollar Libor issued an opinion and order in the six oldest actions, dismissing the plaintiffs' federal and state antitrust claims, racketeering claims and unjust enrichment claims in their entirety, but allowing certain of their CEA claims that were not barred by the applicable statute of limitations to proceed. In May 2013, the plaintiffs in some of those actions filed motions for leave to amend their complaints. Those motions remain pending before the court. The court has stayed proceedings with respect to all other actions in the consolidated proceeding that contain claims similar to those addressed by the court's opinion and order.

Separately, HSBC and other panel banks have also been named as defendants in a putative class action filed in the US on behalf of persons and entities who transacted in euroyen futures and options contracts related to the euroyen Tokyo interbank offered rate ('Tibor'). The complaint alleges, amongst other things, misconduct related to euroyen Tibor, although HSBC is not a member of the Japanese Bankers Association's Euroyen TIBOR panel, as well as Japanese Yen Libor, in violation of US antitrust laws, the US CEA, and state law. In April 2013, the plaintiff filed a second amended complaint, which the defendants moved to dismiss in June 2013. Briefing is expected to be completed in late 2013.

Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these private lawsuits, including the timing and potential impact on HSBC.

## Credit default swap regulatory investigation and litigation

In July 2013, HSBC received a Statement of Objections from the European Commission relating to its on-going investigation of alleged anti-competitive activity by a number of market participants in the credit derivative market between 2006 and 2009. The Statement of Objections sets out the European Commission's preliminary views and does not prejudge the final outcome of its investigation. HSBC is reviewing the Statement of Objections in detail and will submit a response to the European Commission in due course. Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of the European Commission's investigation, including the timing or impact on HSBC.

In July 2013, various HSBC entities including HSBC Bank plc were named as defendants, among others, in three putative class actions filed in federal courts located in New York and Chicago. These class actions allege that the defendants, which include ISDA, Markit and several other financial institutions, conspired to restrain trade in violation of the federal anti-trust laws by, among other things, restricting access to credit default swap pricing exchanges and blocking new entrants into the exchange market, with the purpose and effect of artificially inflating the bid/ask spread paid to buy and sell credit default swaps in the United States. The Plaintiffs in these suits purport to represent a class of all persons who purchased or sold credit default swaps to defendants in the United States. Based on the facts currently known, it is not practicable at this time for HSBC to predict the resolution of these lawsuits, including the timing and potential impact on HSBC.

## 13 Event after the balance sheet date

A first interim dividend for the financial year ending 31 December 2013 of £570 million was declared by the Directors after 30 June 2013.

## 14 Interim Report 2013 and statutory accounts

The information in this *Interim Report 2013* is unaudited and does not constitute statutory accounts within the meaning of section 434(3) of the Companies Act 2006. The *Interim Report 2013* was approved by the Board of Directors on 5 August 2013. The statutory accounts for the year ended 31 December 2012 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 2013 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 2013* 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 Conduct Authority ('the UK FCA'). 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 2013* is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the *Interim Report 2013* in accordance with the DTR of the UK FCA.

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 2013* 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 2013* for the six months ended 30 June 2013 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FCA.

Nicholas Edmonds
For and on behalf of KPMG Audit Plc
Chartered Accountants
London, England

5 August 2013

**HSBC Bank plc**
*Incorporated in England with limited liability. Registered in England: number 14259*

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