# Connecting customers to opportunities

HSBC Holdings plc

**Strategic Report 2013**

HSBC

*This* Strategic Report 2013 *forms a part of HSBC Holdings plc* Annual Report and Accounts 2013 *and is not the Group's statutory accounts. It does not contain the Directors' Report and it does not contain sufficient information to allow as full an understanding of the results and state of affairs of the Group and of its policies and arrangements concerning Directors' remuneration as would be provided by the full* Annual Report and Accounts 2013.

*Additional information, including commentary on 2012 compared with 2011, may be found in the* Form 20-F *filed with the US Securities and Exchange Commission and available on www.hsbc.com and www.sec.gov.*

### Certain defined terms

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

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

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### Cover images: internationalisation of the renminbi

The growth of China's currency, the renminbi ('RMB'), is set to be a defining theme of the 21st century. China is the world's second largest economic power and the world's number one trading nation. As China's economic power continues to grow, the importance of the RMB for trade settlement, investment and funding will increase.

In 2013, the RMB overtook the euro to become the world's second most-used currency for trade finance and the Chinese government set out further reforms that will speed up the RMB's internationalisation. HSBC estimates that one-third of China's trade flows will be settled in RMB by 2015.

The cover images show the views from HSBC's head offices in Shanghai, Hong Kong and London – the three cities that are key to the RMB's development. As mainland China's financial centre and home to a newly established free trade zone, Shanghai is both the onshore trading hub and the testing ground for a fully convertible RMB. Hong Kong is the centre of global RMB trade settlement, responsible for around 80 per cent of mainland China's external trade in RMB. London is now the leading RMB hub in the West, accounting for over 60 per cent of RMB trading outside mainland China and Hong Kong.

HSBC has a proud heritage in all three cities and, with RMB capabilities in over 50 countries and territories worldwide, our customers can count on an expert service wherever they do business in the currency.

# Who we are

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

Customers:
54 million

Served by:
254,000 employees

Through four global businesses:
Retail Banking and Wealth Management
Commercial Banking
Global Banking and Markets
Global Private Banking

Located in:
75 countries and territories

Across six geographical regions:
Europe
Hong Kong
Rest of Asia-Pacific
Middle East and North Africa
North America
Latin America

Offices:
Over 6,300

Global headquarters:
London

Market capitalisation:
US$207 billion

Listed on stock exchanges in:
London
Hong Kong
New York
Paris
Bermuda

Shareholders:
216,000 in 131 countries and territories

# Our purpose

**Our purpose is to be where the growth is, connecting customers to opportunities, enabling businesses to thrive and economies to prosper, and ultimately helping people to fulfil their hopes and realise their ambitions.**

## Our strategic priorities

We aim to be the world's leading and most respected international bank. We will achieve this by focusing on the needs of our customers and the societies we serve, thereby delivering long-term sustainable value to all our stakeholders.

For 2011 to 2013, we defined strategic actions across three areas: capital deployment, organisation and cost efficiency, and growth. In May 2013, we announced a set of three interconnected and equally weighted priorities for 2014 to 2016 to help us deliver our strategy:

- grow the business and dividends;
- implement Global Standards; and
- streamline processes and procedures.

These priorities form the basis for this *Strategic Report*. Each priority is interrelated, complementary and underpinned by initiatives within our day-to-day business. Together they create value for our customers and shareholders, and contribute to the long-term sustainability of HSBC.

*A diagrammatic representation of the priorities and their related themes is provided on page 12.*

## How we measure performance

We track our progress in implementing our strategy with a range of financial and non-financial measures or key performance indicators. Specific targets have been set for the period 2014 to 2016 at both a Group level and for each of our global businesses and regions.

## Rewarding performance

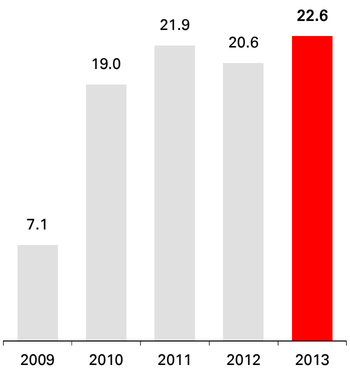
The remuneration of all staff within the Group, including executive Directors, is based on the achievement of financial and non-financial objectives. These objectives, which are aligned with the Group's strategy, are detailed in individuals' annual scorecards. To be considered for a variable pay award, an individual must have fully complied with HSBC Values.

*For further information on HSBC Values, see page 25.*

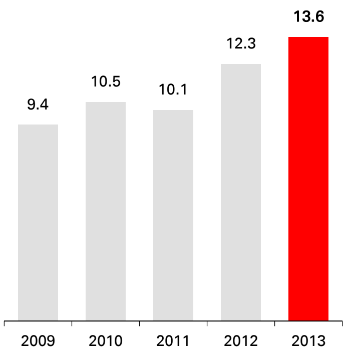
# Highlights of 2013

- **Profit before tax was up 9% to US$22.6bn on a reported basis.** Underlying profit before tax was up 41% to US$21.6bn.
- **Considerable progress in delivering on strategic priorities** including the disposal or closure of a further 20 businesses and non-core investments announced in 2013, helping make HSBC easier to manage and control.
- **Reinforced HSBC's position as one of the best-capitalised banks in the world.** Based on our current understanding of capital rules, we remain well-placed to meet expected future capital requirements.
- **Dividends to shareholders increased to US$9.2bn** as capital strength creates capacity for organic growth and allows us to increase the dividends paid.

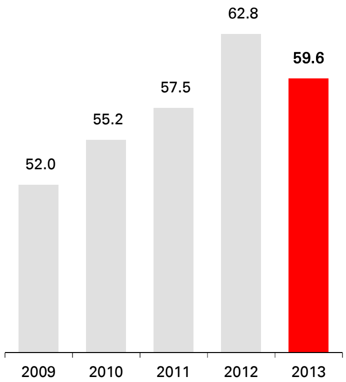
**Profit before taxation**
(reported basis)
US$22.6bn
£14.4bn
HK$175bn



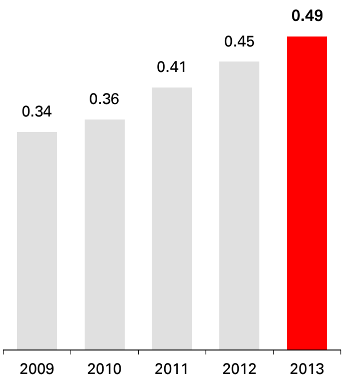

**Capital strength**
(core tier 1 ratio)[1]
13.6%
At 31 December



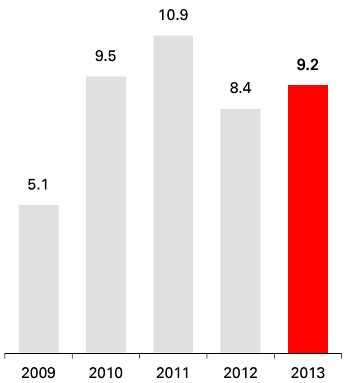

**Cost efficiency ratio**
(reported basis)[2]
59.6%



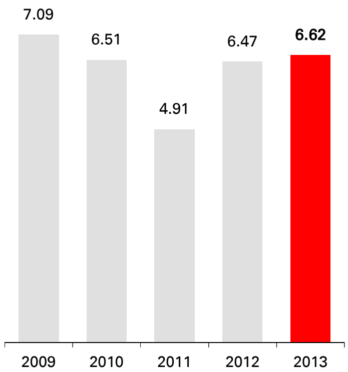

**Dividends per ordinary share**
(in respect of year)[3]
US$0.49
£0.31
HK$3.80




**Return on average ordinary shareholders' equity**[4]
9.2%




**Share price**
at 31 December
£6.62
HK$84.15
US$55.13 American Depositary Share




*For a description of the difference between reported and underlying performance, see page 16.*

*For footnotes, see page 46.*

# Group Chairman's Statement

Against the welcome backdrop of generally improving economic conditions, we significantly progressed the reshaping of HSBC during 2013. The focus of these efforts was two-fold; alongside concentrating on capturing the high quality opportunities from and within our increasingly distinctive international network and diversified business model we strove to improve risk management and control through eliminating or restructuring businesses with higher inherent risk characteristics. The combination of our commitment to implementing Global Standards, addressing regulatory changes and managing increased capital discipline has driven a fundamental review of all aspects of our business. I have no doubt that a stronger HSBC is emerging from this process. The Group Chief Executive's Review gives greater detail of the progress made on this journey and draws out the key elements of HSBC's performance in 2013.

If there is one thing to highlight from all the work being done, it is the recognition of the benefits to our customers of the connectivity we can deliver across geographies and through our universal banking model. As we reshape HSBC we shall not lose sight of the importance of these network benefits or of the fact that this network has taken close to 150 years to build.

Nowhere is this more evident than in our businesses facilitating cross-border investment and trade activities. Our geographic presence, which straddles both the key developed Western economies and the most important markets in Asia, Latin America and the Middle East, adds both comparative advantage and resilience to our competitive positioning.

China finished the year with record trade figures, thereby becoming the largest trading nation in the world, and it is fitting that the cover of this year's Annual Report features the three cities where HSBC's trade credentials were established in 1865 and which are now playing key roles in the internationalisation of the renminbi, namely Shanghai, Hong Kong and London.

## Performance in 2013

HSBC's performance in 2013 was reassuringly sound across our main business areas with good underlying momentum in areas of targeted investment.

Pre-tax profit on a reported basis was US$22.6 billion, 9% or US$1.9 billion higher than that reported in 2012. On an underlying basis, profit before tax was 41% (US$6.3 billion) ahead of last year, driven primarily by welcome reductions in loan impairment charges as well as in fines and penalties and customer redress costs.

These improvements flow in large part from the re-positioning of the Group and from enhanced risk controls given effect over the last three years.

Earnings per share of US$0.84 compared with US$0.74 in 2012. Shareholders' equity stood at US$181.9 billion, some US$6.6 billion higher than at the start of the year. The Group's market capitalisation rose over the year by US$13 billion and at US$207 billion exceeded shareholders' equity by US$25 billion or 14%.

Continuing strong capital generation from operating results, together with the favourable effect of the ongoing run-off of exit portfolios and non-core disposals, lifted our core tier 1 ratio to 13.6% compared with 12.3% at the start of the year.

Taking account of our strong capital position and earnings performance, the Board has approved a fourth interim dividend in respect of 2013 of US$0.19 per share, as against US$0.18 per share in 2012. The Board intends to maintain the first three quarterly interim dividends in respect of 2014 at US$0.10 per share. Total dividends in respect of 2013 of US$0.49 per share were 9% or US$0.04 higher than in 2012, amounting to US$9.2 billion in aggregate, an increase in pay-out of US$0.9 billion.

Once again in 2013, the British Government increased the rate of the bank levy imposed on the consolidated balance sheets of UK domiciled banks and expanded the scope of the levy. This increased the cost to HSBC in 2013 by US$321 million, taking the levy for the year to US$904 million, of which US$484 million related to non-UK banking activity. The impact of the levy represented US$0.05 per share which would otherwise have been available for distribution to shareholders or retained to strengthen the capital base or support incremental growth.

## Global Standards and regulatory change

In the current public policy debates about how best to restore and expand economic growth, two themes critical to our industry stand out. First, how to prevent another financial crisis and what tools are needed to minimise the cost to society should one occur. Second, how to achieve a better balance between economic activity and a more equitable distribution of the economic growth that is generated in the future.

We are clear that through building the further resilience mandated by global regulatory changes and by implementing and adhering to global standards in all aspects of compliance, we can address both sets of objectives and build a more sustainable future for HSBC. Much has been done but there is much still to do.

The Group Chief Executive's Review highlights the priority we give to this agenda. It remains the key focus of the Board's governance of executive performance. In executing these responsibilities, the Board is also acutely aware of its commitments under the Deferred Prosecution Agreement and associated regulatory undertakings entered into in December 2012. As reported at our interim results, Michael Cherkasky, the Monitor appointed to evaluate and report upon the effectiveness of the Group's AML and sanctions compliance function and HSBC's progress in meeting its remedial obligations, commenced his work in July last year. The Board, both directly and through its Financial System Vulnerabilities Committee, has established a good working relationship with the Monitor in order to support him and his team in the execution of their assignment.

## Responding to heightened standards

Sustainable success in banking is founded upon meeting the expectations of society. Fundamentally, this means delivering transparent and fair outcomes to our customers. It also means avoiding any perception of self-interest by ensuring there is a proper division of value between providers and consumers of financial products and services. While regulatory changes seek to address the framework supporting these outcomes, responsibility and accountability rest with the industry itself, and ultimately with the management and boards of individual institutions. We understand this and strive to be seen as proactively responsive to rising expectations. We made good progress in 2013 in this regard. In particular, we redesigned the compensation frameworks in Retail Banking and Wealth Management around the customer, so that from the start of 2014 we have removed the link between financial reward opportunity and product sales for substantially all of our staff in our retail and wealth businesses. We have also stepped up the Board's governance oversight over conduct and behavioural issues, and I deal with this later.

## Board changes

It is critical to all we do that we have the breadth and depth of experience on the Board necessary to provide effective governance and challenge. As we refresh the Board to take account of planned retirements, we seek to add skills and experience complementary to those already on the Board in order to strengthen the range of oversight competences within the Board. Through the Nomination Committee we look up to two years ahead to identify a pipeline of suitable candidates and I am hugely encouraged by the quality of individuals we are able to identify and attract.

We shall be saying goodbye to two long-serving Directors later this year. Both John Coombe and James Hughes-Hallett have given outstanding service and commitment over their nine years on the Board and its Committees. They will not seek re-election at the AGM in May.

In his time on the Board, in addition to his measured contributions to Board discussions, John has brought a wealth of business and financial experience and expertise to the Group Audit Committee, which latterly he chaired, and to the Group Risk and Remuneration Committees. In these roles he has taken on a considerable workload and critical responsibilities throughout periods of significant economic and market uncertainty and major regulatory change. Upon his retirement it is proposed that John will be succeeded in his role as Chair of the Group Audit Committee by Renato Fassbind.

With his deep experience of managing a broad range of international businesses, notably in the Far East, James has brought a businessman's perspective to the Board as well as detailed knowledge of both Hong Kong and mainland China. James has served with distinction on the Group Audit, Risk, Corporate Sustainability and Nomination Committees.

On behalf of the Board and shareholders, I want to take this opportunity to acknowledge their contribution to HSBC and record our appreciation and gratitude for their long and distinguished periods of service.

On 21 February we announced the appointment of a new Director to the Board.

**Kathleen Casey**, a former Commissioner of the US Securities and Exchange Commission ('SEC'), will join the Board as an independent non-executive Director with effect from 1 March 2014. She will become a member of the Group Audit Committee and the Financial System Vulnerabilities Committee.

Kathleen served as an SEC Commissioner from 2006 to 2011, acting as the regulator's principal representative in multilateral and bilateral regulatory dialogues including with the G-20 Financial Stability Board and the International Organisation of Securities Commissions. Before being appointed Commissioner, Kathleen spent 13 years on Capitol Hill, holding various positions including Staff Director and Counsel of the United States Senate Committee on Banking, Housing and Urban Affairs (2003-2006).

Kathleen brings to the Board a wealth of experience of financial services regulation gained though public service at a key time in the regulatory evolution of the sector. Her skills will complement well the diverse background and experience of the Board.

## Governance changes

Recognising the benefits to be had from reinforcing the links between our major subsidiary boards and HSBC Holdings, the Board invited Rona Fairhead to extend her term of service on the Board and take on the Chairmanship of HSBC North America Holdings Inc. The Board was delighted when she accepted this invitation, taking on her new role with effect from the start of this year.

Finally, the Board considered in depth the conclusions and recommendations of the Parliamentary Commission on Banking Standards on conduct and behaviour in banks and concluded that the Board should expand and enhance its oversight of these areas. Accordingly, the Board has established a new Committee, the Conduct and Values Committee, into which will be folded much of what was done historically in the Group Corporate Sustainability Committee. I am delighted to report that Rachel Lomax has agreed to chair this new committee. Further details of its terms of reference and membership are set out on page 362 of the *Annual Report and Accounts 2013.*

## Looking forward

As well as addressing the regulatory and governance challenges we face, it is essential to keep a sense of perspective and be able to focus on the significant opportunities arising from successful execution of our strategy. Let me outline four by way of illustration.

First, trade. HSBC was founded on financing trade and investment flows. By 2050 trade and capital flows between Asia, the Middle East and Latin America, in which we are well represented, could increase tenfold. The internationalisation of the renminbi, where HSBC is already the leading international bank, will amplify these opportunities.

Second, the world's population is ageing, necessitating considerably greater privately funded retirement saving. HSBC's research shows that globally some 48% of people have never saved for retirement and that 56% admit they are not preparing adequately.

Third, as the world's population expands there is an urgent need to fund the technology and infrastructure investment that will deliver the energy, water and food needed to support the extra two billion people predicted to be living by 2050.

Fourth, we need to invest to bring to our customers the benefits available through smarter digital technology and richer data.

The above represent only some of the foreseeable changes to which banking needs to respond in order to enable our customers better to meet their financial needs and aspirations.

The opportunities are clear; HSBC's commitment to be a trusted partner in the delivery of these opportunities lies at the heart of our strategy. Our ability to succeed lies in the strength and range of our networks and our universal banking model. The rest of this *Strategic Report* covers the detail of that strategy.

Finally, what we have achieved in 2013 and what we plan to do rests upon the dedication and commitment of our employees, the continuing support of our customers, counterparties and shareholders, the trust of our regulators and public confidence more generally. On behalf of the Board, I want to take this opportunity to thank our staff for all their efforts and their continuing loyalty to HSBC, and to commit to those we serve and those who regulate us that we are focused on continuing to earn their trust and deserve their confidence in HSBC.

D J Flint, *Group Chairman*
24 February 2014

# Group Chief Executive's Review

2013 marked the end of the first stage of implementation of our strategy for HSBC. Throughout this three-year period we have worked constantly to reshape HSBC and improve returns. The Group today is leaner and simpler than in 2011 with strong potential for growth.

In 2011, I outlined a strategy to realise our purpose as a business and to establish HSBC as the world's leading international bank. It aims to capitalise on two major trends: the continuing growth of international trade and capital flows; and wealth creation, particularly in Asia, the Middle East and Latin America. Over the last three years we have put this into action, pursuing more effective capital deployment, greater organisational efficiency and improved growth.

We have simplified HSBC considerably since 2011, initiating the disposal or closure of 63 non-strategic businesses or non-core investments, including 20 in 2013. This represents a potential reduction in risk-weighted assets of around US$95bn, equivalent to about 9% of 2010 year-end risk-weighted assets. To date, about US$90bn in risk-weighted assets have been released with, potentially, some US$5bn still to come.

We have transformed the way that we run the business, exerting pressure on costs and making it easier to manage and control. We have installed consistent business models, reshaped global businesses and global functions, and removed layers of management to give staff greater responsibility, improve decision making and remove bureaucracy. The number of full-time equivalent employees has been reduced from 295,000 at the start of 2011 to 254,000 at the end of 2013, primarily through disposals and our cost-reduction programmes. We achieved an additional US$1.5bn of sustainable cost savings bringing our total annualised sustainable cost savings to US$4.9bn since 2011. This comfortably exceeded our target of US$2.5-3.5bn and provides good momentum into 2014. On a constant currency basis and excluding UK customer redress and restructuring costs, operating expenses in 2013 were broadly flat compared to 2010. This demonstrates the impact of our sustainable cost savings and business disposals in broadly offsetting cost increases, which came primarily from inflationary pressures, the UK bank levy and investment in risk and compliance, as well as business initiatives.

We have positioned HSBC to capture international trade and capital flows, 90% of which go through markets covered by our international network. We have also sought to capitalise on the advantages that our unique network provides.

We have focused on our product capabilities to broaden client coverage, grown revenue through greater collaboration between global businesses and strengthened them through investment and senior hires in strategic markets such as Hong Kong, mainland China and Germany. We have also combined our market-leading position in Asia and our global reach to cement our position as the number one international bank for renminbi ('RMB') business in the world, as recognised by the 2013 *Asiamoney* Offshore RMB Services Survey. Our leadership in the Greater Chinese market continues to be reflected in our first place rankings in the *dim sum* bond issuance and Hong Kong M&A league tables for 2013, and the announcement that we are the first custodian bank to service London-based renminbi qualified foreign institutional investors.

Our presence in markets across all of the major global trade routes has enabled us to support clients with international growth ambitions. In 2013 alone, we launched funds in Canada, Egypt, France, Mexico, Turkey, the UAE, the UK and the US offering financing to help our internationally focused SME clients. We have continued to build our international network through investments in city clusters, notably in the US, mainland China and Germany. Our clients are also benefiting from the global network of China desks that we established to assist companies trading with and from mainland China.

We also helped many of our customers achieve their personal ambitions. For instance, in the UK we lent £3.8bn (US$6.0bn) to help more than 30,000 first-time buyers purchase their own home in 2013.

We also provided greater convenience for our retail customers by rolling out new mobile applications across 25 key markets, with 2.5 million downloads in 2013.

Through actions like these we have already replaced approximately a third of the reduction in total revenue from disposals by growing our business since the start of 2011.

Although much progress has been made since 2011, we did not meet all of our targets by the end of 2013. Our reported cost efficiency ratio of 59.6% and return on equity of 9.2% in 2013 were both outside our target ranges, in part affected by continuing UK customer redress. In addition, there is further work required to grow our incremental wealth revenues to achieve our target of US$3bn in the medium term.

## Performance

Our performance in 2013 was influenced by the strategic measures that we have taken since the start of 2011.

Reported profit before tax was US$22.6bn, US$1.9bn higher than 2012, and underlying profit before tax was US$21.6bn, US$6.3bn higher than last year. Underlying revenue grew 9% faster than costs in 2013.

Underlying profit before tax was higher in three out of our four global businesses and all of our regions, with the exception of Latin America where underlying profit before tax fell. Whilst our performance in Latin America was affected by slower economic growth and inflationary pressures, we made significant progress in repositioning our portfolios with a focus on our priority markets of Brazil, Mexico and Argentina.

In Commercial Banking, underlying profit before tax increased by 5%, driven by higher revenues and lower costs. Higher revenue reflected average balance sheet growth, partly offset by spread compression, together with higher lending fees and improved collaboration with our other global businesses. These factors were partially offset by higher loan impairment charges, notably in Latin America.

In Global Banking and Markets, underlying profit before tax increased by 15%. This was driven by higher revenue and significantly lower loan impairment charges and other credit risk provisions. The increase in revenue was, in part, underpinned by a resilient performance in the majority of our customer-facing businesses.

In Retail Banking & Wealth Management underlying profit before tax increased by US$2.4bn as we made further progress in running-off the Consumer Mortgage and Lending ('CML') portfolio in North America, with the improvement in loan impairment charges more than offsetting the decline in revenue. Our Retail Banking & Wealth Management business excluding the US run-off portfolio benefited from lower UK customer redress charges and further sustainable cost savings, together with revenue growth, mainly in Hong Kong and Europe excluding the loss on sale of the HFC Bank secured lending portfolio.

We continued to address legacy issues and reposition our business model and client base in Global Private Banking, which in part resulted in a reduction in underlying profit before tax of US$0.7bn.

Our capital position strengthened over the year. Our core tier 1 ratio increased to 13.6% and our estimated CRD IV end point basis common equity tier 1 ratio increased to 10.9%. We remain well placed to meet expected future capital requirements, and will continue to review the evolution of the regulatory environment.

We continued to demonstrate our ability to generate capital to grow our business and to support our progressive dividend policy, cementing our status as one of the highest dividend payers in the FTSE.

## Strategy – next phase

2014 marks the beginning of the next phase of strategy implementation. This will be a continuation of the work that we began in 2011, albeit with new goals informed by our experience of the past three years.

At our investor update in May we reaffirmed our return on equity target at 12-15% and modified our cost-efficiency target for 2014-16 to mid-50s. We also announced three strategic priorities for 2014-16, each of equal importance.

First, our strategy is designed to further grow the business and dividends. We will continue to recycle risk-weighted assets from lower return to higher return parts of the Group. Our capital strategy aims to increase dividends progressively. If we are unable to deploy the remaining capital ourselves in such a way that it provides incremental value for our shareholders, we may seek to neutralise the effect of scrip dividends through share buy-backs, subject to regulatory capital requirements and shareholder approval. We shall also continue to wind down and thus reduce the impact of our portfolio of legacy businesses.

Second, we will continue to implement our Global Standards programme which we believe will increase the quality of the Group's earnings. Global Standards governs all of our activity and will drive consistently high standards through HSBC globally. We have made substantial investment in risk and compliance capabilities across all businesses and regions to strengthen our response to the ongoing threat of financial crime, and will continue to do so. This is the right thing to do, in line with our values, and we believe that it will also become a source of competitive advantage.

Third, we aim to deliver a further US$2-3bn of sustainable savings by streamlining our processes and procedures without in any way compromising our commitment to compliance and Global Standards. There remains considerable scope within the business to globalise and simplify many of our operations and practices.

These priorities are essential to realising our vision of establishing HSBC as the world's leading international bank.

## Outlook

We remain of the view that the GDP of mainland China will grow by 7.4% this year, the UK by 2.6%, the USA by 2.5% and Western Europe by 1.2%.

Although there has been a sharp sell-off in some emerging markets, both when tapering was first talked of last June and more recently in January of this year, we see this as a reflection of specific circumstances rather than a generalised threat. The countries most affected have two common themes, large current account deficits and the uncertain outcomes arising from elections within a year. Other emerging markets such as Mexico have, by contrast, been upgraded by the rating agencies in the same period. Overall, we remain optimistic about the longer-term prospects of emerging markets and especially the opportunities for HSBC, which will arise from the anticipated material expansion in South-South trade and capital flows. In the short term, we stress the importance of differentiating within and between individual countries within the generic category of emerging markets. Nevertheless, we anticipate greater volatility in 2014 and choppy markets as adjustments are made to changing economic circumstances and sentiment.

Stuart Gulliver

S T Gulliver, *Group Chief Executive*
24 February 2014

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

*In May 2013, we reinforced our vision for the long-term direction of HSBC first outlined in 2011, together with a clear strategy that will help us achieve it. It guides where and how we seek to compete. We constantly assess our progress against this strategy and provide regular updates to stakeholders.*

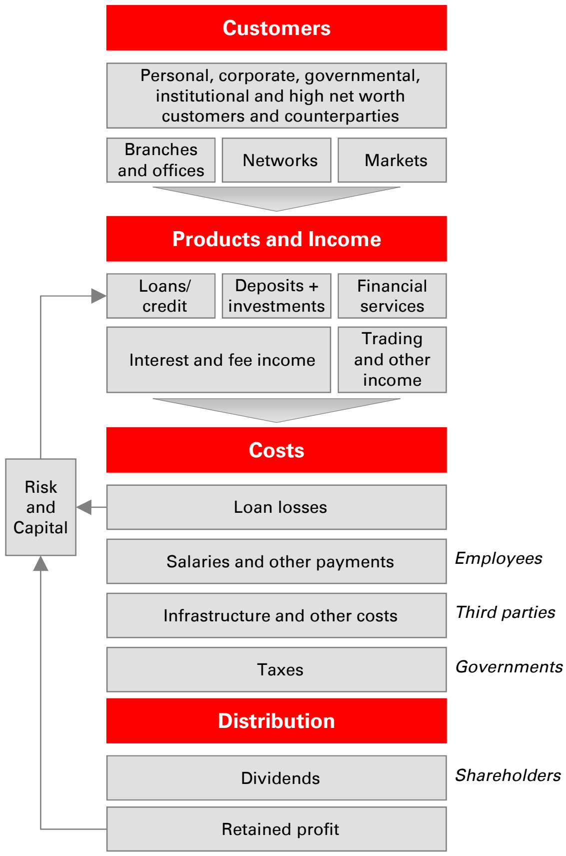
## How we create value

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

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

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

*Value creation*




*Our main products and services are described in more detail on page 79 of the* Annual Report and Accounts 2013.

**Our operating income is primarily derived from:**

- *net interest income* – interest income we earn on customer loans and advances and on our surplus funds, less interest expense we pay on interest-bearing customer accounts and debt securities in issue;
- *net fee income* – fee income we earn from the provision of financial services and products to customers less fees we pay; and
- *net trading income* – income from client driven trading activities primarily conducted in Markets, including Foreign Exchange, Credit, Rates and Equities trading.

We offer products that help a wide range of customers to manage their risks and exposures through, for example, life insurance and pension products for retail customers and receivables finance or documentary trade instruments for companies. Corporate customers also ask us to help with managing the financial risks arising in their businesses by employing our expertise and market access.

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

- using forward foreign currency contracts to hedge their income from export sales or costs of imported materials;
- using an inflation swap to hedge future inflation-linked liabilities, for example, for pension payments;
- transforming variable payments of debt interest into fixed rate payments, or vice versa; or
- providing investors with hedges against movements in markets or particular stocks.

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

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

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

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

*For further information on our risk measures, see page 38, and on how we manage our own risks, see page 39.*

## Long-term sustainability

At HSBC, we understand that the success of our business is closely connected to the economic, environmental and social landscape in which we operate. For us, long-term corporate sustainability means achieving a sustainable return on equity and profit growth so that we can continue to reward shareholders and employees, build long-lasting relationships with customers and suppliers, pay taxes and duties in the countries in which we operate, and invest in communities for future growth. The way we do business is as important as what we do: our responsibilities to our customers, employees and shareholders as well as to the countries and communities in which we operate go far beyond simply being profitable.

Continuing financial success depends, in part, on our ability to identify and address environmental, social and ethical developments which present risks or opportunities for the business. It also depends on the consistent implementation of the highest standards everywhere we operate to detect, deter and protect against financial crime. Our response to these factors shapes our reputation, drives employee engagement and affects the riskiness of the business, and can help reduce costs and secure new revenue streams.

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

*Our business and operating models are described in more detail on page 13. For further information on our response to environmental and community issues, see page 34.*

## Our strategy

### Long-term trends

Our strategy is aligned to two long-term trends:

- The world economy is becoming ever more connected, with growth in world trade and cross-border capital flows continuing to outstrip growth in average gross domestic product. Over the next decade we expect 35 markets to generate 90% of world trade growth with a similar degree of concentration in cross-border capital flows.
- Of the world's top 30 economies, we expect those of Asia-Pacific, Latin America, the Middle East and Africa to have increased by around four-fold in size by 2050, benefiting from demographics and urbanisation. By this time they will be larger than those of Europe and North America combined. By 2050, we expect 18 of the 30 largest economies will be from Asia-Pacific, Latin America or the Middle East and Africa.

### Competitive advantages

What matters in this environment are:

- having an international network and global product capabilities to capture international trade and movements in capital; and
- being able to take advantage of organic investment opportunities in the most attractive growth markets and maintaining the capacity to invest.

HSBC's competitive advantages come from:

- our meaningful presence in and long-term commitment to our key strategic markets;
- our strong ability to add to our capital base while also providing competitive rewards to our staff and good returns to our shareholders;
- our stable funding base, with about US$1.5 trillion of customer accounts of which 73% has been advanced to customers;
- our business network, which covers over 90% of global trade and capital flows; and
- our local balance sheet strength and trading capabilities in the most relevant financial hubs.

### A two-part strategy

Based on these long-term trends and our competitive advantages, we have developed a two-part strategy:

- *A network of businesses connecting the world.* HSBC is well positioned to capture growing international trade and capital flows. Our global reach and range of services place us in a strong position to serve clients as they grow from small enterprises into large multi-nationals through our Commercial Banking and Global Banking & Markets businesses.
- *Wealth management and retail with local scale.* We will capture opportunities arising from social mobility and wealth creation in our priority growth markets across Asia-Pacific, Latin America and the Middle East, through our Premier proposition and Global Private Banking business. We will invest in full scale retail businesses only in markets where we can achieve profitable scale, namely in our home markets of the United Kingdom and Hong Kong.

## Our strategic priorities

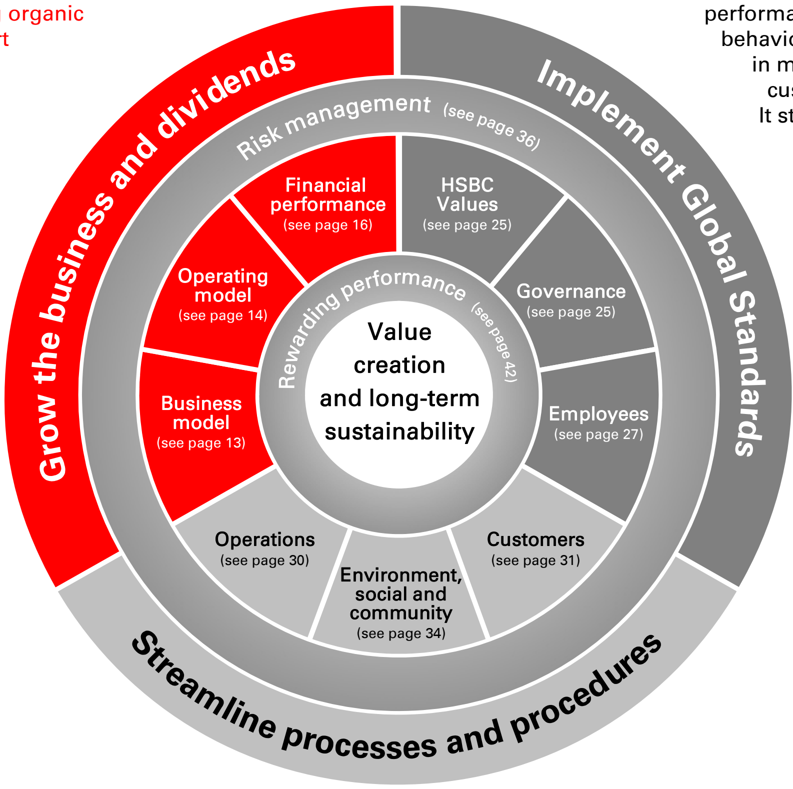
Our strategic priorities are designed to ensure we have a sustainable business for the long term.

### Grow ...

Profit underpins long-term business sustainability and growing our profit is an integral part of our strategy. The conditions for creating value and generating profits are reflected in our business and operating models, which determine how our global businesses, geographical regions and functions interact. Delivering organic growth will support a progressive dividend.

### Implement ...

A global bank needs global standards – consistent operating principles that are fundamental to the way we do business and which help us to detect, deter and protect against financial crime. Implementing Global Standards affects how we govern the Group, the nature of our core business and the performance, recognition and behaviours of all our people in managing high quality customer relationships. It starts with embedding our HSBC Values in everything we do.




### Streamline ...

This initiative is critical to the long-term sustainability of our business. Society's expectations of the financial services industry are evolving and becoming more demanding. At the same time, the digital revolution is reducing barriers to new entrants to the industry and markets are becoming increasingly competitive. In this environment, it is essential that we focus relentlessly on improving efficiency, ensuring that all parts of the Group streamline their processes and procedures and, as a consequence, reduce their costs. In doing so, we must remain cognisant of our wider obligations to the community, including human rights, and the environment.

*Strategic priority 1*

# Grow the business and dividends


- Business model ........ 13
- Operating model ........ 14
- Financial performance ........ 16


*Our success in meeting our targets is described on page 20.*

Our targets are to:

1. grow risk-weighted assets ('RWA's) in line with our organic investment criteria;
2. progressively grow dividends and introduce share buy-backs as appropriate; and
3. reduce the effect of legacy and non-strategic activities on our profit before tax and RWAs.

## Business model

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

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

The UK and Hong Kong are our home markets, and a further 20 countries form our priority growth markets (see table below). These 22 markets accounted for over 90% of our profit before tax in 2013, and are the primary focus of capital deployment. Network markets are markets with strong international relevance which serve to complement our international spread, operating mainly through Commercial Banking and Global Banking and Markets. Our combination of home, priority growth and network markets covers around 85-90% of all international trade and financial flows.

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

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

*HSBC's market structure*

| | Hong Kong and Rest of Asia-Pacific | Europe | Middle East and North Africa | North America | Latin America |
|---|---|---|---|---|---|
| Home markets | • Hong Kong | • UK | | | |
| Priority growth markets | • Australia<br>• Mainland China<br>• India<br>• Indonesia<br>• Malaysia<br>• Singapore<br>• Taiwan<br>• Vietnam | • France<br>• Germany<br>• Switzerland<br>• Turkey | • Egypt<br>• Saudi Arabia<br>• UAE | • Canada<br>• USA | • Argentina<br>• Brazil<br>• Mexico |
| Network markets | • Operations primarily focused on international clients and businesses of Commercial Banking and Global Banking and Markets<br>• Together with home and priority markets these cover 85-90% of international trade and capital flows | | | | |
| Small markets | • Markets where HSBC has profitable scale and focused operations<br>• Representative Offices | | | | |

## Operating model

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

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

### Holding company

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

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

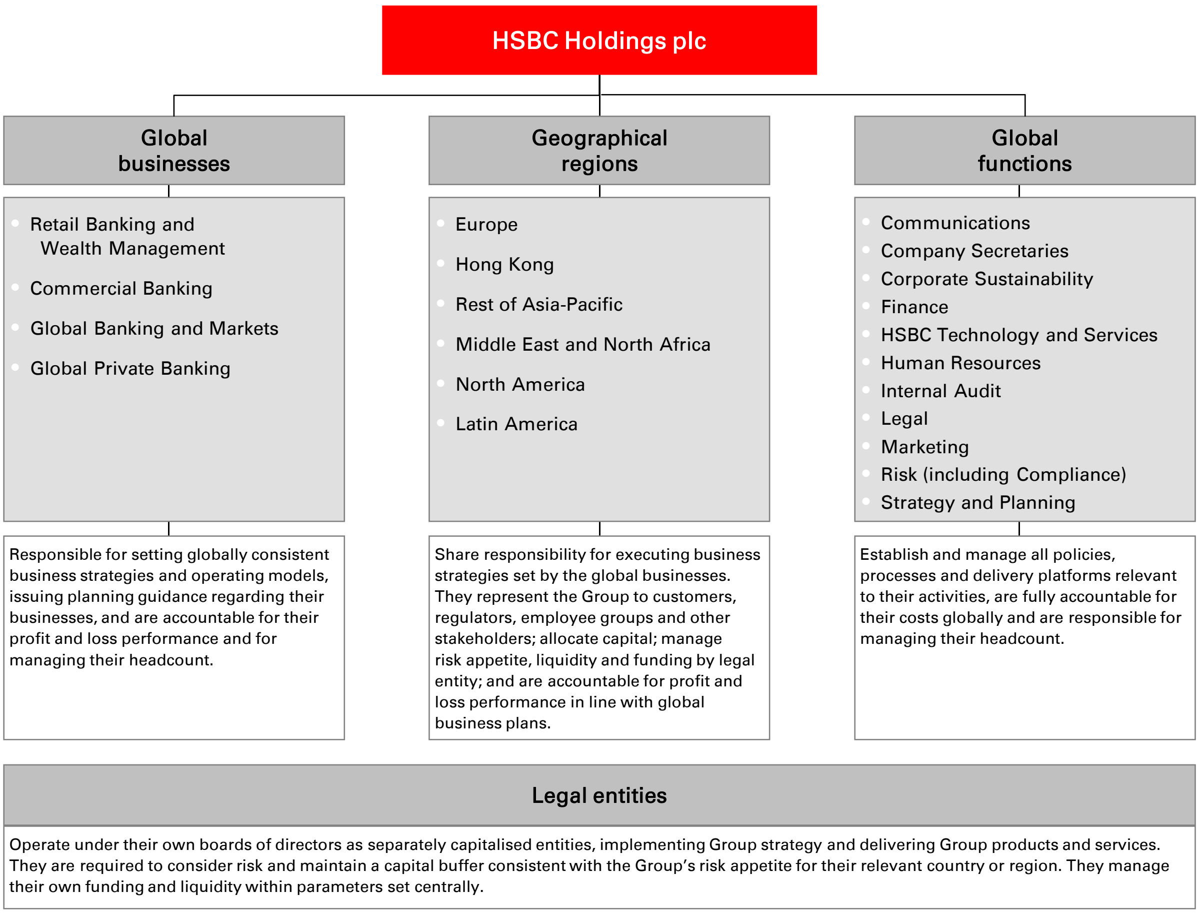
HSBC Holdings does not provide core funding to any banking subsidiary, nor is a lender of last resort and does not carry out any banking business in its own right. Subsidiaries operate as separately capitalised entities implementing the Group strategy.

### Matrix management structure

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

*For details of our principal subsidiaries see Note 24 on the Financial Statements and for a simplified Group structure chart see page 570 of the* Annual Report and Accounts 2013.

*Matrix management structure*



## Global businesses

Our four global businesses are Retail Banking and Wealth Management (‘RBWM’), Commercial Banking (‘CMB’), Global Banking and Markets (‘GB&M’) and Global Private Banking (‘GPB’). They are responsible for developing, implementing and managing their business propositions consistently across the Group, focusing on profitability and efficiency. They set their strategies within the parameters of the Group strategy in liaison with the geographical regions, are responsible for issuing planning guidance regarding their businesses, are accountable for their profit and loss performance, and manage their headcount.

*The main business activities of our global business are summarised below, and their products and services on page 79 of the* Annual Report and Accounts 2013.

*Main business activities by global business and reported revenue[5] in 2013*

| Global businesses | RBWM | CMB | GB&M | GPB |
|---|---|---|---|---|
| Liability driven | • Deposits<br>• Account services | • Deposits<br>• Payments and cash management | • Deposits<br>• Payments and cash management<br>• Balance sheet management | • Deposits<br>• Account services |
| Asset driven | • Credit and lending | • Credit and lending<br>• International trade and receivables finance | • Credit and lending<br>• Asset and trade finance | • Credit and lending |
| Fee driven and other | • Asset management<br>• Wealth solutions and financial planning<br>• Broking[6]<br>• Life insurance manufacturing | • Commercial insurance and investments | • Corporate finance[7]<br>• Markets[8]<br>• Securities services | • Asset management[9]<br>• Financial advisory[10]<br>• Broking[6]<br>• Corporate finance (via GB&M)[7]<br>• Alternative investments[11] |

*For footnotes, see page 46.*

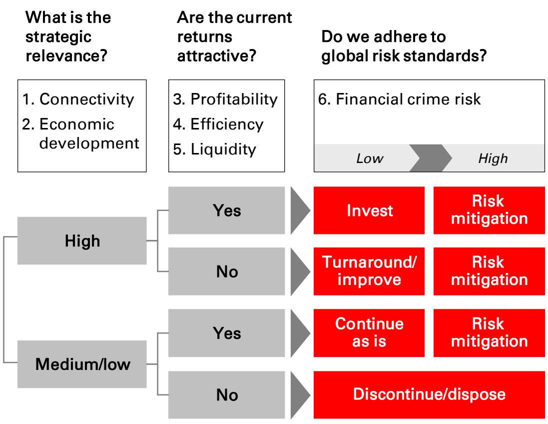
## Investment criteria

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

Decisions over where to invest additional resources have three components:

- *Strategic* – we will only invest in businesses aligned to our strategy, mostly in our 22 home and priority growth markets and in target businesses and clients;
- *Financial* – the investment must be value accretive for the Group, and must meet minimum returns, revenue and cost hurdles; and
- *Risk* – the investment must be consistent with our risk appetite.

*Using the six filters in decision-making*



## Financial performance

### Performance reflected underlying momentum in areas of targeted investment

### Reported results

| | 2013 US$m | 2012 US$m | 2011 US$m |
|---|---|---|---|
| Net interest income | **35,539** | 37,672 | 40,662 |
| Net fee income | **16,434** | 16,430 | 17,160 |
| Other income | **12,672** | 14,228 | 14,458 |
| **Net operating income**[5] | **64,645** | 68,330 | 72,280 |
| LICs[12] | **(5,849)** | (8,311) | (12,127) |
| **Net operating income** | **58,796** | 60,019 | 60,153 |
| Total operating expenses | **(38,556)** | (42,927) | (41,545) |
| **Operating profit** | **20,240** | 17,092 | 18,608 |
| Income from associates[13] | **2,325** | 3,557 | 3,264 |
| **Profit before tax** | **22,565** | 20,649 | 21,872 |

*For footnotes, see page 46.*

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

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

### Underlying performance

*For further information on non-GAAP financial measures, see page 47 of the* Annual Report and Accounts 2013.

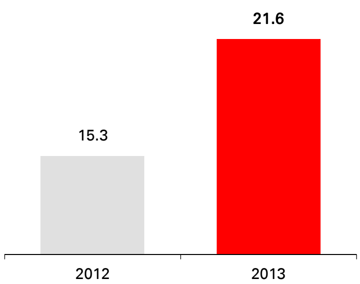
**From reported results to underlying performance**

To arrive at underlying performance,

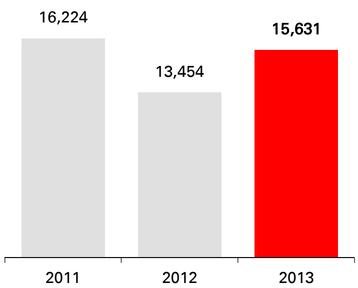
- we adjust for the year-on-year effects of foreign currency translation;
- we eliminate the fair value movements on our long-term debt attributable to credit spread (own credit spread) where the net result of such movements will be zero upon maturity of the debt; and
- we adjust for acquisitions, disposals and changes of ownership levels of subsidiaries, associates and businesses, by eliminating the gain or loss on disposal in the year incurred and removing the operating profit or loss of the acquired and disposed of businesses from all years presented.

Reconciliations of our reported results to an underlying basis are provided in the Form 20-F filed with the Securities and Exchange Commission which is available on www.hsbc.com.

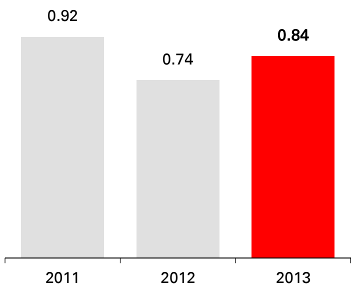
*Underlying profit before tax (US$bn)*




*Profit attributable to ordinary shareholders (US$m)*




*Earnings per share (US$)*



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

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

The following commentary is on an underlying basis.

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

Underlying revenue rose by US$1.7bn or 3% to US$63.3bn. This reflected a number of factors including net favourable fair value movements on non-qualifying hedges of US$0.8bn, a net gain recognised on completion of the disposal of our investment in Ping An of US$0.6bn offsetting the adverse fair value movements on the contingent forward sale contract recorded in 2012, and foreign exchange gains on sterling debt issued by HSBC Holdings of US$0.4bn.

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

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

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

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

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

Excluding these items, operating expenses were higher, mainly due to a rise in the UK bank levy, increased litigation-related expenses, notably a provision in respect of regulatory investigations in GPB, a Madoff-related charge in GB&M and investment in strategic initiatives, risk management and compliance. Higher operational costs also contributed, in part driven by general inflationary pressures and rental costs. These factors were partially offset by sustainable cost savings in the year and an accounting gain relating to changes in delivering ill-health benefits to certain employees in the UK.

The additional US$1.5bn of sustainable cost savings across all regions, took our total annualised cost savings to US$4.9bn since 2011 as we continued with our organisational effectiveness programmes during 2013. Together with business disposals, these led to a fall in the number of full-time equivalent staff ('FTE's) of more than 6,500 to 254,000.

### Income from associates rose, mainly driven by strong results in mainland China

Underlying income from associates increased, primarily from Bank of Communications Co., Limited ('BoCom'), where balance sheet growth and increased fee income were partially offset by higher operating expenses and a rise in LICs.

## The effective tax rate was 21.1% compared with 25.7% in 2012

The effective tax rate was lower than in 2012, reflecting non-taxable gains on profits associated with the reclassification of Industrial Bank as a financial investment and the disposal of our operations in Panama and our investment in Ping An Insurance (Group) Company of China, Ltd ('Ping An'). In addition, the 2012 tax expense included the non-tax deductible effect of fines and penalties paid as part of the settlement of the US AML, BSA and OFAC investigations.

*For more details of the Group's financial performance, see page 51 of the* Annual Report and Accounts 2013.

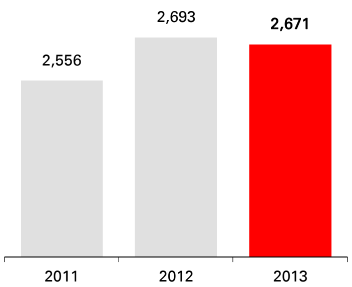
## Balance sheet strength

Total reported assets were US$2.7 trillion, 1% lower than at 31 December 2012 on both a reported and a constant currency basis. Our balance sheet remained strong with a ratio of customer advances to customer accounts of 72.9%. This is a consequence of our business model and of our conservative risk appetite, which is predominantly to fund the growth in commercial assets with growth in customer accounts.

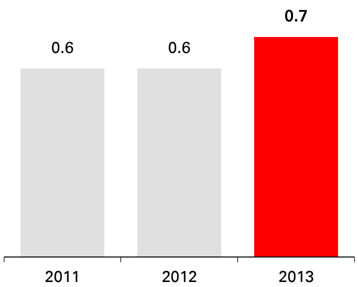
Loans and advances grew by US$87.0bn and customer accounts increased by US$148.6bn on a constant currency basis. These included a US$52.8bn increase in reverse repo agreements and a rise of US$92.3bn in repo agreements, reflecting the change in the way GB&M manages these activities (see page 68 of the *Annual Report and Accounts 2013*). Excluding these, loans and advances to customers grew by more than US$34.0bn in 2013, notably in term and trade-related lending to corporate and commercial customers in Hong Kong and Rest of Asia-Pacific as demand for financing continued and, to a lesser extent, commercial real estate and other property-related lending grew. Mortgage lending rose in Rest of Asia-Pacific, Hong Kong and also in the UK. This was broadly offset by the strategic reduction in the US run-off portfolio. Customer accounts increased by over US$56.0bn in 2013, driven by growth mainly in Europe, Hong Kong and Rest of Asia-Pacific reflecting customer sentiment.

*For further information on the Balance Sheet, see page 65, and on the Group's liquidity and funding, see page 213 of the* Annual Report and Accounts 2013.

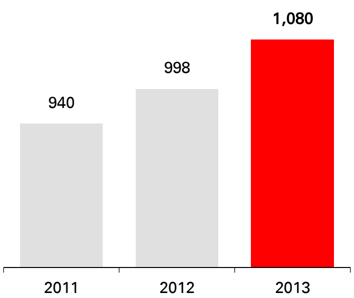
*Total assets (US$bn)*



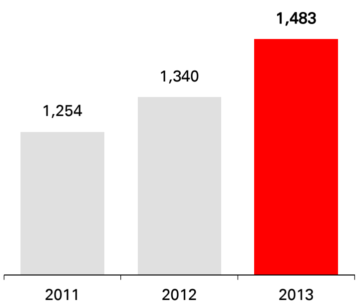

*Post-tax return on average total assets (%)*



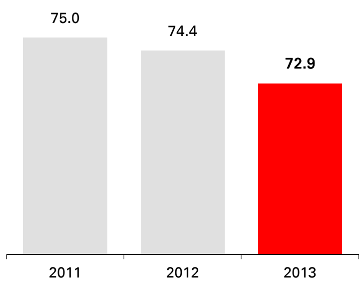

*Loans and advances to customers*[14] *(US$bn)*




*Customer accounts*[14] *(US$bn)*




*Ratio of customer advances to customer deposits (%)*




*For footnote, see page 46.*

## Capital strength

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

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

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

Under the new regime, common equity tier 1 ('CET1') represents the highest form of eligible regulatory capital against which the capital strength of banks is measured. In 2013 we managed our capital position to meet an internal target ratio of 9.5-10.5% on a CET1 end point basis, changing to greater than 10% from 1 January 2014. We continue to keep this under review.

### Leverage ratio

The following table presents our estimated leverage ratio in accordance with PRA instructions. The numerator is calculated using the CRD IV end point tier 1 capital definition and the exposure measure is calculated using the December 2010 Basel III text.

*Estimated leverage ratio*

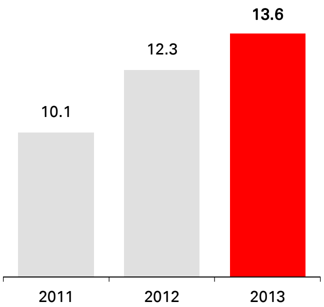
| | At 31 December | |
|---|---|---|
| | **2013** | 2012 |
| | **US$bn** | US$bn |
| Tier 1 capital under CRD IV (end point) | **133** | 116 |
| Exposures after regulatory adjustments | **3,028** | 2,760 |
| Estimated leverage ratio (end point) | **4.4%** | 4.2% |

*For further details of the leverage ratio, see page 312 of the* Annual Report and Accounts 2013.

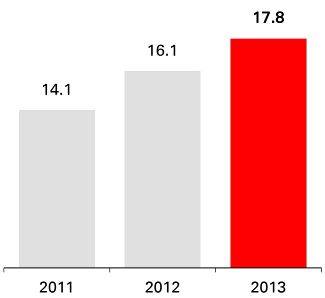
The above calculation excludes those tier 1 capital instruments which will be ineligible for inclusion in regulatory capital after the Basel III transitional period has fully elapsed. If we were to calculate the leverage ratio by adding back those instruments, the effect would be to increase estimated end point tier 1 capital by US$16bn and the leverage ratio by some 50 basis points at 31 December 2013.

*For further information on the Group's capital and our risk-weighted assets, see page 298 of the* Annual Report and Accounts 2013.

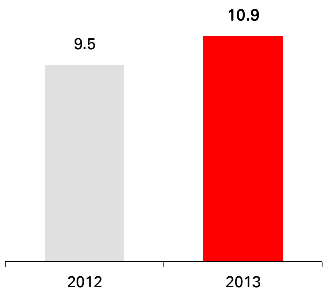
*Core tier 1 ratio*[1]
*(%)*




*Total capital ratio*
*(%)*




*Common equity tier 1 ratio*[15]
*(%)*




*For footnotes, see page 46.*

## Meeting our targets

### Grow risk-weighted assets in line with our organic investment criteria

In 2013, the reduction in RWAs was mainly a result of the reclassification of Industrial Bank from an associate to a financial investment and the run-off of the US CML portfolio. We will continue to recycle RWAs from low to high performing opportunities within the Group's risk appetite in line with our organic investment criteria. Organic investment decisions are made by GMB under authority delegated by the Board.

On the basis of current assumptions regarding the regulatory and the business operating environment, discretionary RWA growth remains targeted towards Rest of Asia-Pacific, Hong Kong, Latin America and Middle East and North Africa. Discretionary RWA growth excludes the effect of legacy and run-off portfolios, transactions, associates and major regulatory changes.

Return on risk-weighted assets ('RoRWA'), as measured by pre-tax return on average risk-weighted assets, is one of the main operational measures by which we assess business performance and organic investment opportunities. RoRWA targets are set to ensure that business decisions remain aligned with our medium-to-longer term financial performance objectives.

### Progressively grow dividends and introduce share buy-backs as appropriate

We remain one of the best-capitalised banks in the world, providing capacity for both organic growth and dividend return to shareholders. Over the past two years we have increased our dividend per ordinary share by 20%.

Although significant regulatory uncertainty remains, we continue to demonstrate our ability to generate capital and support a progressive dividend policy based on our three key strategic priorities of growing the business and dividends, implementing Global Standards and streamlining processes and procedures.

Our policy on share buy-backs will be strongly influenced by the emerging requirements for capital by regulators. In order to give ourselves the full range of options, we will seek to table a resolution at our 2014 Annual General Meeting for shareholders to enable share buybacks at a future date.

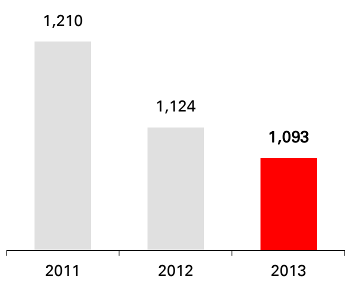
Uncertainty remains around the amount of capital that banks will be required to hold as key technical standards and consultations from regulatory authorities are pending. These include the levels, timing and interaction of CRD IV capital buffers and a review of the Pillar 2 framework. As more information becomes available, this will inform our capital target, planning and dividend policy.

### Reduce the effect of legacy and non-strategic activities on our profit before tax and RWAs

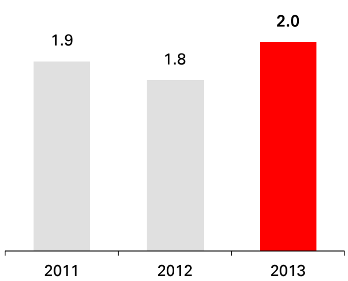
We continue to make good progress reshaping our business, announcing 20 transactions disposing of or closing non-strategic businesses in 2013, bringing the total number since the start of 2011 to 63. These transactions have released around US$90bn in risk weighted-assets to date, with a further potential release of around US$5bn to come.

In 2013, in addition to the reclassification of Industrial Bank, we completed the sale of our Panama operations and, in the US CML portfolio, the sale of the non-real estate loan portfolio together with several tranches of real estate loans. We expect the ongoing recovery of the US housing market and increased investor appetite may provide further opportunities to accelerate the run-off of our CML portfolio in 2014, following significant RWA reductions in 2013.

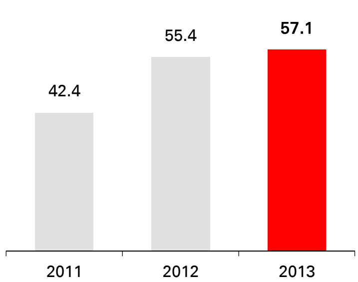
*Risk-weighted assets (US$bn)*




*Return on risk-weighted assets (%)*

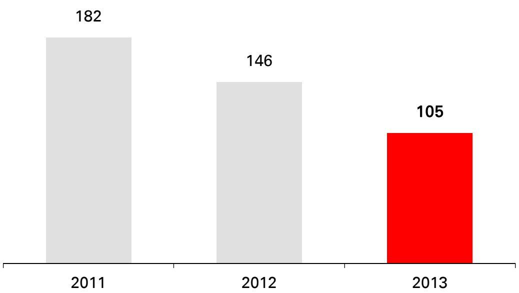



*Dividend payout ratio (%)*



We continue to actively manage down legacy RWA positions in GB&M. In 2013, increased disposals and amortisations contributed to the reduction in legacy RWA positions in GB&M.

*Run-off portfolios' contribution to RWAs (US$bn)*



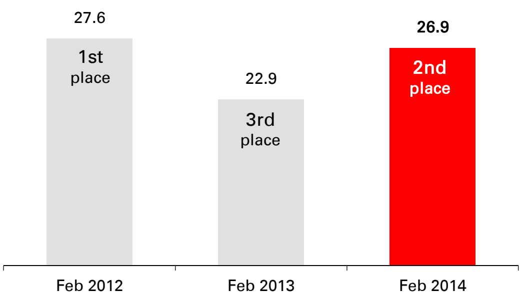

Run-off portfolios consist of legacy credit in GB&M and the US CML and other portfolios.

## Brand value

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

We continue to use the Brand Finance valuation method as reported in *The Banker* magazine as our core metric. This is our third year of using this benchmark. The Brand Finance methodology provides a comprehensive measure of the strength of the brand and its impact across all business lines and customer segments. It is wholly independent and is publicly reported. Our target is a top three position in the banking peer group and we have achieved this target with an overall value of US$26.9bn (up 18% from 2013), placing us second. We are the only company to be given an AAA rating for our brand in this year's report.

*Brand value (US$bn)*




In addition to the Brand Finance measure, we have reviewed our performance in two other rating agency evaluations that receive substantial public coverage. In the Brand Z Most Valuable Global Brand tables published in the *Financial Times* in May 2013, we achieved first place in the International Banks peer grouping with a valuation of US$24bn (up 24% from 2012). The *Interbrand* Annual Best Global Brands report, published in September 2013, showed HSBC as the top ranked banking brand with a valuation of US$12bn (up 7% from 2012) and in second place when all financial services brands are considered.

We believe this performance is driven by an underlying strong brand equity established in recent years and a consistent and active programme of activities in support of the brand throughout 2013.

## Economic contribution

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

HSBC 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 the territories in which we operate. In January 2013, the Global Standards Steering Meeting of the GMB agreed terms of a new Global Standard on 'tax transparency' to ensure that HSBC's banking services are not associated with any arrangements that are known or suspected to be designed to facilitate tax evasion by a customer.

This supplements anti-money laundering and 'know your customer' ('KYC') checks and is supported by an educational programme to train employees on how to identify possible tax evasion by customers and the procedures for reporting and escalating such situations.

*HSBC's net tax paid*

| | **2013 US$bn** | 2012 US$bn |
|---|---|---|
| Tax on profits | **4.7** | 5.6 |
| Employer taxes | **1.6** | 1.6 |
| UK bank levy[16] | **0.7** | 0.5 |
| Irrecoverable value-added tax | **0.8** | 0.8 |
| Other duties and levies | **0.8** | 0.8 |
| | **8.6** | 9.3 |

*For footnote, see page 46.*

# Strategic Report (continued)

**Strategic priority 1 – Grow the business and dividends // Strategic priority 2 – Implement Global Standards**

*Distribution of economic benefits*

| | 2013 US$bn | 2012 US$bn | 2011 US$bn |
|---|---|---|---|
| Net cash tax outflow | **8.6** | 9.3 | 8.0 |
| Distributions to shareholders and non-controlling interests | **10.2** | 8.7 | 8.3 |
| Employee compensation and benefits | **19.2** | 20.5 | 21.2 |
| General administrative expenses including premises and procurement | **17.1** | 20.0 | 17.5 |

*Pro-forma post-tax profit allocation*[17]

| | 2013 % | 2012 % |
|---|---|---|
| Retained earnings/capital | **53** | 60 |
| Dividends | **35** | 29 |
| Variable pay | **12** | 11 |
| | **100** | 100 |

*For footnote, see page 46.*

## Market capitalisation and total shareholder return

| **US$0.50 ordinary shares in issue** | **Market capitalisation** | **Closing market price** London | Hong Kong | American Depositary Share[18] |
|---|---|---|---|---|
| 18,830m | US$207bn | £6.62 | HK$84.15 | US$55.13 |
| 2012: 18,476m<br>2011: 17,868m | 2012: US$194bn<br>2011: US$136bn | 2012: £6.47<br>2011: £4.91 | 2012: HK$81.30<br>2011: HK$59.00 | 2012: US$53.07<br>2011: US$38.10 |

**Total shareholder return**[19]

| | Over 1 year | Over 3 years | Over 5 years |
|---|---|---|---|
| **To 31 December 2013** | 107 | 118 | 144 |
| Benchmarks: | | | |
| – FTSE 100[20] | 119 | 128 | 183 |
| – MSCI World[20] | 127 | 141 | 207 |
| – MSCI Banks[20] | 125 | 132 | 186 |

*For footnotes, see page 46.*

*Strategic priority 2*

# Implement Global Standards


- HSBC Values ........ 25
- Governance ........ 25
- Employees ........ 27


Our target is to make significant progress in implementing Global Standards for the benefit of HSBC and the financial system as a whole.

*Our Values, good governance and commitment to operating sustainably guide the way we manage our business and help us create value for our stakeholders.*

We have committed to develop Global Standards shaped by the highest or most effective standards of financial crime compliance available in any jurisdiction where HSBC operates and to deploy them globally on a consistent basis.

By definition, the impact of Global Standards is organisation-wide, and the principal means by which we drive consistently high standards is through universal application of our HSBC Values, strong systems of governance and the behaviours, performance and recognition of all our people in managing high quality customer relationships.

In line with our ambition to be recognised as the world's leading international bank, we aspire to set the industry standard for knowing our customers and detecting, deterring and protecting against financial crime. As international markets become more interconnected and complex and as threats to the global financial system grow, we are strengthening further the policies and practices which govern how we do business and with whom.

We greatly value our reputation. Our success over the years is due in no small part to our reputation for trustworthiness and integrity. In areas where we have fallen short in recent years – in the application of our standards and in our ability to identify and so prevent misuse and abuse of the financial system through our networks – we have moved immediately to strengthen our governance processes and have committed to adopt and enforce the highest or most effective financial crime compliance standards across HSBC.

We continue to reinforce the status and significance of compliance and adherence to our Global Standards by building strong internal controls, developing world class capabilities through communication, training and assurance programmes to make sure employees understand and can meet their responsibilities, and redesigning core elements of how we assess and reward senior executives.

We see the implementation of Global Standards as a source of competitive advantage. Global Standards allow us to:

- strengthen our response to the ongoing threat of financial crime;
- make consistent – and therefore simplify – the ways by which we monitor and enforce high standards at HSBC;
- strengthen policies and processes that govern how we do business and with whom; and
- ensure that we consistently apply our HSBC Values.

## Implementing Global Standards

We expect our Global Standards programme to underpin our business practices in the future. Initially, we are concentrating on transforming how we detect, deter and protect against financial crime. We are implementing a more consistent, comprehensive approach to assessing financial crime risk in order to help protect our customers, our employees and the financial system as a whole.

### Governance framework

The Global Standards Execution Committee provides execution control based on direction and priorities set by the Global Standards Steering Meeting (a meeting of the GMB), details of which may be found in the Directors' Report on page 354 of the *Annual Report and Accounts 2013*. The Financial System Vulnerabilities Committee and the Board receive regular reports on the Global Standards programme.

Under this governance structure, a sequenced approach to global implementation was designed, tested and deployed during 2013 following detailed planning, to closely identify and manage execution risk, ensure that our Global Standards are delivered in a globally consistent and coherent way, and embed sustained ways of working.

The process of embedding Global Standards and the supporting controls and capabilities that allow the business to identify and mitigate financial crime risk is underway and will continue in 2014 and beyond. The implementation programme is focused on the following four areas:

- *data readiness:* creating a complete, cleansed data set to improve our understanding of the customer base and facilitate our financial crime risk assessment. This will provide the basis for transaction monitoring and assist capacity planning to improve the quality and efficiency of our KYC activities.
- *customer due diligence:* strengthening the rigour with which we research and evaluate our customers and affiliates to better understand them and their activities; improving KYC profiling through enhanced due diligence, customer identification, screening and financial crime risk scoring; tightening our controls around tax transparency and bearer shares and putting a global customer selection and exit policy in place.
- *financial crime compliance:* building HSBC's Financial Crime Compliance organisation with the right people and capabilities to support the business; developing global policies for anti-money laundering ('AML'), sanctions and anti-bribery and corruption and enhancing the monitoring, screening and testing that will allow us to manage financial crime risk more effectively; and designing a new, annual HSBC-wide risk assessment to better understand the financial crime risk we carry in the business and determine the best approach to managing it.
- *financial intelligence:* establishing a new global network of Financial Intelligence Units that use cutting edge technology to identify and investigate significant cases, trends and strategic issues related to financial crime risks.

## Changes in day-to-day activities

### Risk appetite

Our global Financial Crime Risk Appetite statement was approved by the Board in October 2013 on the recommendation of the Risk Management Meeting of the GMB, the Group Risk Committee and the Financial System Vulnerabilities Committee. It was incorporated into the Risk Management Meeting's process monitoring from November 2013. The statement sets the Global Standard for financial crime compliance across HSBC, and is expected to evolve and be refined over time.

### Enterprise-wide risk assessment

We completed enterprise-wide assessments of our risks relating to sanctions and AML compliance. The outcome of these assessments is the basis for risk management planning, prioritisation and resource allocation for 2014. In the future, we shall conduct such assessments annually.

### Incentives

We adapted our remuneration strategy to balance short-term and sustainable performance. It rewards commercial success and compliance with our risk management framework.

### Organisation

We continued to significantly reinforce our second line of defence (described on page 39) through an increase in Regulatory and Financial Crime Compliance headcount of more than 1,750 in 2013 (up by more than 50% since December 2012).

We are raising awareness and capabilities among our employees through a comprehensive global campaign to 'Ask the Right Questions'.

## The Monitor

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

Michael Cherkasky began his work as the Monitor on 22 July 2013, charged with evaluating and reporting upon the effectiveness of the Group's internal controls, policies and procedures as they relate to ongoing compliance with applicable AML, sanctions, terrorist financing and proliferation financing obligations, over a five-year period. The Monitor's work is proceeding as anticipated, consistent with the timelines and requirements set forth in the relevant agreements.

HSBC is taking concerted action to remediate AML and sanctions compliance deficiencies and to implement Global Standards. We recognise we are only at the start of a long journey, being one year into our US DPA. We look forward to maintaining a strong, collaborative relationship with the Monitor and his team.

## HSBC Values

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

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

*HSBC Values*

**Be dependable and do the right thing**

- stand firm for what is right, deliver on commitments, be resilient and trustworthy;
- take personal accountability, be decisive, use judgement and common sense, empower others.

**Be open to different ideas and cultures**

- communicate openly, honestly and transparently, value challenge, learn from mistakes;
- listen, treat people fairly, be inclusive, value different perspectives.

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

- build connections, be externally focused, collaborate across boundaries;
- care about individuals and their progress, show respect, be supportive and responsive.

*For further details on the role of HSBC Values in the employee proposition, see page 27.*

### Business principles

HSBC Values describe how we should interact with each other, with customers, regulators and the wider community. Our business principles set the standard by which we derive our strategy and make commercial decisions. Together our values and business principles form our character and define who we are as an organisation and what makes us distinctive. They describe the enduring nature of how we do business. We aim to bring these values and business principles to life through our day-to-day actions.

The emphasis we place on adhering to high behavioural standards and doing the right thing has led us to establish a new Board committee, the Conduct & Values Committee, which will oversee design and application of HSBC's policies, procedures and standards to ensure that we conduct business responsibly and consistently adhere to HSBC Values.

*Business principles*

- **Financial strength** – maintain capital strength and liquidity
- **Risk-management** – be enterprising and commercial, understand and be accountable for the impact of our actions, take prudent decisions
- **Speed** – be fast and responsive, make principles-led decisions
- **Performance-focus** – drive leading, competitive levels of performance, act with urgency and intensity, prioritise, simplify
- **Efficiency** – focus on cost discipline and process efficiency
- **Quality** – pursue excellence
- **Customer-focus** – provide outstanding customer experience
- **Integrated** – align the Group and break down silos
- **Sustainability** – take a long-term outlook, understand impact of actions on stakeholders, brand and reputation

## Governance

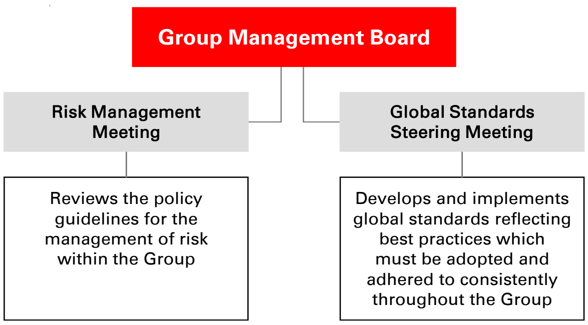
The Board is committed to establishing and maintaining the highest standards of corporate governance wherever we operate. This is key to the Group's ability to capitalise on the opportunities arising from successful implementation of our strategic priorities.

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

### Role of the Board and Committees

The strategy and risk appetite for HSBC is set by the Board, which delegates the day-to-day running of the business to the GMB. Risk Management Meetings and Global Standards Steering Meetings of the GMB are held in addition to regular GMB meetings.

*GMB executive committees*

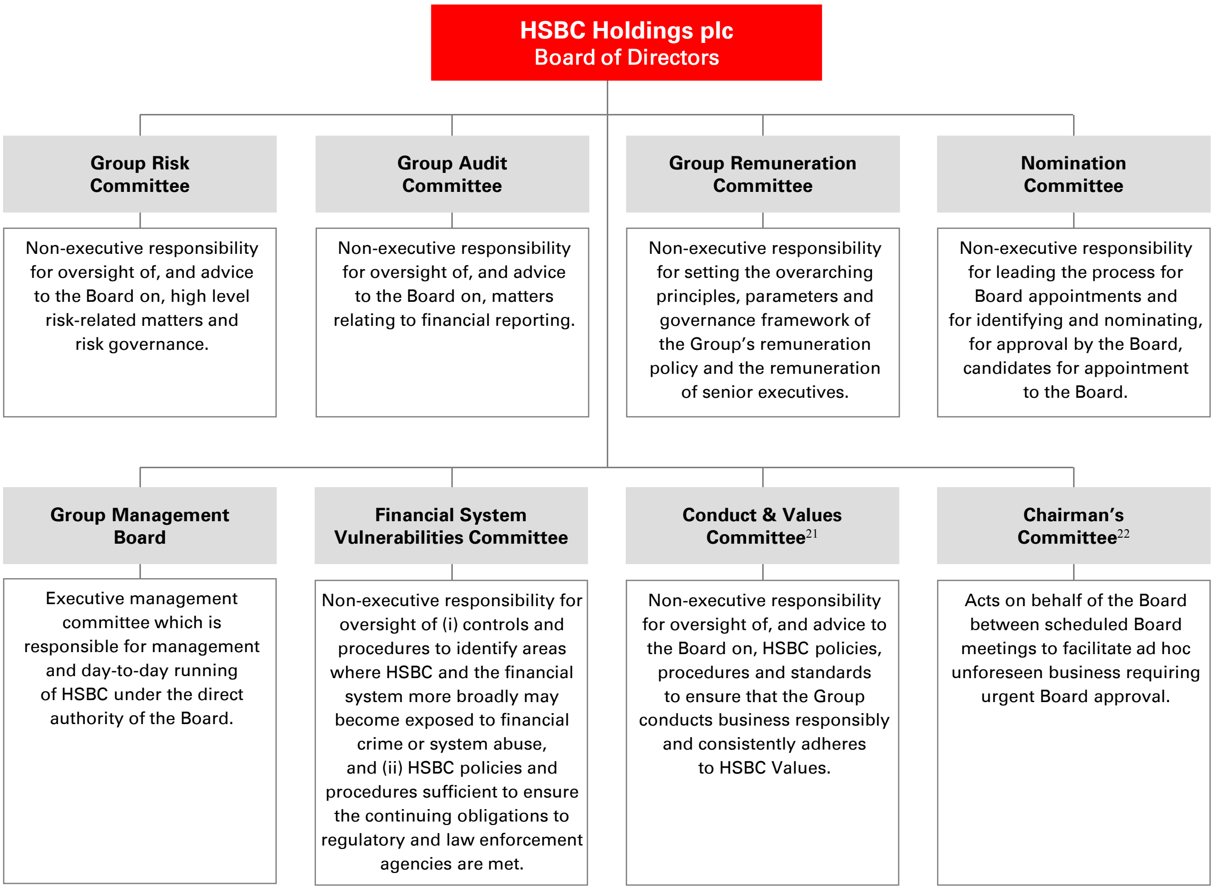



The key roles of the non-executive committees established by the Board are described in the chart below.

## Strategic Report (continued)

**Strategic priority 2 – Implement Global Standards > Employees**

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




*For footnotes, see page 46.*

The terms of reference of the principal non-executive Board committees are available at www.hsbc.com/ boardcommittees.

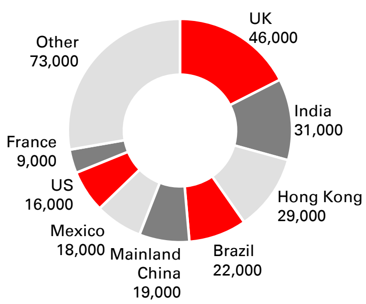
*For further details on Group corporate governance, see page 329 of the* Annual Report and Accounts 2013.

## Employees

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

- We aim to attract, retain and motivate the very best people, and our remuneration policy supports this endeavour.
- We actively manage succession planning by defining the capabilities we need and complementing this by identifying talented individuals and ensuring they are provided with appropriate career and development opportunities to fulfil their potential in HSBC.
- We provide training and development opportunities to enable employees to acquire the technical and leadership skills needed to enhance their careers.
- We are committed to a diverse and inclusive culture reflective of our customer base.
- We encourage employees to engage in the local communities in which they work.

At the end of 2013 we had a total workforce of 263,000 full-time and part-time employees compared with 270,000 at the end of 2012 and 298,000 at the end of 2011. Our main centres of employment were as follows (approximate numbers):




### Profile of leadership

The executive management of HSBC consists of four Executive Directors, 13 Group Managing Directors, and 51 Group General Managers. This leadership team is based in ten different countries and comprises 14 nationalities. 70% have served with HSBC for more than ten years and the total average tenure is 19 years.

HSBC has 13 non-executive directors. Of the 17 Directors, four (23.5%) are female.

### Employment proposition

#### HSBC Values

In 2013, education on HSBC Values continued for all levels of employees, through induction and training programmes that covered relevant technical, management and leadership skills. We require a high behavioural standard from all our employees, and our focus on values and courageous integrity is being instilled at every level of the Group. For example, the values of being open, connected and dependable are an important first part of every appraisal for employees, including the most senior managers. In 2013, nearly 135,000 employees received values training, in addition to the 103,000 employees in 2012. A number of employees left the Group for breaching our values.

#### Employee development

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

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

#### Employee engagement

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

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

The overall engagement score in 2013 was 68%, which was four points ahead of the financial services industry norm and eight points behind the best-in-class benchmark. Strong scores were registered in risk awareness (81% and nine points above best-in-class), leadership capability (67%) and living the HSBC Values (77%). Employee development significantly improved from six points below best-in-class in 2011 to three points above in 2013. Aspects that require attention included pride and advocacy, which were 12 and 13 points, respectively, below best-in-class norms and had fallen from 2011 levels.

### Succession planning

Our talent strategy aims to ensure that high-quality candidates are available to fill key positions and meet business needs across all areas of the Group. We closely align succession planning with talent management, individual development and career planning. The succession plan defines the number, distribution and types of roles and capabilities needed by HSBC, and talented individuals are then aligned to these roles. This approach in turn defines the individual's career path and development plan. In 2013, we assessed about 24,000 senior employees with the potential to become leaders and determined their career development needs. Potential successors must demonstrate an understanding of our Global Standards and exemplify HSBC Values.

Our talent strategy supports our aspirations in the emerging markets, where in 2013 we maintained 2012's proportion of those defined as talent at 39%. 25% of CEOs in emerging markets were local nationals. We closely monitor local nationals identified as short-term and medium-term successors to key leadership roles and have established base lines by which we intend to improve the proportion of local nationals over the medium term.

## Diversity and inclusion

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

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

### Gender balance

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

The gender balance for HSBC Directors and employees at 31 December 2013 was as follows:

*Gender balance*

| | Male | Female | Total |
|---|---|---|---|
| Executive Directors | 3 | – | 3 |
| Non-executive Directors | 9 | 4 | 13 |
| Directors | 12 | 4 | 16 |
| Senior employees | 6,339 | 1,867 | 8,206 |
| Other employees | 118,980 | 135,714 | 254,694 |
| Total | 125,331 | 137,585 | 262,916 |

| | Male % | Female % | Total % |
|---|---|---|---|
| Executive Directors | 100.0 | – | 100 |
| Non-executive Directors | 69.2 | 30.8 | 100 |
| Directors | 75.0 | 25.0 | 100 |
| Senior employees | 77.3 | 22.7 | 100 |
| Other employees | 46.7 | 53.3 | 100 |
| Total | 47.7 | 52.3 | 100 |

Overall, global female representation was 52.3% at 31 December 2013, having been as high as 53.3% in 2009. Female representation at senior levels rose from 21.4% in 2010 to 22.7% in 2013, and our target is to improve this to 25% by 2014/15. The proportion of females in our talent pipeline improved from 25.8% in 2010 to 32.2% in 2013 and female representation on the GMB increased significantly from 10% (one out of 10) to 19% (three out of 16) in December 2013.

The average age of our employees is 36 years and average tenure is 8.9 years.

## Unconscious bias

It is recognised that social behaviour may be driven by stereotypes that operate automatically and therefore unconsciously. These stereotypes can lead to a less inclusive environment. We are addressing this through 'unconscious bias' training which was delivered through e-learning to 8,300 managers and nearly 50,000 employees in 2013 (21,000 managers and 8,000 employees in 2012).

In 2014, our diversity and inclusion priorities will include continuing to address unconscious bias through targeted education, encouraging the career development of diverse talent with an emphasis on gender and local nationals, enhancing a bias-free approach to performance management and improving internal and external candidate lists, connecting and leveraging our Employee Resource Network Groups, and maintaining a consistent framework for governance and sponsorship.

## Health, welfare and safety

We regard the physical and psychological health, welfare and safety of our people as being of the utmost importance. We recently introduced a global occupational health framework which requires the proactive management of employee welfare and encourages the sharing of best practice across the Group. Between August 2012 and the end of 2013, 94% of assigned HSBC employees carried out our bi-annual online health and safety training.

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

## Whistleblowing

The HSBC Group operates a global Compliance Disclosure Line (telephone and email) which is available to allow employees to make disclosures when the normal channels for airing grievances or concerns are unavailable or inappropriate.

The Compliance Disclosure Line is available to capture employee concerns on a number of matters, including breaches of law or regulation, allegations of bribery and corruption, failure to comply with Group policies, suspicions of money laundering, breaches of internal controls and fraud or deliberate error in the financial records of any Group company. Global Regulatory Compliance is responsible for the operation of the Compliance Disclosure Line and the handling of disclosure cases. Each case is reviewed and referred for appropriate investigation. The disclosure is acknowledged (when contact details are provided) and the employee is advised when the investigation has been concluded. Global Regulatory Compliance may also be made aware of whistleblowing cases made directly to senior executives, line managers, Human Resources and Security and Fraud, and will investigate accordingly.

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

*Strategic priority 3*

# Streamline processes and procedures


- Operational performance ..... 30
- Customers ..... 31
- Environmental, social and community obligations ..... 34


Our aim is to achieve a cost efficiency ratio in the mid 50's.

*We are redesigning key processes and procedures in order to manage risk, improve customer service, enhance quality and reduce expenses. Sustainable savings will release funds to invest in growing our business, Global Standards and increasing dividends.*

## Operational performance

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

Sustainable savings are the financial outputs from our organisational effectiveness and streamlining programmes. They arise from the reduction or elimination of complexity, inefficiencies or unnecessary activities, and release capital that can be reinvested in growing our business as well as increasing returns to shareholders.

We are transitioning from organisational effectiveness to streamlining, which is the next phase of our transformation. While organisational effectiveness was about how HSBC is managed, streamlining is about how we operate.

We committed to deliver US$2.5-3.5bn of sustainable savings at the outset of the organisational effectiveness programme. We have achieved US$4.5bn for the period from 2011 to the end of 2013, equivalent to US$4.9bn on an annualised (run rate) basis, as follows:

*Sustainable savings 2011 to 2013*

| | US$bn |
|---|---|
| Re-engineering operational processes | 1.6 |
| Re-engineering global functions | 1.4 |
| Implementing consistent business models | 0.7 |
| Streamlining IT | 0.8 |
| | 4.5 |

In implementing our operational effectiveness programme, we concentrated on a number of key elements:

- *people and structure* – we implemented an 8x8 reporting structure, moved to a global operating model, and defined and introduced target business models across all global businesses and functions;
- *software development* – we improved software development productivity and shifted the mix of employees towards lower-cost locations;
- *process optimisation* – we improved the efficiency of our operational activities such as contact centres (including offshoring), trade and payments services; and
- *corporate real estate* – we rationalised our property portfolio by leasing and launching facilities management initiatives.

In phase 2, from 2014 to 2016, we will concentrate on streamlining operations, focusing on reducing or eliminating complexity, inefficiencies, risks or unnecessary activities across the whole Group. This exercise will be applied to:

- propositions, and sales channels;
- processes and servicing channels, including production management, multi-channel servicing, operational processes and the locations of activities; and
- infrastructure, including real estate, technology, supplier management and global functions.

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

### Cost efficiency ratio

Our cost efficiency ratio for 2013 was 59.6%, down from 62.8% in 2012.

## Customers

Our purpose is to connect customers to opportunities, enabling businesses to thrive and economies to prosper, helping people to fulfil their hopes and realise their ambitions.

Our dealings with customers are conditioned by our understanding of their needs, the quality of the service we provide and the standards which govern how we operate. With over 54 million personal and business customers around the world, we know that only by putting customers at the centre of what we do can we achieve our purpose.

### Customer service and satisfaction

Throughout 2013 we concentrated on enhancing the customer service we provide through our global businesses.

In RBWM, we measure customer satisfaction through an independent market research survey of retail banking customers in selected countries and calculate a Customer Recommendation Index ('CRI') to score performance. This CRI score is benchmarked against average scores of a peer group of banks in each market and we set targets for our business relative to our competitive set of banks. The Group target is for 75% of all the markets (based on their weighted revenue) to meet their CRI targets. This year, RBWM met its target of 75% with a score of 85% through strong performances in our home markets of Hong Kong and the UK and significant improvements in other major markets such as Brazil and Turkey. Historically, our strongest performance markets have been in Asia and this continued in 2013 with excellent results recorded in Taiwan, Malaysia and mainland China.

In CMB, we continued to measure our client engagement through a survey of key customers, the Client Engagement Programme ('CEP'). This survey is conducted by an independent third party. We have gained valuable insights from this work which help us tailor solutions and service offerings to meet our customers' individual needs.

The survey was conducted in the following markets: UK, Germany, France, Turkey, US, Canada, UAE, mainland China, Hong Kong, India, Australia, Singapore, Mexico, Argentina and Brazil, and provides aggregate scores for each of our Business Banking and Corporate Banking businesses.

We have conducted over 2,500 interviews with our Corporate Banking customers and over 6,000 interviews in our Business Banking customers. These interviews allow us to build an overall score from a possible 100 by our customers rating us on seven key relationship criteria. We have seen consistent positive performance, and in 2012 our score for the Corporate Banking segment was 84, rising slightly to 85 in 2013 with strong performances in mainland China, the US, Brazil and Germany. In our Business Banking segment our score was 81 in 2012 and 82 in 2013, with strong performances in a number of priority markets notably our home markets of Hong Kong and UK. Given the complex and competitive environment we have seen in many of the markets surveyed, we believe this to be a very good, consistent, performance and shows a positive relationship for HSBC with these valuable customers.

### Retail Banking and Wealth Management

#### Standardising our propositions to make it easier for customers to do business

We continue to make significant progress in executing our customer strategy in RBWM.

In HSBC Premier, we are focusing on meeting the wealth management needs of our customers in five respects: protection, education, retirement, managing and growing wealth, and legacy planning. We have improved the platforms used by both customers and relationship managers, helping us to enhance customer experience and raise the standards of our financial planning.

We intend to refresh HSBC Advance in all our priority markets in 2014, putting digital functionality at the heart of the updated proposition. We are focusing on the day-to-day banking needs of our customers and improving their access to personal lending.

In 2013, we deployed service enhancements for customers in all segments (Premier, Advance and personal banking) using mobile phones and saw 2.5m downloads of our global mobile banking 'app' in 25 countries, with over 1.1m downloads in the fourth quarter of 2013 alone. We also selectively piloted Twitter and Facebook-based services for customers and were voted the top social media bank in the UK in 2013 by IMGroup, the digital management consultancy.

We have undertaken a full review of all our products in RBWM, and are standardising our offering across all categories. Products are assessed on grounds of fairness and transparency before being approved. For example, in the UK, we made money management easier by simplifying automated teller machine ('ATM') withdrawals, we improved our branch infrastructure to enable customers to reset their telephone security at the branches and we updated our on-line avatar, 'Ask Olivia', so that customers can easily get online answers to questions about error codes on their secure key. In Vietnam, an SMS Alert message will now be sent to a customer's registered mobile phone number as soon as they complete a credit card transaction, preventing fraud and helping to protect our credit cardholders.

We are also continuing to develop new products. We have extended our range of renminbi offerings and improved our foreign exchange services, particularly online. Through our Asset Management Group, we have now launched Managed Solutions in eight of our priority markets.

### Interacting with customers

In 2013, we took a major step to align our staff's remuneration with customer interests by introducing a new incentive programme for our Wealth Management relationship managers. The programme removed all formulaic links to sales volumes and focused on assessing how well we are meeting our customers' needs. We developed a similar incentive programme covering the rest of the RBWM front line staff and all our retail products. This was partially implemented in the UK and France in 2013 and will be effective in most markets from the beginning of 2014.

We continue to invest in all the channels that customers use to enhance ease of use and improve the overall customer experience. Upgrades to our physical estate included increasing physical access for disabled customers to branches in the UK and Hong Kong. In Canada, the upgraded ATMs now feature paperless bill payments and voice guidance in English, French, Cantonese and Mandarin. On digital channels, we launched new mobile applications and increased the functionality of our internet banking platforms. In Brazil, we were recognised as best internet bank in the market for the second year running, and launched bill payment by digital picture on mobiles. We are working on improving our international account opening processes while also raising the standards we employ for combating financial crime risk.

### Supporting home ownership

Mortgages are a key product for our customers in enabling home ownership, and we continue to improve our products and processes.

In the UK, we granted over 30,000 first time buyer loans, and started selectively offering 95% loan-to-value mortgages as part of the government's 'Help to Buy' scheme. We won the *Moneyfacts* award for Best Bank Mortgage Provider for the fifth year running.

In mainland China, where we have achieved double digit growth in balances in each of the last three years, we re-engineered our processes to accommodate increased volumes and to speed up the granting of loans. We have reduced overall turnaround times from 12 days to six days. Through our 'Decision in Principle' service we can now give customers the results of their initial screening within one hour.

In the UAE, we launched a tracker rate mortgage linked to a public benchmark, along with other initiatives including assisting customers with the registry process. Customer feedback was very positive and RBWM continued to grow strongly even as the overall market fell slightly.

In the US, we continued to work with the Federal Home Loan Bank of New York in offering 'First Home Club', a savings and education programme that assists low income families generate the down payment required to buy their first home.

### Supporting customers in financial difficulty

We recognise that some of our customers are facing challenging financial situations, and we have looked to support them during difficult times.

Across Europe, frontline specialists were trained to offer an income and expenditure review for customers who are likely to face difficulty in making repayments to HSBC in the near future. We also eliminated certain current account charges in the UK (unpaid transaction fees). We updated our restructure and payment programme suites in the Middle East and Mexico while collaborating with charities, associations and government loan relief programmes in the US, Canada and France. In the Philippines, we offer a 'General Restructuring' Facility as a restructuring programme for both non-delinquent and delinquent customers, and responded to Typhoon Haiyan with targeted payment holidays to credit card customers affected by the catastrophe. In Australia, we offered hardship relief on mortgage repayments to customers affected by bushfires in New South Wales.

## Commercial Banking

### Supporting small and medium-sized entities

To help our customers find the right financial solutions to succeed in the global economy, we launched a series of funds to support SME's that trade or aspire to trade internationally. We launched SME funds in the UK, France and Mexico in the first half of 2013 and in the US and Canada in the second half of the year. The latter two were of US$1bn each. We also launched our fourth SME fund in the UAE of AED1bn (US$272m) for international trade customers.

Our International Exchange programme continued to be a cornerstone of our client retention activity. In 2013, we hosted four events, in Singapore, Guangzhou, Mexico City and Istanbul, and provided leadership content and networking opportunities for over 300 corporate clients from around the world. We work closely with local government, trade bodies and central banks to provide the best possible insights and information for these customers. The client feedback confirmed that customers derive huge value from connecting with like-minded businesses, and there are multiple examples of new business relationships formed as a result of these conferences.

## Interacting with customers

- In 2013, our CEP undertook over 10,000 customer interviews in 15 of CMB's priority markets. The programme gives customers the opportunity to share their views, and demonstrates that HSBC is listening and actively working to improve our ability to support customers with global operations.
- We are enhancing our customers' account opening experience, enabling it to take place anytime anywhere, provided we can fulfil regulatory and Group KYC requirements. At the end of 2013, we launched a multi-channel business account opening tool in the UK for customers who wish to open accounts using online channels or call centres without visiting a branch.
- In Hong Kong, in the fourth quarter of 2013, we made *iPads* available in Business Banking centres to enable customers to register for internet banking at the time of account opening.
- We are expanding the servicing and transaction options available on our international online platform, HSBCnet, to better cater for the requirements of businesses of different sizes and needs. In addition to our payments and cash management HSBCnet package, which is available in all markets, we launched domestic and international HSBCnet packages in our top 12 markets during 2013.
- Relationship managers now update and validate customer information through regular routine discussions.
- Significant training is being provided for staff, including around the use of tools to help them support customers in completing required customer due diligence information.

## New renminbi products and services

The growing use of China's currency worldwide is creating new opportunities for our customers engaging in trade, capital transactions and financing business in or with mainland China. We continued to strengthen our ability to meet these customers' needs by playing a major part in a number of innovative transactions for the currency, including being the first international bank to:

- offer an automated foreign currency cross-border sweeping structure in mainland China to help multinationals optimise the use of internal funding by consolidating their liquidity positions onshore and offshore;
- pilot foreign currency cross-border netting in mainland China, enabling multinationals to offset foreign currency payables and receivables between Chinese subsidiaries and netting centres overseas. The product allows companies to reduce inter-company transactions while lowering processing costs and currency risk exposure; and
- implement a tailor-made renminbi cross-border centralised payments and collections settlement product in mainland China. This eliminates foreign exchange exposure and optimises working capital management for companies.

*For further information on the products and services we offer, see page 79 of the* Annual Report and Accounts 2013.

## Client selection

Client selection is core to our growth strategy as we seek to generate long-term relationships and sustainable revenue streams within acceptable risk parameters. In 2013, we initiated a comprehensive programme to reposition our portfolios and better manage our business. This involves reviewing our customer base and establishing robust client selection filters designed to ensure that our controls and information flows are such that we can be confident that we only do business with customers who meet our criteria.

We are also undertaking a review of business policies and controls as part of our implementation of Global Standards to further guard against money laundering and sanctions risks.

*Our risk profile is described on page 134 of the* Annual Report and Accounts 2013.

## Environmental, social and community obligations

We will create a robust, resilient and sustainable business in which our clients can have confidence, our employees can take pride and our communities can trust.

Our continuing success depends, in part, on our ability to identify and address environmental, social and ethical factors which present risks to our business or offer opportunities to support customers in a more sustainable way. These can affect our reputation, drive employee engagement, help manage the risks of lending, leverage savings through eco-efficiency and secure new revenue streams.

### Human rights

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

### Our sustainability risk framework

We recognise that businesses can have an impact on the environment and communities around them. For over 10 years we have been developing, implementing and refining our approach to working with our business customers to understand and manage these issues. We assess and support customers in six sensitive sectors using our own policies and, in financing projects, using the Equator Principles as a starting point. By extending their application to all relevant corporate loans and providing independent assurance on their implementation, we go beyond the minimum requirements of the Equator Principles framework. Our sustainability risk framework is based on robust policies, formal processes and well-trained, empowered people.

We welcome constructive feedback from non-governmental organisations (‘NGO’s) and campaign groups and regularly engage with a number of them on matters of shared interest. In 2013, HSBC was approached by NGOs raising concerns regarding the implementation of our forest land and forest products sector policy. If our clients do not comply fully with our policies, or cannot show that they are on a credible path to do so, we will exit our relationship with them.

*Our approach to managing sustainability risk is described on page 297 of the* Annual Report and Accounts 2013.

### Climate business

We define ‘climate business’ as seeking long-term commercial business opportunities to support transition to a low-carbon economy. Our climate business includes clients in the solar, wind, biomass, energy efficiency, low carbon transport and water sectors, and revenues are growing year on year. HSBC’s Climate Change Centre of Excellence, part of our global research team focusing on business risks and opportunities created by climate change, was established in 2007 and its research estimates that the climate business sector could exceed US$2.2 trillion by 2020.

### Our sustainable operations strategy

HSBC’s carbon dioxide emissions are calculated on the basis of the energy used in our buildings and employee business travel from over 30 countries (covering about 93% of our operations by FTE). The data gathered on energy consumption and distance travelled are converted to carbon dioxide emissions using conversion factors from the following sources, if available, in order of preference:

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

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

*Carbon dioxide emissions in tonnes*

| | 2013 | 2012 |
|---|---|---|
| Total | **889,000** | 963,000 |
| From energy | **755,000** | 825,000 |
| From travel | **134,000** | 138,000 |

*Carbon dioxide emissions in tonnes per FTE*

| | 2013 | 2012 |
|---|---|---|
| Total | **3.43** | 3.61 |
| From energy | **2.91** | 3.09 |
| From travel | **0.52** | 0.52 |

Our greenhouse gas reporting year runs from October to September. For the year from 1 October 2012 to 30 September 2013, carbon dioxide emissions from our global operations were 889,000 tonnes.

HSBC Technology and Services employs around a third of our workforce and runs our operations, including real estate, IT infrastructure and supply chain. One of its goals, known as 'REDUCE', is to cut annual carbon dioxide emissions per employee by a tonne between 2012 and 2020 to 2.5 tonnes. Our baseline year is 2011, in which emissions were 3.44 tonnes (rounded up to 3.5).

To tackle this challenge, we set a 10-point sustainable operations strategy at the start of 2012, listed below. This strategy covers issues from sustainability leadership and engagement to supply-chain collaboration, and includes ambitious targets to reduce our use of energy and reduce our waste. We made progress in 2013, but recognise that stretching goals like these will take time to achieve. We have capitalised on 'quick wins' where possible, but have also spent time to analyse thoroughly and prepare for achieving these targets.

**Our 10-point sustainable operations strategy**

1. We are engaging all employees in delivering improved efficiency by 2020 with training and sustainability leadership programmes.
2. We will increase energy consumption from renewables from 24% to 40% and increase self-generated electricity capacity from zero to 5%.
3. We will collaborate with our supply chain to achieve sustainable savings through efficiency and innovation.
4. We will improve the energy efficiency of our Group data centres.
5. An annual US$5m investment in an HSBC Eco-efficiency Fund has been committed to trial sustainable innovation.
6. Our target is to increase the recycling of HSBC's waste from 60% to 100% of our office waste and electronic-waste.
7. Work on all new and redesigned buildings costing over US$10m in our portfolio of 7,500 buildings will be done to Leadership in Energy and Environmental Design ('LEED') certification standards.
8. We aim to reduce annual energy consumption per employee by 1MWh.
9. We will reduce paper usage, ensure it comes from sustainable sources, and encourage paperless banking for all retail and commercial customers.
10. We continue to promote alternatives to travel, reducing travel carbon emissions per employee.

*Further details on our progress with achieving our sustainability operations programme will be published in our* Sustainability Report 2013 *on 23 May 2014.*

## Community investment

In 2013, we donated a total of US$117m to community investment projects (2012: US$120m).

### Youth education

Education is key to prosperity. We seek to help young people fulfil their potential through global and local investment in education programmes. Our programmes span various levels of need, including financial literacy training, scholarships, cultural awareness programmes and teaching life skills.

In 2013, we launched the three-year £30m (US$47m) Opportunity Partnership, to help transform the lives of 25,000 disadvantaged young people in the UK through education, training and work.

### Staff volunteering

Thousands of HSBC employees globally are involved every year through volunteering for our Community Investment programmes. We report in detail on this in the HSBC *Sustainability Report 2013*.

### HSBC Water Programme

2013 was the second year of our flagship environmental project, the HSBC Water Programme. This is a five-year, US$100m programme in partnership with Earthwatch, WaterAid and WWF to deliver water provision, protection, information and education across the world. In 2013, we developed the programme by connecting specific parts of our business with HSBC Water Programme activities.

# Risk overview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Our risk profile is underpinned by our core philosophy of maintaining a strong balance sheet and liquidity position, and capital strength.

*All our activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks. Our risk management framework, employed at all levels of the organisation, ensures that our risk profile remains conservative and aligned to our risk appetite and strategy.*

## Risk and our strategic priorities

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

*Grow both business and dividends* – we ensure risk is maintained at appropriate levels while HSBC is positioned for growth and capital is deployed accordingly to maximise revenue opportunities.

*Implement Global Standards* – our management of financial crime risk is strengthened by the implementation of Global Standards, which are enhancing the procedures, policies, capabilities and controls that govern how we do business and with whom.

*Streamline processes and procedures* – during 2013, we initiated a comprehensive programme to reposition our portfolios in line with our updated risk appetite, and we made progress with programmes to make HSBC easier to manage and control. We also continued to simplify the Group structure through our disposal programme and to de-risk legacy portfolios. The steps we have taken to reshape HSBC have released around US$90bn in risk-weighted assets to date.

*Our business and operating models are described on page 13. For further information on Global Standards, see page 23.*

## Risk in 2013

Financial markets were volatile during 2013, reflecting concerns over the US fiscal cliff and debt ceiling, the potential tapering of quantitative easing, the continuing political instability in the Middle East and its possible effect on global energy prices, and the widely held view that the global economic recovery remains fragile. We maintained a conservative risk profile by reducing exposure to the most likely areas of stress:

- we managed selectively our exposure to sovereign debt and bank counterparties to ensure that the overall quality of the portfolio remained strong;
- we regularly assessed higher risk countries and adjusted our risk appetite and exposures accordingly;
- we repositioned certain portfolios through our six filters process (see page 15) and our focus on certain products or customer segments;
- we made our client selection filters more robust in managing the risk of financial crime; and
- we mitigated risks, for example reputational and operational, when they were forecast to exceed our risk appetite.

The diversification of our lending portfolio across global businesses and regions, together with our broad range of products, ensured that we were not overly dependent on a limited number of countries or markets to generate income and growth.

We monitored a range of key risk metrics in 2013, including the following:

| | **2013 US$bn** | 2012 US$bn |
|---|---|---|
| Maximum exposure to credit risk | **3,112** | 3,140 |
| of which: | | |
| – loans and advances held at amortised cost[14] | **1,292** | 1,150 |
| Risk-weighted assets | **1,093** | 1,124 |
| of which: | | |
| – credit risk RWAs | **864** | 898 |
| – market risk RWAs | **63** | 55 |
| – operational risk RWAs | **119** | 122 |
| Proportion of RWAs on standardised approach | **30%** | 34% |
| Trading value at risk (US$m) | **52** | 79 |
| Advances to deposits ratio[14] | **73%** | 74% |
| Advances to core funding (year end)[14]: | | |
| HSBC UK[23] | **100%** | 106% |
| HBAP[24] | **72%** | 73% |
| HSBC USA[25] | **85%** | 78% |

*For footnotes, see page 46.*

## Risks incurred in our business activities

Our principal banking risks are credit risk, liquidity and funding risks, market risk, operational risk, compliance risk, fiduciary risk, reputational risk pension risk and sustainability risk. We also incur insurance risk. The chart below provides a high level guide to how our business activities are reflected in our risk measures and in the Group's balance sheet. The third-party assets and liabilities indicate the contribution each business makes to the balance sheet, while RWAs illustrate the relative size of the risks incurred in respect of each business.

*For a description of our principal risks, see page 136 of the* Annual Report and Accounts 2013.

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

HSBC

| | | | | | Other (including holding company) |
|---|---|---|---|---|---|
| **Global business** | **RBWM** | **CMB** | **GB&M** | **GPB** | |
| **Business activities** | Deposits<br>Accounts services<br>Credit and lending<br>Asset management<br>Wealth solutions and financial planning<br>Broking<br>Life insurance manufacturing | Deposits<br>Payments and cash management<br>Credit and lending<br>International trade and receivables finance<br>Commercial insurance and investments | Deposits<br>Payments and cash management<br>Balance sheet management<br>Credit and lending<br>Asset and trade finance<br>Corporate finance<br>Markets<br>Securities services | Deposits<br>Account services<br>Credit and lending<br>Asset management<br>Financial advisory<br>Broking<br>Corporate finance (via GB&M)<br>Alternative investments | HSBC holding company and central operations |
| **Balance sheet** [26] | US$bn<br>Assets 517<br>Customer accounts 580 | US$bn<br>Assets 361<br>Customer accounts 354 | US$bn<br>Assets 1,976<br>Customer accounts 450 | US$bn<br>Assets 98<br>Customer accounts 97 | US$bn<br>Assets 172<br>Customer accounts 1 |
| **RWAs** | US$bn<br>Credit risk 195<br>Operational risk 39 | US$bn<br>Credit risk 359<br>Operational risk 33 | US$bn<br>Credit risk 270<br>Counterparty credit risk 46<br>Operational risk 43<br>Market risk 63 | US$bn<br>Credit risk 17<br>Operational risk 4 | US$bn<br>Credit risk 23<br>Operational risk – |
| **Risk profile** | Liquidity and funding risk (page 213), Pension risk (page 260), Fiduciary risk (page 248), Reputational risk (page 260), Compliance risk (page 247), Sustainability risk (page 263) and Insurance risk (page 249). The latter is predominantly in RBWM and CMB. | | | | |

*Page references in the above table are to the* Annual Report and Accounts 2013*. For footnote, see page 46.*

*For further information on credit risk, see page 150; capital and risk-weighted assets, see page 298; market risk, including value at risk, see page 230; and operational risk see page 244 of the* Annual Report and Accounts 2013.

## Top and emerging risks

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

The ongoing assessment of our top and emerging risks is informed by a comprehensive suite of risk factors (see page 135 of the *Annual Report and Accounts 2013*) which may result in our risk appetite being revised. During 2013, senior management paid particular attention to a number of top and emerging risks. These risks, as at 31 December 2013, are tabulated below.

We made a number of changes to our top and emerging risks to reflect revised assessment of their effect on HSBC during 2013. Threats to the global economy from a disorderly exit from quantitative easing, which emerged as a risk during the first half of 2013 following announcements that monetary stimuli may be scaled back, receded during the second half of the year. This followed announcements by central banks on the likely pace and scale of tapering together with an acceleration of economic growth in the US and UK.

*Top and emerging risks – T / E*

| Macroeconomic and geopolitical risks | Macro-prudential, regulatory and legal risks to our business model | Risks related to our business operation, governance and internal control systems |
|---|---|---|
| **E** Emerging markets' slowdown | **T** Regulatory developments affecting our business model and Group profitability | **T** Heightened execution risk |
| Growth decelerated in a number of emerging markets during 2013. Any contraction in trade and capital flows would affect both emerging and developed economies. | Governments and regulators in numerous jurisdictions continue to develop policy which may impose new requirements, including in the areas of capital and liquidity management and business structure. | Regulatory demands, a challenging external environment, the level of internal transformation and risks arising from business and portfolio disposals may affect our ability to execute our strategy. |
| **E** Increased geopolitical risk | **T** Regulatory investigations, fines, sanctions, commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand | **T** Internet crime and fraud and **T** Information security risk |
| Our operations are exposed to risks arising from political instability and civil unrest in a number of countries, which may have a wider effect on regional stability and regional and global economies. | Financial service providers are at risk of regulatory sanctions or fines related to conduct of business and financial crime.<br>In December 2012, HSBC entered into agreements with US and UK authorities in relation to investigations regarding past inadequate compliance with AML and sanctions laws and we continue to be subject to other regulatory proceedings, the outcome of which is difficult to predict. There is a risk that we fail to meet agreed deadlines or are found to have material gaps in our plans or the implementation progress compared with that required by the DPAs and other orders. | Our businesses face a range of operational risks, including those arising from internet crime and fraud and cyber attacks affecting the security of Group and customer information.<br>**T** Data management<br>New regulatory requirements necessitate more frequent and granular data submissions, which must be produced on a consistent, accurate and timely basis. |
| | **T** Dispute risk | **E** Model risk |
| | HSBC is party to legal proceedings arising out of its normal business operations which could give rise to potential financial loss and significant reputational damage. | Regulatory requirements relating to models and assumptions in areas such as capital calculations and stress testing could potentially result in an increased and more volatile capital requirement. |

Heightened execution risk was also assessed as a top risk to reflect the external and internal challenges to delivering our strategy at the same time as implementing the changes necessitated by regulatory change and the implementation of Global Standards.

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

*For a detailed account of these risks and for a summary of our risk factors, see pages 141 and 135, respectively, of the* Annual Report and Accounts 2013.

## How we manage risk

Our risk culture is fundamental to the delivery of our strategic objectives. It may be characterised as conservative, control-based and collegiate. It is reinforced by our HSBC Values and our Global Standards, and forms the basis on which our risk appetite and risk management framework are established. These are instrumental in aligning the behaviour of individuals with the Group's attitude to assuming and managing risk.

We manage risk actively, with five main elements underpinning our risk culture.

### Running risk like a business

Running risk like a business means ensuring that the Global Risk function is dynamic and responsive to the needs of its stakeholders. We continue to focus on:

- making systems compatible (for example, in Global Risk and Global Finance) so a complete picture of our risks is obtained;
- streamlining data production and re-engineering processes to create time to spend on risk management; and
- understanding the detail behind our risks and costs.

### Organisation and structure

Robust risk governance and accountability are embedded throughout the Group, fostering a continuous monitoring of the risk environment and an integrated evaluation of risks and their interactions. Adherence to consistent standards and risk management policies is required across HSBC by our Global Standards and our Global Risk Operating Model.

Our risk governance framework, of which our risk appetite framework is a significant element, ensures the appropriate oversight of and accountability for the effective management of risk, including financial crime risk, at Group, regional and global business levels. Similar arrangements are in place in our major operating subsidiaries.

The Group Risk Committee is responsible for advising the Board on high-level risk related matters and risk governance. The risk governance framework was augmented by the establishment in January 2013 of the Financial System Vulnerabilities Committee, which reports to the Board on matters relating to financial crime and financial system abuse and provides a forward-looking perspective on financial crime risk.

A Conduct & Values Committee was established in January 2014, to oversee the design and application of HSBC's policies, procedures and standards, to ensure that we conduct business responsibly and consistently adhere to HSBC Values and to advise the Board accordingly.

*For a description of the governance structure for managing risk at the Group level, see the report of the Group Risk Committee on page 352 of the* Annual Report and Accounts 2013. *The Report of the Financial System Vulnerabilities Committee is on page 358.*

### Three lines of defence

The Group has adopted a risk management and internal control structure referred to as the 'three lines of defence' to ensure we achieve our commercial aims while meeting regulatory and legal requirements. It is a key part of our operational risk management framework.

- *First line* – every employee is responsible for the risks that are part of their day to day jobs. The first line of defence ensures that all key risks within their operations are identified, mitigated and monitored by appropriate internal controls within an overall control environment.
- *Second line* – global functions, such as Global Risk, Global Finance and Global Human Resources form the second line of defence. They have similar responsibilities to the first line of defence for the processes and activities they own. In addition, they are responsible for setting policy and for providing oversight and challenge of the activities conducted by the first line.
- *Third line* – Internal Audit forms the third line of defence, providing independent assurance to senior management and the Board over the design and operation of HSBC's risk management, governance and internal control processes.

*For details of our operational risk management framework, see page 244 of the* Annual Report and Accounts 2013.

## People

All employees are required to identify, assess and manage risk within the scope of their assigned responsibilities and, as such, they are critical to the effectiveness of the three lines of defence. Personal accountability for Global Standards is reinforced by HSBC Values.

Clear and consistent employee communication on risk conveys strategic messages and sets the tone from senior leadership. A suite of mandatory training on critical risk and compliance topics is deployed to embed skills and understanding and strengthen the risk culture within HSBC. It reinforces the attitude to risk in the behaviour expected of employees, as described in our risk policies. The training is updated regularly, describing technical aspects of the various risks assumed by the Group and how they should be managed effectively. Staff are supported in their roles by a disclosure line which enables them to raise concerns confidentially (see page 29).

Our risk culture is reinforced by our approach to remuneration. Individual awards are based on compliance with HSBC Values and the achievement of financial and non-financial objectives which are aligned to our risk appetite and global strategy.

*For further information on risk and remuneration, see the Report of the Group Remuneration Committee on page 360 of the* Annual Report and Accounts 2013.

## Risk management processes and procedures

Risk management within HSBC is driven by the following four processes:

- risk identification;
- risk appetite;
- mapping our risk profile; and
- stress testing and scenario analysis.

### Risk identification

We identify and monitor risks continuously. This process, which is informed by analysis of our risk factors and the results of our stress testing programme, gives rise to the classification of certain key risks as top or emerging. Changes in our assessment of top and emerging risks may result in adjustments to our business strategy and, potentially, our risk appetite.

### Risk appetite

The Group's Risk Appetite Statement describes the types and levels of risk that we are prepared to accept in executing our strategy. The Risk Appetite Statement is approved by the Board on the advice of the Group Risk Committee. It is a key component of our risk management framework, informs our annual operating plan and plays an important role in our six filters process.

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

Quantitative and qualitative metrics are assigned to nine key categories: earnings, capital, liquidity and funding, securitisations, cost of risk, intra-group lending, strategic investments, risk categories and risk diversification and concentration. Measurement against the metrics:

- guides underlying business activity, ensuring it is aligned to risk appetite statements;
- informs risk-adjusted remuneration;
- enables the key underlying assumptions to be monitored and, where necessary, adjusted through subsequent business planning cycles; and
- promptly identifies business decisions needed to mitigate risk.

Some of the core metrics that are measured and presented to the Board monthly are tabulated below:

*Key risk appetite metrics*

| | 2013 | |
|---|---|---|
| | Target[27] | **Actual** |
| Core tier 1 ratio | 9.5% to 10.5% | **13.6%** |
| Common equity tier 1 ratio | 9.5% to 10.5% | **10.9%** |
| Return on equity | 12% to 15% | **9.2%** |
| Return on RWAs | 2.1% to 2.7% | **2.0%** |
| Cost efficiency ratio | 48% to 52% | **59.6%** |
| Advances to customer accounts ratio[14] | Below 90% | **72.9%** |
| Cost of risk (loan impairment charges) | Below 15% of operating income | **7.7%** |

*For footnotes, see page 46.*

In 2013, we changed the targets for two of these risk appetite metrics. Our return on risk-weighted assets target was raised from 1.8-2.6% to the current target of 2.1-2.7%, reflecting changes in our risk profile as we reshaped our portfolio of businesses in line with our strategy and our six filters framework. As our portfolios became less risky, we reduced the acceptable cost of risk from below 20% to below 15% of operating income.

Our core tier 1 ratio exceeded the target, although remained within our risk tolerance to ensure we were well placed to meet requirements on a Basel III basis (page 309 of the *Annual Report and Accounts 2013*).

*Our six filters are described on page 15.*

## Mapping our risk profile

Risks are assumed by our global businesses in accordance with their risk appetite and are managed at Group, global business and regional levels. All risks are recorded and monitored through our risk mapping process, which describes our risk profile by category in the different regions and global businesses.

In addition to our banking and insurance risks, the risk mapping process identifies and monitors risks such as model, financial management, capital, Islamic finance and strategic risks. These risks are regularly assessed through our risk appetite framework, stress tested and considered for classification as top and emerging risks.

*For a summary of our banking and insurance risks, see page 136 of the* Annual Report and Accounts 2013.

## Stress testing and scenario analysis

We conduct stress-testing scenarios across the Group on both enterprise-wide and regional bases, reflecting our business strategy and resultant risk exposures. These scenarios include, but are not limited to, adverse macroeconomic events, failures at country, sector and counterparty levels and a variety of projected major operational risk events. The results of the stress tests are used to assess potential unplanned demand for regulatory capital under the various scenarios. We also participate in scenario analyses requested by regulatory bodies including the Bank of England concurrent stress test exercise and the US Federal Reserve Comprehensive Capital Analysis and Review ('CCAR') and Dodd-Frank Stress Testing programmes.

We tested several scenarios in the course of 2013. The results of these stress tests demonstrated that HSBC would remain satisfactorily capitalised after taking account of assumed management actions to mitigate the effect of the scenarios in question.

*For further information on our stress-testing and scenario analyses, see page 139 of the* Annual Report and Accounts 2013.

# How risk affects our performance

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

The execution of our strategy, including the exit from non-strategic markets, the sale of businesses and non-core investments, the repositioning of our portfolios and implementation of revised client selection filters, together with an improvement in market conditions, led to a modest improvement in credit metrics in our retail portfolios during 2013, while our wholesale portfolios remained stable.

LICs fell in North America, Europe and the Middle East and North Africa following a general improvement in credit conditions but rose in Latin America for reasons outlined on page 17.

Operational losses declined significantly compared with 2012, although remained above historical trend. The decrease reflected the non-recurrence of fines and penalties paid in 2012 as part of the settlement of investigations into past inadequate compliance with AML and sanctions laws. Provisions related to UK customer redress, principally payment protection insurance and interest rate protection products, also declined. There are many factors which could affect these estimated liabilities and there remains a high degree of uncertainty as to the eventual cost of redress for these matters.

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of its normal business operations. We recognise 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. Our provisions for legal proceedings and regulatory matters and for customer remediation at 31 December 2013 totalled US$4.2bn. While the outcome of these matters is inherently uncertain, management believes that, based on the information available to it, appropriate provisions have been made.

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

*For a description of material legal proceedings and regulatory matters, see Note 43 on the Financial Statements on page 554 of the* Annual Report and Accounts 2013.

*Provisions for legal proceedings and regulatory matters and for customer remediation are disclosed in Note 31 on the Financial Statements on page 526 of the* Annual Report and Accounts 2013.

*For details of operational losses, see page 246 of the* Annual Report and Accounts 2013.

*For details of our critical accounting policies, see page 72 of the* Annual Report and Accounts 2013.

# Rewarding performance


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

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

## Employee remuneration

HSBC's reward package comprises four key elements of remuneration:

- fixed pay;
- benefits;
- annual incentive; and
- the Group Performance Share Plan ('GPSP').

These elements support the achievement of our objectives through balancing reward for both short-term and long-term sustainable performance. Our strategy is designed to reward only success, and aligns employees' remuneration with our risk framework and risk outcomes. For our most senior employees the greater part of their reward is deferred and thereby subject to malus, that is, it can be cancelled if warranted by events.

In order to ensure alignment between what we pay our people and our business strategy, we assess individual performance against annual and long-term financial and non-financial objectives which are summarised in performance scorecards. This assessment also takes into account adherence to the HSBC Values of being 'open, connected and dependable' and acting with 'courageous integrity'. Altogether, performance is therefore judged not only on what is achieved over the short and long-term but also importantly on how it is achieved, as we believe the latter is essential to the long-term sustainability of the business.

### Industry changes and key challenges

The main drivers of change in remuneration policy and practice within the financial services industry are the new regulations under CRD IV which apply globally to all employees of EU headquartered banks. The key change is the application of a cap on variable pay that can be paid to any 'material risk taker' (being employees who have been identified as having a material impact on the institution's risk profile). This presents significant challenges for HSBC given the fact that as a worldwide business, a significant number of our material risk takers are based outside the EU.

This situation has necessitated a review of our remuneration policy, especially the balance between fixed and variable pay, to ensure we can remain competitive on a total compensation basis and retain our key talent. Bearing in mind the interests of our shareholders, the Board believes it is necessary to increase the variable pay cap to the 200% of fixed pay for material risk takers that is permitted under CRD IV with shareholder approval. This will enable us to hold back a larger proportion of variable pay, subject to malus, than would be the case if we were not to take advantage of this provision. It will require shareholder approval at the AGM on 23 May 2014.

Overall, a representative number of our major institutional shareholders have been supportive of the proposed changes to our remuneration policy and recognise the importance of ensuring we can retain our key talent.

### Variable pay pool determination

Determining the quantum of variable pay requires consideration of affordability, the equitable distribution between shareholders and employees and market-based judgements around peer comparisons and retention risk. The Group Remuneration Committee considers many factors in determining HSBC's variable pay pool funding. The total variable pay pool for 2013 was US$3.9bn, increased from US$3.7bn in 2012, as shown in the table below:

*Variable pay pool*

| | Group 2013 US$m | Group 2012 US$m |
|---|---|---|
| Variable pay pool | | |
| – total | **3,920** | 3,689 |
| – as a percentage of underlying profit | **15%** | 17% |
| – percentage of pool deferred[28] | **18%** | 17% |

*For footnote, see page 46.*

### Funding

The variable pay pool takes into account the performance of the Group which is considered within the context of our Risk Appetite Statement. This ensures that the variable pay pool is shaped by risk considerations, and is shaped by an integrated approach to business, risk and capital management which supports achievement of our strategic objectives.

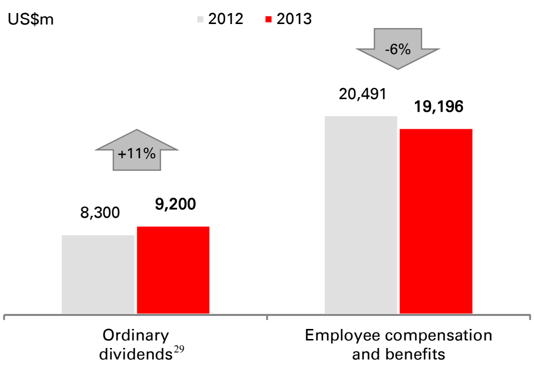
Funding is calibrated with reference to Group profitability, capital strength, and shareholder returns. This approach ensures that performance-related awards for any global business, global function, geographical region or level of staff are considered in a holistic fashion.

The methodology also considers the relationship between capital, dividends and variable pay to ensure that the distribution of post-tax profits between these three elements is considered appropriate.

*For the Directors' Remuneration Report for the 2012, 2013 and target split, see page 394 of the* Annual Report and Accounts 2013.

### Relative importance of spend on pay

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




*For footnote, see page 46.*

## Directors' remuneration

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

*Executive Directors*

| | Douglas Flint | | Stuart Gulliver | | Iain Mackay | |
|---|---|---|---|---|---|---|
| | **2013 £000** | 2012 £000 | **2013 £000** | 2012 £000 | **2013 £000** | 2012 £000 |
| Fixed pay | | | | | | |
| Base salary | **1,500** | 1,500 | **1,250** | 1,250 | **700** | 700 |
| Pension | **750** | 750 | **625** | 625 | **350** | 350 |
| | **2,250** | 2,250 | **1,875** | 1,875 | **1,050** | 1,050 |
| Benefits | **48** | 64 | **591** | 642 | **33** | 36 |
| Variable pay | | | | | | |
| Annual incentive | **–** | – | **1,833** | 780 | **1,074** | 539 |
| GPSP | **–** | – | **3,667** | 3,000 | **2,148** | 1,400 |
| | **–** | – | **5,500** | 3,780 | **3,222** | 1,939 |
| Notional return on deferred cash | **27** | 12 | **–** | – | **7** | 3 |
| Non-taxable benefits | **102** | 98 | **67** | 65 | **53** | 50 |
| Total single figure of remuneration | **2,427** | 2,424 | **8,033** | 6,362 | **4,365** | 3,078 |
| *Addendum* | | | | | | |
| Annual incentive with performance conditions[30] | **–** | – | **–** | 1,170 | **–** | 809 |
| Total single figure of remuneration and annual incentive with performance conditions | **2,427** | 2,424 | **8,033** | 7,533 | **4,365** | 3,887 |

*For footnote, see page 46.*

# Strategic Report (continued)



Douglas Flint, as Group Chairman, is not eligible for an annual incentive and did not receive a GPSP award in 2013.

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

A full summary of the variable pay performance outcomes for the two eligible executive Directors receiving such awards in 2013 is tabulated below.

*For full details of Directors' remuneration, see page 389 of the* Annual Report and Accounts 2013.

*Variable pay performance for 2013*

| | Stuart Gulliver | | | | | | Iain Mackay | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Maximum multiple | Pre-discretion performance outcome | Multiple awarded | Pre-discretion value £000 | Committee discretion[31] £000 | Post-discretion value £000 | Maximum multiple | Post-discretion performance outcome | Multiple awarded | Value £000 |
| Salary | 1.00 | 100% | 1.00 | 1,250 | n/a | 1,250 | 1.00 | 100% | 1.00 | 700 |
| Annual incentive | 3.00 | 60% | 1.80 | 2,250 | (417) | 1,833 | 3.00 | 51% | 1.53 | 1,074 |
| GPSP | 6.00 | 60% | 3.60 | 4,500 | (833) | 3,667 | 5.10 | 60% | 3.07 | 2,148 |
| Total | | | | 8,000 | (1,250) | 6,750 | | | | 3,922 |

*For footnote, see page 46.*

## Remuneration policy going forward

In order to deal with the challenges of CRD IV we have introduced changes to our remuneration structure for executive Directors in 2014 as summarised in the table below, subject to shareholders' approval at the 2014 AGM. If approved, the policy is intended to apply for three years to the conclusion of the AGM in 2017.

*For full details of the remuneration policy for executive Directors, see page 381 of the* Annual Report and Accounts 2013.

*Changes in remuneration policy for 2014*

| Purpose and link to strategy | Operation | Maximum opportunity | Performance metrics |
|---|---|---|---|
| Salary | No change | No change | No change (none) |
| Fixed pay allowance[32] | Introduction of share allowance | Maximum fixed pay allowance for each executive Director will be the difference between (i) 50% of the target remuneration of the executive Director under this policy and (ii) the aggregate of the base salary and cash allowance in lieu of pension for that executive Director | None |
| Benefits | No change | No change | No change (none) |
| Total variable pay | No change | Maximum at 900% of salary reduced to 200% of fixed pay | No change |
| Annual incentive[32] | No change | Maximum incentive reduced from 300% of base salary to 67% of fixed pay | See page 382 of the *Annual Report and Accounts 2013* |
| GPSP[32] | No change | Maximum incentive reduced from 600% of base salary to 133% of fixed pay | See page 383 of the *Annual Report and Accounts 2013* |
| Pension | No change | No change | No change (none) |

*For footnote, see page 46.*

The mix of fixed and variable pay granted to an employee is commensurate with the individual's role, experience and responsibility and the local market.

Fixed pay allowances will only be granted to certain material risk takers based on their role, function, experience and technical expertise. The Group Chairman will not be eligible for a fixed pay allowance.

Executive Directors, Group Managing Directors and Group General Managers will receive shares that vest immediately. The shares (net of shares sold to cover any income tax and social security) will be subject to a retention period. 20% of these shares will be released in March immediately following the end of the financial year in which the shares are granted. The remaining 80% will be subject to a retention period of at least five years.

All other employees will receive the fixed pay allowance in cash when it is below a specified threshold. Where the fixed pay allowance is above the specified threshold, all of it will be received in shares that vest immediately. Any shares delivered (net of shares sold to cover any income tax and social security) as part of the fixed pay allowance would be subject to a retention period. 40% of the shares will be released in March following the end of the relevant financial year in which the shares were granted. The remaining 60% will be released in three equal annual tranches on each anniversary of the initial release.

Group Managing Directors participate in both the annual incentive and the GPSP. Group General Managers participate in the annual incentive and may receive other long-term awards. Other employees across the Group are eligible to participate in annual incentive arrangements.

## External reporting

The required remuneration disclosures for Directors and highest paid employees in the Group are made in the Directors Remuneration Report on page 378 of the *Annual Report and Accounts 2013*.

Remuneration disclosures for Code Staff can be found in the *Pillar 3 Disclosures 2013*.

On behalf of the Board 24 February 2014
D J Flint, *Group Chairman*
HSBC Holdings plc
Registered number 617987

## Footnotes to Strategic Report

1 *A Basel II measure, of core tier 1 capital expressed as percentage of total risk-weighted assets.*
2 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*
3 *Dividends recorded in the financial statements are dividends per ordinary share declared in a year and are not dividends in respect of, or for, that year. The third interim dividend for 2012 of US$0.09 was paid on 12 December 2012. The fourth interim dividend for 2012 of US$0.18 was paid on 8 May 2013. First, second and third interim dividends for 2013, each of US$0.10 per ordinary share, were paid on 11 July 2013, 9 October 2013 and 11 December 2013, respectively. Note 10 on the Financial Statements provides more information on the dividends declared in 2013. On 24 February 2014 the Directors declared a fourth interim dividend for 2013 of US$0.19 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 30 April 2014 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 22 April 2014, with a scrip dividend alternative. The reserves available for distribution at 31 December 2013 were US$49,339m.*
*Quarterly dividends of US$15.5 per 6.2% non-cumulative Series A US dollar preference share, equivalent to a dividend of US$0.3875 per Series A American Depositary Share, each of which represents one-fortieth of a Series A US dollar preference share, were paid on 15 March 2013, 17 June 2013, 16 September 2013 and 16 December 2013.*
*Quarterly coupons of US$0.508 per security were paid with respect to 8.125% capital securities on 15 January 2013, 15 April 2013, 15 July 2013 and 15 October 2013.*
*Quarterly coupons of US$0.5 per security were paid with respect to 8% capital securities on 15 March 2013, 17 June 2013, 16 September 2013 and 16 December 2013.*
4 *The return on average ordinary shareholders' equity is defined as profit attributable to ordinary shareholders of the parent company divided by average ordinary shareholders' equity.*
5 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as 'revenue'.*
6 *Intermediation of securities, funds and insurance products, including Securities Services in GB&M.*
7 *Merger and acquisition, event and project financing, and co-investments in GPB.*
8 *Including Foreign Exchange, Rates, Credit and Equities.*
9 *Including portfolio management.*
10 *Including private trust and estate planning (for financial and non-financial assets).*
11 *Including hedge funds, real estate and private equity.*
12 *Loan impairment charges and other credit risk provisions.*
13 *Share of profit in associates and joint ventures.*
14 *In 2013, GB&M changed the way it manages repo and reverse repo activities in the Credit and Rates businesses as set out on page 68 of the* Annual Report and Accounts 2013*. This led to an increase in the amount of reverse repo and repo agreements classified as 'Loans and advances to customers' at amortised cost and 'Customer accounts' at amortised cost in the balance sheet, respectively.*
15 *A Basel III measure, of common equity tier 1 capital expressed as percentage of total risk exposure amount.*
16 *UK bank levy paid reflects the payments made to the tax authorities during the calendar year and may differ from the recognition of liabilities charged to the income statement.*
17 *Excludes movements in the fair value of own debt and before variable pay distributions (page 378 of the* Annual Report and Accounts 2013*).*
18 *Each American Depositary Share represents five ordinary shares.*
19 *Total shareholder return is defined as the growth in share value and declared dividend income during the relevant period.*
20 *The Financial Times Stock Exchange 100 Index, The Morgan Stanley Capital International World Index and The Morgan Stanley Capital International World Bank Index.*
21 *Established on 17 January 2014.*
22 *Established on 22 November 2013.*
23 *The HSBC UK entity shown comprises five legal entities; HSBC Bank plc (including all overseas branches), and SPEs consolidated by HSBC Bank plc for Financial Statement purposes, Marks and Spencer Financial Services Limited, HSBC Private Bank (UK) Ltd, HFC Bank Ltd and HSBC Trust Company (UK) Limited, managed as a single operating entity, in line with the application of UK liquidity regulation as agreed with the UK PRA.*
24 *The Hongkong and Shanghai Banking Corporation represents the bank in Hong Kong including all overseas branches. Each branch is monitored and controlled for liquidity and funding risk purposes as a standalone operating entity.*
25 *The HSBC USA principal entity shown represents the HSBC USA Inc consolidated group; predominantly HSBC USA Inc and HSBC Bank USA, NA. The HSBC USA Inc consolidated group is managed as a single operating entity.*
26 *The sum of balances presented does not agree to consolidated amounts because inter-company eliminations are not presented here.*
27 *Targets for 2014 to 2016 were announced at our Investor Update on 15 May 2013.*
28 *The percentage of variable pay deferred for the Code Staff population was 64%.*
29 *Dividends per ordinary share in respect of that year. For 2013, this includes the first, second and third interim dividends paid in 2013 of US$5.6bn (gross of scrip) and a fourth interim dividend of US$3.6bn.*
30 *60% of the 2012 annual incentive for Stuart Gulliver and Iain Mackay disclosed in the 2012 Directors' Remuneration Report was deferred for five years. The vesting of these awards is subject to a service condition and satisfactory completion of the DPA. The DPA condition ends on the fifth anniversary of the award date unless the DPA is extended or otherwise continues beyond that date, in which case the awards will vest on the date on which the DPA expires and otherwise ceases to operate.*
31 *In its meeting of 15 January 2014, the Group Remuneration Committee used its discretion to reduce overall variable pay by £1.25m (equivalent to 18.5% of the total annual incentive and GPSP). This adjustment was considered appropriate in the context of overall Group-wide year-over-year profitability and incentive pool funding, Group-wide risk and compliance, market remuneration benchmarks and the remuneration recommendations for the Group CEO's direct reports.*
32 *Maximum award potentials for fixed pay allowances and variable pay awards are based on obtaining shareholder approval to increase the maximum variable pay award as a percentage of fixed pay under CRD IV from 100% to 200% at the Annual General Meeting on 23 May 2014. If shareholder approval is not obtained the maximum fixed pay allowance payable for each executive Director under the policy will be the difference between (i) 50% of maximum total remuneration of the executive Director under this policy as shown in the Remuneration scenarios chart on page 389 of the* Annual Report and Accounts 2013 *and (ii) the aggregate of the base salary and cash allowance in lieu of pension for that executive Director. Maximum variable pay award levels will be revised to 100% of fixed pay and the maximum annual incentive and GPSP awards will accordingly be reduced to 1/3 and 2/3 of this amount (i.e. 33% and 67% of fixed pay, respectively). The requested increase in the cap to 200% would enable us to minimise the increase in fixed remuneration costs and so help to maintain greater flexibility on total pay.*

# Directors


**Douglas Flint**, CBE
**Group Chairman**


**Stuart Gulliver**
**Group Chief Executive**


**Kathleen Casey**[1]
*Non-executive Director*


**Safra Catz**
*Non-executive Director*


**Laura Cha**, GBS
*Non-executive Director*


**Marvin Cheung**, GBS, OBE
*Non-executive Director*


**John Coombe**[2]
*Non-executive Director*


**Sir Jonathan Evans**
*Non-executive Director*


**Joachim Faber**
*Non-executive Director*


**Rona Fairhead**, CBE
*Non-executive Director*


**Renato Fassbind**
*Non-executive Director*

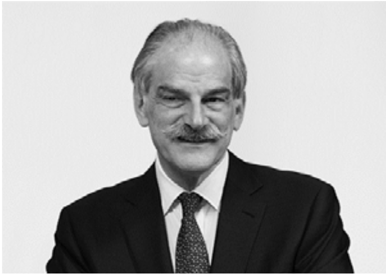

**James Hughes-Hallett**, CMG, SBS[2]
*Non-executive Director*

# Strategic Report (continued)

## Directors / Supplementary information

### *Directors (continued)*

**Sam Laidlaw**
*Non-executive Director*



**John Lipsky**
*Non-executive Director*

**Rachel Lomax**
*Non-executive Director*

**Iain Mackay**
**Group Finance Director**

**Marc Moses**[1]
**Group Chief Risk Officer**

**Sir Simon Robertson**
**Deputy Chairman and senior independent non-executive Director**

**Ben Mathews**
**Group Company Secretary**

1 *Marc Moses was appointed as a Director on 1 January 2014 and Kathleen Casey will be appointed on 1 March 2014.*
2 *James Hughes-Hallett and John Coombe are due to retire at the conclusion of the 2014 Annual General Meeting.*

For full biographies of the Directors, see page 330 of the *Annual Report and Accounts 2013* and online at www.hsbc.com.

# Supplementary information


- Status of the *Strategic Report 2013*
- Copies of the *Annual Report and Accounts 2013*
- Shareholder enquiries and communications
- Report of the auditor


## Status of the *Strategic Report 2013*

This *Strategic Report 2013* is a part of HSBC Holdings plc *Annual Report and Accounts 2013* and is not the Group's statutory accounts. It does not contain the full text of the Directors' Report and it does not contain sufficient information to allow as full an understanding of the results and state of affairs of the Group and of its policies and arrangements concerning Directors' remuneration as would be provided by the full *Annual Report and Accounts 2013*.

## Copies of the *Annual Report and Accounts 2013*

Further copies of the *Strategic Report 2013* and the *Annual Report and Accounts 2013* may be obtained from Global Communications, HSBC Holdings plc, 8 Canada Square, London E14 5HQ, United Kingdom; from Communications (Asia), The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong; or from Global Publishing Services, HSBC – North America, 26525 North Riverwoods Boulevard, Mettawa, Illinois 60045, USA. The *Strategic Report 2013* and the *Annual Report and Accounts 2013* may also be downloaded from the HSBC website, www.hsbc.com.

## Shareholder enquiries and communications

### Enquiries

Any enquiries relating to your shareholdings on the share register, for example transfers of shares, change of name or address, lost share certificates or dividend cheques, should be sent to the Registrars at the address given below. The Registrars offer an online facility, Investor Centre, which enables shareholders to manage their shareholding electronically.

*Principal Register*

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
United Kingdom

Telephone: +44 (0) 870 702 0137
Email via website:
www.investorcentre.co.uk/contactus
Investor Centre:
www.investorcentre.co.uk

*Hong Kong Overseas Branch Register*

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Investor Centre:
www.investorcentre.com/hk

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Telephone: +33 1 40 70 22 56
Email: ost-agence-des-titres-hsbc-reims.hbfr-do@hsbc.fr
Website: www.hsbc.fr

# Strategic Report (continued)

## Supplementary information

Persons whose shares are held on their behalf by another person may have been nominated to receive communications from HSBC pursuant to section 146 of the UK Companies Act 2006 ('nominated person'). The main point of contact for a nominated person remains the registered shareholder (for example your stockbroker, investment manager, custodian or other person who manages the investment on your behalf). Any changes or queries relating to a nominated person's personal details and holding (including any administration thereof) must continue to be directed to the registered shareholder and not HSBC's Registrars. The only exception is where HSBC, in exercising one of its powers under the UK Companies Act 2006, writes to nominated persons directly for a response.

### Electronic communications

Shareholders may at any time choose to receive corporate communications in printed form or to receive notifications of their availability on HSBC's website. To receive future notifications of the availability of a corporate communication on HSBC's website by email, or revoke or amend an instruction to receive such notifications by email, go to www.hsbc.com/ecomms. If you provide an email address to receive electronic communications from HSBC, we will also send notifications of your dividend entitlements by email. If you received a notification of the availability of this document on HSBC's website and would like to receive a printed copy or, if you would like to receive future corporate communications in printed form, please write or send an email (quoting your shareholder reference number) to the appropriate Registrars at the address given below. Printed copies will be provided without charge.

A Chinese translation of this and future documents may be obtained on request from the Registrars. Please also contact the Registrars if you have received a Chinese translation of this document and do not wish to receive such translations in future.

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本文件及日後的相關文件均備有中譯本，如有需要，請向適當的股份登記處索取。股東如收到本報告的中譯本，但不希望再收取此等譯本，亦請聯絡股份登記處。

股東如已委託其他人士代為持有股份，可能會獲提名(「獲提名人士」)收取滙豐根據英國《2006年公司法》第146條的規定發出的通訊。獲提名人士之主要聯絡人仍為登記股東(例如：股票經紀、投資經理、託管商或代表　閣下管理投資的其他人士)。獲提名人士的個人資料及持股量(包括任何相關管理事宜)如有任何變更或查詢，必須繼續交由登記股東而非滙豐的股份登記處辦理。除非滙豐根據英國《2006年公司法》行使其中一項權力時，直接致函獲提名人士要求回應，則屬例外。

### Report of the auditor

The auditor's report on the full accounts for the year ended 31 December 2013 was unqualified, and their statement under section 496 (whether the Strategic Report and the Directors' Report are consistent with the accounts) of the Companies Act 2006 was unqualified.

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