HSBC HOLDINGS PLC
Form 20-F
February 26, 2015
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As filed with the Securities and Exchange Commission on February 26, 2015.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934**

Or

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2014

Or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Or

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Date of event requiring this shell company report __________

For the transition period from N/A to N/A

Commission file number: 001-14930

HSBC Holdings plc

(Exact name of Registrant as specified in its charter)

N/A	**United Kingdom**
(Translation of Registrant s name into English)	(Jurisdiction of incorporation or organisation)

8 Canada Square

London E14 5HQ

United Kingdom

(Address of principal executive offices)

Russell C Picot

8 Canada Square

London E14 5HQ

United Kingdom

Tel +44 (0) 20 7991 8888

Fax +44 (0) 20 7992 4880

(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of each class	Name of each exchange on which registered
Ordinary Shares, nominal value US$0.50 each.	London Stock Exchange Hong Kong Stock Exchange Euronext Paris Bermuda Stock Exchange New York Stock Exchange*
American Depository Shares, each representing 5 Ordinary Shares of nominal value US$0.50 each.	New York Stock Exchange
6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange*
American Depositary Shares evidenced by American Depositary receipts, each representing one-fortieth of a Share of 6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange
5.10% Senior Unsecured Notes Due 2021	New York Stock Exchange
4.00% Senior Unsecured Notes Due 2022	New York Stock Exchange
4.875% Senior Unsecured Notes Due 2022	New York Stock Exchange
7.625% Subordinated Notes due 2032	New York Stock Exchange
7.35% Subordinated Notes due 2032	New York Stock Exchange
6.5% Subordinated Notes 2036	New York Stock Exchange

6.5% Subordinated Notes 2037	New York Stock Exchange
6.8% Subordinated Notes Due 2038	New York Stock Exchange
6.100% Senior Unsecured Notes due 2042	New York Stock Exchange
8.125% Perpetual Subordinated Capital Securities Exchangeable at the Issuer s Option into Non- Cumulative Dollar Preference Shares	New York Stock Exchange
8.00% Perpetual Subordinated Capital Securities Exchangeable at the Issuer s Option into Non- Cumulative Dollar Preference Shares, Series 2	New York Stock Exchange
4.250% Subordinated Notes due 2024	New York Stock Exchange
5.250% Subordinated Notes due 2044	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Securities Exchange Act of 1934: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Securities Exchange Act of 1934: None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

Ordinary Shares, nominal value US$0.50 each 19,217,874,260

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

þ Yes ¨ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

¨ Yes þ No.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

þ Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

¨ Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ¨ International Financial Reporting Standards as issued by the International Accounting Standards Board þ Other ¨

If Other has been checked in response to the previous question indicate by check mark which financial statement item the registrant has elected to follow.

¨ Item 17 ¨ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

¨ Yes þ No

* Not for trading, but only in connection with the registration of American Depositary Shares.

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HSBC HOLDINGS PLC   ANNUAL REPORT AND ACCOUNTS 2014

Shareholder Information

Certain defined terms

Unless the context requires otherwise, HSBC Holdings means HSBC Holdings plc and HSBC , the Group , we , us our refer 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 a those preference shares and capital securities issued by HSBC Holdings classified as equity. The abbreviations US$m and US$bn represent millions and billions (thousands of millions) of US dollars, respectively.

Financial statements

The consolidated financial statements of HSBC and the separate financial statements of HSBC Holdings have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU). EU endorsed IFRSs could differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs were not to be endorsed by the EU. At 31 December 2014, there were no unendorsed standards effective for the year ended 31 December 2014 affecting these consolidated and separate financial statements, and there was no difference between IFRSs endorsed by the EU and IFRSs issued by the IASB in terms of their application to HSBC. Accordingly, HSBC s financial statements for the year ended 31 December 2014 are prepared in accordance with IFRSs as issued by the IASB.

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.

When reference to adjusted is made in tables or commentaries, the comparative information has been expressed at constant currency (see page 40), the impact of fair value movements in respect of credit spread charges on HSBC s own debt has been eliminated and the effects of other significant items have been adjusted as reconciled on page 44. Adjusted return on risk-weighted assets is defined and reconciled on page 62.

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Strategic Report

Who we are

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

Customers:

51m

Served by:

266,000

employees (257,600 FTE)

Through four global businesses:

- Retail Banking and Wealth Management
- Commercial Banking
- Global Banking and Markets
- Global Private Banking

Located in:

73

countries and territories

Across five geographical regions:

Europe

Asia

Middle East and North Africa

North America

Latin America

Offices:

Over 6,100

Global headquarters:

London

Market capitalisation:

US$182bn

Listed on stock exchanges in:

London

Hong Kong

New York

Paris

Bermuda

Shareholders:

216,000 in 127

countries and territories

HSBC HOLDINGS PLC

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Strategic Report (continued)

Cautionary statement regarding forward-looking statements

The *Annual Report and Accounts 2014* contains certain forward-looking statements with respect to HSBC s financial condition, results of operations, capital position and business.

Statements that are not historical facts, including statements about HSBC s beliefs and expectations, are forward-looking statements. Words such as expects , anticipates , intends , plans , believes , seeks , estimates , and reasonably possible , variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made. HSBC makes no commitment to revise or update any forward-looking statements to reflect events or circumstances occurring or existing after the date of any forward-looking statements.

Written and/or oral forward-looking statements may also be made in the periodic reports to the US Securities and Exchange Commission, summary financial statements to shareholders, proxy statements, offering circulars and prospectuses, press releases and other written materials, and in oral statements made by HSBC s Directors, officers or employees to third parties, including financial analysts.

Forward-looking statements involve inherent risks and uncertainties. Readers are cautioned that a number of factors could cause actual results to differ, in some instances materially, from those anticipated or implied in any forward-looking statement. These include, but are not limited to:

changes in general economic conditions in the markets in which we operate, such as continuing or deepening recessions and fluctuations in employment beyond those factored into consensus forecasts; changes in foreign exchange rates and interest rates; volatility in equity markets; lack of liquidity in wholesale funding markets; illiquidity and downward price pressure in national real estate markets; adverse changes in central banks policies with respect to the provision of liquidity support to financial markets; heightened market concerns over sovereign creditworthiness in over-indebted countries;
adverse changes in the funding status of public or private defined benefit pensions; and consumer perception as to the continuing availability of credit and price competition in the market segments we serve;

changes in government policy and regulation, including the monetary, interest rate and other policies of central banks and other regulatory authorities; initiatives to change the size, scope of activities and interconnectedness of financial institutions in connection with the implementation of stricter regulation of financial institutions in key markets worldwide; revised capital and liquidity benchmarks which could serve to deleverage bank balance sheets and lower returns available from the current business model and portfolio mix; imposition of levies or taxes designed to change business mix and risk appetite; the practices, pricing or responsibilities of financial institutions serving their consumer markets; expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; changes in bankruptcy legislation in the principal markets in which we operate and the consequences thereof; general changes in government policy that may significantly influence investor decisions; extraordinary government actions as a result of current market turmoil; other unfavourable political or diplomatic developments producing social instability or legal uncertainty which in turn may affect demand for our products and services; the costs, effects and outcomes of product regulatory reviews, actions or litigation, including any additional compliance requirements; and the effects of competition in the markets where we operate including increased competition from non-bank financial services companies, including securities firms; and

factors specific to HSBC, including discretionary RWA growth and our success in adequately identifying the risks we face, such as the incidence of loan losses or delinquency, and managing those risks (through account management, hedging and other techniques). Effective risk management depends on, among other things, our ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and our success in addressing operational, legal and regulatory, and litigation challenges, notably compliance with the DPA.

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Strategic Report (continued)

Highlights

Profit before tax was down 17% to US$18.7bn on a reported basis. Adjusted profit before tax, excluding the effect of significant items and currency translation, was broadly unchanged at US$22.8bn.

Reinforced HSBC s capital strength. Our CRD IV transitional common equity tier 1 ratio was 10.9% compared with 10.8% at the end of 2013.

Dividends to shareholders increased to US$9.6bn as capital strength created capacity for organic growth and allowed us to increase the dividends paid.

Profit before taxation	**Capital strength**	**Dividends per ordinary share**
(reported basis)	(CRD IV common equity tier 1 ratio transitional)[1]	(in respect of year)[3]
US$18.7bn	**10.9%**	**US$0.50**
£11.3bn		
HK$145bn	At 31 December	
Cost efficiency ratio	**Return on average ordinary**	**Share price**
(reported basis)[2]	**shareholders equity**[4]	(at 31 December)
67.3%	7.3%	£6.09 HK$74.00 US$47.23 American Depositary Share

For a description of the difference between reported and adjusted performance, see page 40.

For footnotes, see page 39.

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Strategic Report (continued)

Group Chairman s Statement

HSBC s performance in 2014 reflected another year of consolidation in the reshaping and strengthening of the Group against a backdrop of geopolitical and economic headwinds, many of which could not have been foreseen at the outset of the year.

As economic activity in much of the world failed to reach the levels required to rebuild sustainable consumer confidence and prompt renewed investment expenditure, governments most impacted expanded their stimulus measures and the major central banks maintained interest rates at their unprecedented low levels. Concerns over deflationary trends, particularly in the eurozone, grew. Although China delivered growth which comfortably surpassed all other major economies, expectations of slower growth in the future weighed heavily on market sentiment and contributed to significant commodity price falls and further curtailment of global investment spending.

Unsurprisingly in this environment, revenue growth opportunities were strongest in our Asian businesses, with expansion in lending and debt capital financing. Cost progression continued globally in large part to implement regulatory change and enhance risk controls, notably around financial system integrity and conduct. Streamlining initiatives could only partly offset this cost expansion. Further customer redress costs and regulatory penalties around past failings reinforced the Board s continuing commitment to prioritise whatever further investment in systems and controls is necessary to mitigate future repetition.

It is clear now that societal, regulatory and public policy expectations of our industry are changing its long-term cost structure. Technological advancements around data analytics, including big data , are providing much more sophisticated tools to enhance our capabilities to protect the financial system from bad actors. Also, as more and more customers choose to transact online and through mobile devices, we are making the necessary investment to protect ourselves and our customers from cyber threats. Building the required analytical capabilities entails considerable investment in systems and in maintaining customer data which is accurate and up to date. Reconfiguring customer and transactional data to the digital age is no small endeavour given legacy systems and a multiplicity of historical data standards globally. The benefits, however, of enhanced customer due diligence capabilities and greater systems security essentially go to the core of our systemic role and allow us to be more proactive in fulfilling that role as a key gatekeeper to the financial system.

As our industry reshapes in response to public policy and regulatory directives, we now need to demonstrate, through clarity of our business model, the value to society of our scale and diversification. We must

never forget that investors have choices where to invest and individuals have choices where to make their careers. Thus it is essential that we can demonstrate a positive contribution to the societies we serve in order to bolster the business friendly environment that all agree is essential for economic growth and prosperity.

For 150 years HSBC has been following trade and investment flows to serve customers as they fulfil their financial ambitions. In a world which has moved from being interconnected to being interdependent, our business model is increasingly relevant to companies of all sizes and to individuals whose financial future is linked to economic activity in multiple countries.

This can be seen most markedly in our Commercial Banking business, which delivered a record year buoyed by the expansion of supply chain management solutions and increasing cross-border payment flows. Our network coverage of the countries which originate more than 85% of the world s payment activity drives this key element of our business model. On the investment side, throughout our network we saw corporate flows continuing to target the higher growth emerging markets. At the same time, growth in outward investment from mainland China accelerated as its major companies sought diversification and access to both skill bases and markets. These trends played to HSBC s scale and presence in the key financial centres, allowing us to support customers with debt and equity financing solutions, offering tailored liquidity and transactional banking support and providing risk management solutions primarily against our clients interest rate and foreign exchange exposures. Success was evidenced by growing recognition in industry awards, the most important of which are referred to in the Group Chief Executive s Review. Finally, our Retail Banking and Wealth Management business continued its journey to build a sustainable customer focused business model, completing the removal of formulaic links between product sales and performance-related pay of our staff, and expanding our digital and mobile offerings.

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Strategic Report (continued)

Performance in 2014

Profit before tax of US$18.7bn on a reported basis was US$3.9bn or 17% lower than that achieved in 2013. This primarily reflected lower business disposal and reclassification gains and the negative effect, on both revenue and costs, of significant items including fines, settlements, UK customer redress and associated provisions. On the adjusted basis that is one of the key metrics used to assess current year management and business performance, profit before tax was US$22.8bn, broadly in line with 2013 on a comparable basis.

Earnings per share were US$0.69, against US$0.84 in 2013. The Group s capital position remained strong with the transitional common equity tier 1 ratio standing at 10.9% at the end of the year, compared with 10.8% 12 months earlier, and our end point ratio at 11.1% compared with 10.9%. Based on this capital strength and the Group s capital generating capabilities, the Board approved a fourth interim dividend in respect of 2014 of US$0.20 per share, taking the total dividends in respect of the year to US$0.50 per share (US$9.6bn, US$0.4bn higher than in respect of 2013).

Taking into account this financial performance, together with the further progress made in reshaping the Group, responding to regulatory change and implementing Global Standards, the Board considered executive management to have made good progress during 2014 towards strengthening HSBC s long-term competitive position.

The Group Chief Executive s Review analyses in detail the important benchmarks and highlights of 2014.

Regulatory landscape becomes clearer but still much to do

A great deal of progress was made during 2014 to finalise the framework under which globally systemic banks like HSBC will be required to operate when it is fully implemented. This clarity is essential if we are to be able to position our global businesses to meet the return expectations of those who invest in us within an acceptable risk appetite.

In particular, major progress was made in addressing the challenge of too big to fail , largely through finalising proposals to augment existing loss absorbing capacity with bail-inable debt and through greater definition of how resolution frameworks

would operate in practice. In both cases, this involved the critical issue of how to address cross-border implications and home and host country regulatory responsibilities.

There is, however, still much to complete. The regulatory reform agenda for 2015 is very full with pending public policy decisions, regulatory consultations and impact studies in areas of far reaching influence to the structure of our industry. These include the conclusion of structural separation deliberations in Europe, further work on so called shadow banking including identifying non-bank systemically important institutions, addressing the resolution framework for central counterparties, finalising the calibration of the leverage ratio, calibrating the quantum of total loss absorbing capacity to be raised and settling the disposition of that capacity within global groups.

Restoration of trust in our industry remains a significant challenge as further misdeeds are uncovered but it is a challenge we must meet successfully.

In addition, further work will be undertaken on utilising standardised risk weights to overcome regulatory loss of confidence in internally modelled capital measures and a fundamental review of the trading book is also underway within the regulatory community to look again at capital support for this activity. These measures, which in aggregate are designed to make the industry structurally more stable, will take the next five or so years to implement, an indication of the scale of the transformation to be completed.

During 2014, the UK government also confirmed the permanence of the UK bank levy. This was introduced in 2010, in part to address the burden borne by taxpayers from failures during the global financial crisis; in 2014, the cost to HSBC of the levy was US$1.1bn, an increase of US$0.2bn over 2013. 58% of the levy we pay does not relate to our UK banking activity.

Rebuilding trust

Restoration of trust in our industry remains a significant challenge as further misdeeds are uncovered but it is a challenge we must meet successfully. We owe this not just to

society but to our staff to ensure they can be rightly proud of the organisation to which they have committed their careers. When commentators extrapolate instances of control failure or individual misconduct to question the culture of the firm it strikes painfully at the heart of our identity.

Swiss Private Bank

The recent disclosures around unacceptable historical practices and behaviour within the Swiss private bank remind us of how much there still is to do and how far society s expectations have changed in terms of banks responsibilities. They are also a reminder of the need for constant vigilance over the effectiveness of our controls and the imperative to embed a robust and ethical compliance culture.

We deeply regret and apologise for the conduct and compliance failures highlighted which were in contravention of our own policies as well as expectations of us.

In response to, and in parallel with, the tax investigations prompted by the data theft more than eight years ago, we have been completely overhauling our private banking business, putting the entire customer base through enhanced due diligence and tax transparency filters. Our Swiss Private Bank customer base and the countries we serve are now both about one-third of the size they were in 2007. In addition, HSBC is already working to implement the OECD s Common Reporting Standard and other measures to foster greater transparency. We cannot change the past. But, looking to the future, we can and must reinforce controls and provide demonstrable evidence of their effectiveness. This forms part of our commitment to Global Standards, to ensure that we will never knowingly do business with counterparties seeking to evade taxes or use the financial system to commit financial crime.

Banking standards

More broadly, following the publication in 2013 of the Parliamentary Commission on Banking Standards, considerable progress has been made in giving effect to its recommendations. The Financial Services (Banking Reform) Act of 2013 provided greater clarity on the accountabilities and responsibilities of management and the Board. We welcome the appointment of Dame Colette Bowe to lead the Banking Standards Review Council and have committed to support her fully in its work. The current Fair and Effective Markets

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Strategic Report (continued)

Review being conducted by the Bank of England, Her Majesty s Treasury and the Financial Conduct Authority is an extremely timely and important exercise to re-establish the integrity of wholesale financial markets.

In terms of our own governance of these areas, the Conduct & Values Committee of the Board that we created at the beginning of 2014 to focus on behavioural issues has established itself firmly as the central support to the Board in these important areas.

Board changes

Since we reported at the interim stage we have taken further steps to augment the skills and experience within the Board and to address succession to key roles.

On 1 January 2015, Phillip Ameen joined the Board and the Group Audit Committee as an independent non-executive Director. Phil was formerly Vice President, Comptroller and Principal Accounting Officer of General Electric Corp. He brings with him extensive financial and accounting experience gained in one of the world s leading international companies as well as a depth of technical knowledge from his long service in the accounting standard setting world. As a serving Director on HSBC s US businesses he also brings further detailed insight to Group Board discussions and enhances the strong links that already exist between the Group Board and its major subsidiaries.

Sir Simon Robertson had previously indicated his intention to retire from the Board at the upcoming AGM. I am delighted to report that Simon has agreed to stay on for at least a further

year as Deputy Chairman. He has been a considerable support to me and to Stuart Gulliver, in addition to his role leading the non-executives, and we are all delighted that we shall continue to benefit from his wisdom and experience.

150th anniversary

2015 marks the 150th anniversary of our founding back in Hong Kong and Shanghai as a small regional bank focused on trade and investment. All of us within HSBC owe a huge debt of gratitude and respect to our forebears who charted the course that has taken HSBC to one of the most important institutions serving the financial needs of this inter-dependent world.

Outlook

It is impossible not to reflect on the very broad range of uncertainties and challenges to be addressed in 2015 and beyond, most of which are outside our control, particularly against a backdrop of patchy economic recovery and limited policy ammunition. Unexpected outcomes arising from current geopolitical tensions, eurozone membership uncertainties, political changes, currency and commodity price realignments, interest rate moves and the effectiveness of central banks unconventional policies, to name but a few, all could materially affect economic conditions and confidence around investment and consumption decisions. One economic uncertainty stands out for a major financial institution headquartered in the UK, that of continuing UK membership of the EU. Today, we publish a major research study which concludes that working to complete the Single Market in services and reforming the EU to make it more competitive are far less risky than going it alone, given the importance of EU markets to British trade.

There are also many underlying positive trends that shape our thinking about the coming year. We are very encouraged by the trends in outward investment from China, the potential for further liberalisation and internationalisation of the renminbi and the reshaping of the Chinese economy from export dependence to domestic consumption. We are positive on the opportunities that will arise from Capital Markets Union within Europe and the declared focus of the incoming Commission on growth and jobs. The strength of the US economy and the benefits of lower oil prices should be positive drivers of growth. There is much to be gained from successful negotiation of the Transatlantic Trade and Investment Partnership and the Trans-Pacific Partnership. Current attention on funding infrastructure investment globally is potentially of huge significance.

Finally, on behalf of the Board, I want again to express our thanks and gratitude to our 266,000 colleagues around the world who worked determinedly in 2014 to build an HSBC fit for the next 150 years.

D J Flint

Group Chairman

23 February 2015

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Strategic Report (continued)

Group Chief Executive s Review

2014 was a challenging year in which we continued to work hard to improve business performance while managing the impact of a higher operating cost environment.

Profits disappointed, although a tough fourth quarter masked some of the progress made over the preceding three quarters. Many of the challenging aspects of the fourth quarter results were common to the industry as a whole. In spite of this, there were a number of encouraging signs, particularly in Commercial Banking, Payments & Cash Management and renminbi products and services. We were also able to continue to grow the dividend.

Reported profit before tax in 2014 was US$18.7bn, US$3.9bn lower than in the previous year. This reflected lower gains from disposals and reclassifications, and the negative effect of other significant items, including fines, settlements, UK customer redress and associated provisions, totalling US$3.7bn.

Adjusted profit before tax, which excludes the year-on-year effects of currency translation differences and significant items, was US$22.8bn, broadly unchanged on 2013.

Asia continued to provide a strong contribution to Group profits. Middle East and North Africa reported a record profit before tax in 2014. Together, Asia and MENA generated more than 70% of adjusted Group profit before tax.

Commercial Banking also delivered a record reported profit, which is evidence of the successful execution of our strategy. Revenue in CMB continued to grow,

notably in our two home markets of Hong Kong and the UK.

Global Banking and Markets performed relatively well for the first three quarters of the year, but, like much of the rest of the industry, suffered a poor fourth quarter. Revenue was lower in 2014, particularly in our Markets businesses, but all other client-facing businesses delivered year-on-year growth.

Revenue was also lower in Retail Banking and Wealth Management, due primarily to the continuing repositioning of the business. However, in our Global Asset Management business we continued our strategy of strengthening collaboration across our global businesses, which helped to attract net new money of US$29bn.

Global Private Banking continues to undergo a comprehensive overhaul which was accelerated from 2011. As part of this overhaul, we are implementing tough financial crime, regulatory compliance and tax transparency measures. In order to achieve our desired business model and informed by our six filters process, we have also sold a number of businesses and customer portfolios, including assets in Japan, Panama and Luxembourg. The number of customer accounts in our Swiss Private Bank is now nearly 70% lower than at its peak. We continued to remodel the Private Bank in 2014, which included the sale of a customer portfolio in Switzerland to LGT Bank. One consequence of this remodelling was a reduction in revenue. We have also

grown the parts of the business that fit our new model, attracting US$14bn of net new money in 2014, mostly through clients of Global Banking & Markets and Commercial Banking.

Loan impairment charges were lower, reflecting the current economic environment and the changes we have made to our portfolio since 2011.

Operating expenses were higher due to increased regulatory and compliance costs, inflationary pressures and investment in strategic initiatives to support growth, primarily in Commercial Banking in Asia and Europe. Significant items, which include restructuring costs, were also higher than last year.

We agreed settlements in respect of inquiries by the UK Financial Conduct Authority and the US Commodity Futures Trading Commission into the foreign exchange market in 2014. HSBC was badly let down by a few individuals whose actions do not reflect the vast majority of employees who uphold the values and standards expected of the bank. This matter is now rightly in the hands of the Serious Fraud Office.

Our balance sheet remained strong, with a ratio of customer advances to customer accounts of 72%. Excluding the effects of currency translation, customer loans and advances grew by US$28bn during 2014.

The common equity tier 1 ratio on a transitional basis was 10.9% and on a CRD IV end point basis was 11.1% at 31 December 2014.

Connecting customers to opportunities

2015 is HSBC s 150th anniversary. Founded in Hong Kong in 1865 to finance local and international trade, the bank expanded rapidly to capture the increasing flow of commerce between Asia, Europe and North America. Our ability to connect customers across the world remains central to the bank s strategy today and in 2014 we continued to develop and grow the product areas that rely on international connectivity.

Our market-leading Global Trade and Receivables Finance business remains strong and we were voted best global trade finance bank and best trade finance bank in MENA in the *Global Trade Review* Leaders In Trade Awards.

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Strategic Report (continued)

In Payments and Cash Management, we increased customer mandates and improved client coverage. We were recognised as the best global cash management bank for the third successive year in the 2014 *Euromoney* Cash Management Survey.

Our share of the capital financing market continued to improve and we were ranked number one for debt capital markets in our home markets of the UK and Hong Kong, and number one for Equity Capital Markets in Hong Kong by *Dealogic*. HSBC was also named global bond house of the year, global derivatives house of the year and Asian bond house of the year in the *International Financing Review* Awards 2014.

We consolidated our leadership of the rapidly growing renminbi market in 2014. According to SWIFT, the renminbi is now the fifth most widely used payment currency in the world, up from 13th just two years ago. We increased revenue from renminbi products and retained our ranking as number one issuer of offshore renminbi bonds worldwide over the last twelve months. HSBC was also recognised as the best overall provider for products and services in Asiamoney s Offshore Renminbi Services Survey in 2014, and renminbi house of the year in the 2014 Asia Risk Awards.

Operating a global business

It is already clear that the regulatory costs of operating a global business model have increased since we announced our strategy for HSBC in 2011.

As the Group Chairman s Statement explains, the regulatory environment continues to evolve.

Our commitment to be the world s leading international bank means that improving our regulatory and compliance abilities and implementing Global Standards must remain priorities for HSBC. Our Compliance staff headcount has more than doubled since 2011 and there is more work still to do to strengthen the Group s compliance capability.

At the same time, the level of capital that we hold has increased by over 60% since before the financial crisis. Specifically, we have further strengthened our capital levels in response to increasing capital

requirements from the UK Prudential Regulation Authority.

Whilst we expected an increase in the amount of capital we were required to hold when setting targets for the Group in 2011, we could not have foreseen the full extent of the additional costs and capital commitment that would subsequently be asked of us. The pace of change has been exceptional. As a consequence, some of the targets that we set for the Group in 2011 are no longer realistic.

In recognition of that fact, we have set new medium-term targets that better reflect the ongoing operating environment.

We are setting a revised return on equity target of more than 10%. This target is modelled using a common equity tier 1 capital ratio on a CRD IV end point basis in the range of 12% to 13%.

Our cost target will be to grow our revenue faster than costs (positive jaws) on an adjusted basis.

We are also restating our commitment to grow the dividend. To be clear, the progression of dividends should be consistent with the growth of the overall profitability of the Group and is predicated on our ability to meet regulatory capital requirements in a timely manner.

These targets offer a realistic reflection of the capabilities of HSBC in the prevailing operating environment.

Our employees

I am grateful for the hard work, dedication and professionalism of all of our employees in 2014.

Extensive work was required to prepare HSBC for stress tests in a number of jurisdictions throughout the year, the results of which confirmed the capital strength of the Group. HSBC will face additional stress testing in 2015.

We all have to work continuously to make sure that the Group remains compliant with anti-money laundering and sanctions legislation and this effort continued in 2014.

Management and staff across the Group continued to work very closely with the Monitor to deliver our commitments under the terms of our December 2012

settlement agreements with the US authorities and the UK Financial Conduct Authority. We have now received the second annual report from the Monitor. Whilst it confirmed that we continue to comply with the obligations we undertook in the Deferred Prosecution Agreement with the US Department of Justice, as we expected we still have substantial work to do.

Summary and outlook

The business remains in a good position structurally to capitalise on broader market trends and the macroeconomic backdrop remains favourable, notwithstanding the continuing low interest rate environment. There are still a number of historical issues left to resolve and we will make further progress on these in 2015. We will also continue the work we started in 2011 to simplify the Group to make it easier to manage and control.

Our 2014 results show a business powered by our continued strength in Hong Kong, with significant additional contributions from the rest of Asia and the Middle East and North Africa. The continuing success of Commercial Banking and the resilience of our differentiated Global Banking & Markets business illustrate the effectiveness of our strategy to bridge global trade and capital flows. Retail Banking & Wealth Management remains a work in progress, but we took considerable further steps to de-risk the business in 2014. Global Private Banking continues to attract net new money from clients in our other global businesses. We maintain a sharp focus on generating net savings to offset increased costs arising from inflation, and the cost of implementing global standards.

Our early 2015 performance has been satisfactory.

We continue to focus on the execution of our strategy and on delivering value to shareholders.

S T Gulliver

Group Chief Executive

23 February 2015

HSBC HOLDINGS PLC

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Strategic Report (continued)

Strategic objectives

Value creation

and long-term sustainability

We continue to follow the vision for HSBC we first outlined in 2011 along with the clear strategy that will help us achieve it. Our strategy guides where and how we seek to compete. We constantly assess our progress against this strategy and provide regular updates to stakeholders.

Through our principal activities making payments, holding savings, enabling trade, 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.

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 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. 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 services, 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.

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.

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Strategic Report (continued)

We charge customers a spread, 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 spread 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, our customers both buy and sell relevant instruments, in which case our focus is 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 risks, see page 21, and on how we manage them, see page 24.

Long-term sustainability

At HSBC, we understand that the continuing financial success of our business is closely connected to the economic, environmental and social landscape in which we operate. For us, sustainability means building our business for the long term by balancing social, environmental and economic considerations in the decisions we make. This enables us to help businesses thrive, reward shareholders and employees, pay taxes and duties in

the countries in which we operate and contribute to the health and growth of communities. Achieving a sustainable return on equity and long-term profit growth is built on this foundation.

How we do business is as important as what we do: our responsibilities to our customers, employees and shareholders as well as to wider society go far beyond simply being profitable. These include our consistent implementation of the highest standards everywhere we operate to detect, deter and protect against financial crime.

Sustainability underpins our strategic priorities and enables us to fulfil our purpose. Our ability to identify and address environmental, social and ethical developments which present risks or opportunities for the business contributes to our financial success. Sustainable decision-making shapes our reputation, drives employee engagement and affects the risk profile of the business and can help reduce costs and secure new revenue streams.

Our international presence 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 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 12. For further information about sustainability at HSBC, see page 36.

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 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.

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Strategic Report (continued)

Our strategy

Long-term trends

Our strategy is aligned to two long-term trends:

The world economy is becoming ever more interconnected, 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 growth in trade and capital flows to outstrip GDP growth and 35 markets to generate 85% 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, 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, Latin America or the Middle East and Africa.

Competitive advantages

What matters in this environment is:

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 business network, which covers over 85% of global trade

A two-part approach

Responding to these long-term trends, we have developed a two-pronged approach that reflects our competitive advantages:

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 aim to capture opportunities arising from social mobility and wealth creation in our priority growth markets across Asia, Latin America and the Middle East, through our Premier proposition and Global Private Banking business. We expect to invest in and capital flows;

our balanced business portfolio centred on our global client franchise;

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$1.4 trillion of customer accounts of which 72% has been advanced to customers; and

our local balance sheet strength and trading capabilities in the most relevant financial hubs.

full scale retail businesses only in markets where we can achieve profitable scale.

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Strategic Report (continued)

Business model

Market presence

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 19 countries form our priority growth markets (see below). These 21 markets accounted for over 90% of our profit before tax in 2014, and are the primary focus of capital deployment. Network markets are markets with strong international relevance which serve to complement our international presence, operating mainly through Commercial Banking and Global Banking and Markets. Our combination of home, priority growth and network markets covers around 85% 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 markets

Investment criteria

We use six filters to guide our decisions about when and where to invest. The first two international connectivity and economic development determine whether the business is strategically relevant. The next three 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 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.

We conduct an annual geographic and business portfolio review following the six filter approach to update our market and business priorities.

Using the six filters in decision-making

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Strategic Report (continued)

Organisation

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 it 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.

Global management structure

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

For details of our principal subsidiaries see Note 22 on the Financial Statements. A simplified Group structure chart is provided on page 462.

Global management structure

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Strategic Report (continued)

Structural Reform

Banking structural reform and recovery and resolution planning Globally there have been a number of developments relating to banking structural reform and the introduction of recovery and resolution regimes.

As recovery and resolution planning has developed, some regulators and national authorities have also required changes to the corporate structures of banks. These include requiring the local incorporation of banks or ring-fencing of certain businesses. In the UK, ring-fencing legislation has been enacted requiring the separation of retail and small and medium-sized enterprise (SME) deposits from trading activity (see below). Similar requirements have been introduced or are in the process of being introduced in other jurisdictions.

Policy background to recovery and resolution

Following the financial crisis, G20 leaders requested that the Financial Stability Board (FSB) establish more effective arrangements for the recovery and resolution of 28 (now 30) designated Global Systemically Important Banks (G-SIBs), resulting in a series of policy recommendations in relation to recovery and resolution planning, cross-border co-operation agreements and measures to mitigate obstacles to resolution.

In December 2013, the PRA set out rules for the recovery and resolution of UK banks and international banks operating in the UK. These rules were modified as part of the implementation of the EU Bank Recovery and Resolution Directive from January 2015.

HSBC resolution strategy and corporate structure changes

We have been working with the Bank of England, the PRA and our other primary regulators to develop and agree a resolution strategy for HSBC. It is our view that a resolution strategy whereby the Group breaks up at a subsidiary bank level at the point of resolution (referred to as a Multiple Point of Entry strategy) rather than being kept together as a Group at the point of resolution (referred to as a Single Point of Entry strategy) is the optimal approach as it

is aligned to our existing legal and business structure.

In common with all G-SIBs, we are working with our regulators to understand inter-dependencies between different businesses and subsidiary banking entities in the Group in order to enhance resolvability.

We have initiated plans to mitigate or remove critical inter-dependencies to further facilitate the resolution of the Group. In particular, in order to remove operational dependencies (where one subsidiary bank provides critical services to another), we have determined to transfer such critical services from the subsidiary banks to a separately incorporated group of service companies (ServCo group). The ServCo group will be separately capitalised and funded to ensure continuity of services in resolution. A significant portion of the ServCo group already exists and therefore this initiative involves transferring the remaining critical services still held by subsidiary banks into the ServCo group. The services will then be provided to the subsidiary banks by the ServCo group.

UK ring-fencing

In December 2013, the UK s Financial Services (Banking Reform) Act 2013 (Banking Reform Act) received Royal Assent. It implements most of the recommendations of the Independent Commission on Banking (ICB), which *inter alia* require large banking groups to ring-fence UK retail banking activity in a separately incorporated banking subsidiary (a ring-fenced bank) that is prohibited from engaging in significant trading activity. For these purposes, the UK excludes the Crown Dependencies. Ring-fencing is to be completed by 1 January 2019.

In July 2014, secondary legislation was finalised. This included provisions further detailing the applicable individual customers to be transferred to the ring-fenced bank by reference to gross worth and enterprises to be transferred based on turnover, assets and number of employees. In addition, the secondary legislation places restrictions on the activities and geographical scope of ring-fenced banks.

In October 2014, the PRA published a consultation paper on ring-fencing rules in

relation to legal structure, governance, and continuity of services and facilities. The PRA intends to undertake further consultations and finalise ring-fencing rules in due course. The PRA also published a discussion paper concerning operational continuity in resolution.

As required by the PRA s consultation paper, a provisional ring-fencing project plan was presented to the UK regulators in November 2014. This plan provided for ring-fencing of the activities prescribed in the legislation, broadly the retail and SME services that are currently part of HSBC Bank plc (HSBC Bank), in a separate subsidiary.

In addition, the plan reflected the operational continuity expectations of each of the PRA s consultation and discussion papers by providing for the proposed enhancement of the ServCo group. The plan remains subject to further planning and approvals internally and is ultimately subject to the approval of the PRA, FCA and other applicable regulators.

European banking structural reform

In January 2014, the European Commission published legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors, at their discretion, to require certain trading activities to be undertaken in a separate subsidiary from deposit taking activities.

The ring-fenced deposit taking entity would be subject to separation from the trading entity including requirements for separate capital and management structures, issuance of own debt and arms-length transactions between entities.

The draft proposals contain a provision which would permit derogation by member states that have implemented their own structural reform legislation, subject to meeting certain conditions. This derogation may benefit the UK in view of the Banking Reform Act.

The proposals are currently subject to discussion in the European Parliament and the Council. The implementation date for any separation under the final rules would depend upon the date on which the final legislation (if any) is agreed.

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Strategic Report (continued)

Governance

The Board is committed to establishing and maintaining the highest standards of corporate governance wherever we operate. Good corporate governance is critical to HSBC s long-term success and sustainability.

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 for the Board.

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 of the GMB are held in addition to regular GMB meetings.

The key roles of the non-executive committees established by the Board are described in the chart below. 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 263.

The committee structure and governance framework of the HSBC Holdings Board

Strategic Report (continued)

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 and their products and services are summarised below.

Main business activities by global business in 2014

For footnotes, see page 39.

Retail Banking and Wealth Management

Products and services

RBWM takes deposits and provides transactional banking services to enable customers to manage their day-to-day finances and save for the future. We offer credit facilities to assist them in their short or longer-term borrowing requirements and we provide financial advisory, broking, insurance and investment services to help them to manage and protect their financial futures.

We develop products designed to meet the needs of specific customer segments, which may include a range of different services and delivery channels.

RBWM offers four main types of service:

HSBC Premier: we provide a dedicated relationship manager to our mass affluent customers and their immediate families, offering specialist and tailored advice. Customers can access emergency travel assistance, priority telephone banking and an online global view of their Premier accounts around the world.

HSBC Advance: we offer our emerging affluent customers control over their day-to-day finances and access to a range of preferential products, rates and terms. HSBC Advance is also the start of a relationship where we give customers support and guidance to help them to realise their ambitions.

Wealth Solutions & Financial Planning: a financial planning process designed around individual customer needs to help our clients to protect, grow and manage their wealth. We offer investment and wealth insurance products manufactured by Global Asset Management, Markets and HSBC Insurance and by selected third-party providers.

Personal Banking: we provide globally standardised but locally delivered, reliable, easy to understand, good-value banking products and services using global product platforms and globally set service standards.

RBWM delivers services through four principal channels: branches, self-service terminals, telephone service centres and digital (internet and mobile).

Customers

RBWM serves nearly 50 million customers. We are committed to building lifelong relationships with our customers as they move from one stage of their lives to the next, offering tailored products and services

appropriate to their diverse goals, aspirations and ambitions. We recognise that some of our customers face financial challenges and, in these cases, we aim to be tolerant, fair and understanding and to support them during difficult times.

We put the customer at the heart of everything we do. We constantly carry out research and invest resources to make sure that customers can access our services conveniently, securely and reliably. We have conducted work to ensure that we sell products that meet their needs and at a price that represents a fair exchange of value between customers and shareholders, and have introduced new incentive programmes that have no formulaic links to sales volumes but are focused on assessing how well we are meeting our customers needs.

We measure customer satisfaction through an independent market research survey of retail banking customers in selected countries and calculate a Customer Recommendation Index to measure performance. This is benchmarked against average scores of a peer group of banks in each market and we set targets for our business relative to our competitor set of banks. We expect continuous improvements across markets in which we operate. We aim

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Strategic Report (continued)

to handle customer complaints promptly and fairly, monitoring trends to further improve our services.

Commercial Banking

Products and services

CMB provides a broad range of banking and financial services to enable customers to manage and grow their businesses domestically and internationally. We aim to be recognised as the leading international trade and business bank by connecting customers to markets and by enhancing collaboration within the Group, both geographically and between global businesses. A global operating model increases transparency, enables consistency, improves efficiency and ensures the right outcomes for our customers.

CMB customer offerings typically include:

Credit and Lending: we offer a broad range of domestic and cross-border financing, including overdrafts, corporate cards, term loans and syndicated, leveraged, acquisition and project finance. Asset finance is also offered in selected countries.

Global Trade and Receivables Finance: we support customers access to the world s trade flows and provide unrivalled experience in addressing today s most complex trade challenges. Our comprehensive suite of products and services, letters of credit, collections, guarantees, receivables finance, supply chain solutions, commodity and structured finance and risk distribution, can be combined into global solutions that make it easier for businesses to manage risk, process transactions and fund activities throughout the trade cycle.

Payments and Cash Management: we are strategically located where most of the world s payments and capital flows originate. We provide local, regional and global transaction banking services including payments, collections, account services, e-commerce and liquidity management via e-enabled platforms to address the needs of our customers.

Insurance and Investments: we offer business and financial protection, trade insurance, employee benefits, corporate wealth management and a variety of other commercial risk insurance products in selected countries.

Collaboration: our CMB franchise represents a key client base for products and services provided by GB&M, RBWM and GPB, including foreign exchange, interest rate, capital markets and advisory services, payroll and personal accounts services and wealth management and wealth transition services.

HSBC is leading the development of the renminbi as a trade currency, with renminbi capabilities in more than 50 markets.

Our range of products, services and delivery channels is tailored to meet the needs of specific customer segments.

Customers

We have organised ourselves around our customers needs and their degree of complexity by developing three distinct segments within CMB: Business Banking, Mid-Market and Large Corporates.

Business Banking now has two distinct needs-based servicing models: relationship managers focused on customers with more complex needs; and portfolio management for customers requiring simpler, more routine products and services.

We have brought increased focus to our Mid-Market customers and are re-configuring our organisation and resources across our home and priority growth markets to provide enhanced relationship management.

For our Large Corporate customers, who typically have complex and multi-country needs, we provide globally managed senior coverage teams, who are also able to coordinate with other global businesses.

To ensure that our customers remain at the heart of our business, we continue to place the utmost value on customer feedback and customer engagement. We are now in the 6th year of our Client Engagement Programme, a global survey of 15 markets designed to deepen our understanding of our customers and reinforce our relationship with them. This initiative, combined with other insight programmes, helps us to identify customers critical business issues so that we can tailor solutions and services offered to better meet their needs.

Building long-term relationships with reputable customers is core to our growth strategy and organisational values.

Global Banking and Markets

Products and services

GB&M provides wholesale capital markets and transaction banking services organised across eight client-facing businesses.

GB&M products and services include:

Sales and trading services in the secondary market are provided in **Markets**, which includes four businesses organised by asset class:

Credit and **Rates** sell, trade and distribute fixed income securities to clients including corporates, financial institutions, sovereigns, agencies and public sector issuers. They assist clients in managing risk via interest rate and credit derivatives, and facilitate client financing via repurchase (repo) agreements.

Foreign Exchange provides spot and derivative products to meet the investment demands of institutional investors, the hedging needs of small and medium-sized enterprises (SME s), middle-market enterprises (MME s) and large corporates in GB&M and CMB, and the needs of RBWM and GPB customers in our branches. Foreign Exchange trades on behalf of clients in over 90 currencies.

Equities provides sales and trading services for clients, including direct market access and financing and hedging solutions.

Capital Financing offers strategic financing and advisory services focusing on a client s capital structure. Products include debt and equity capital raising in the primary market, transformative merger and acquisition advisory and execution, and corporate lending and specialised structured financing solutions such as leveraged and acquisition finance, asset and structured finance, real estate, infrastructure and project finance, and export credit.

Payments and Cash Management helps clients move, control, access and invest their cash. Products include non-retail deposit taking and international, regional and domestic payments and cash management services.

Securities Services provides custody and clearing services to corporate and institutional clients and funds administration to both domestic and cross-border investors.

Global Trade and Receivables Finance provides trade services on behalf of GB&M clients to support them throughout their trade cycle.

In addition to the above, Balance Sheet Management is responsible for the management of liquidity and funding for the Group. It also manages structural interest rate positions within the Markets limit structure.

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Strategic Report (continued)

Customers

GB&M provides tailored financial solutions to major governmental, corporate and institutional clients worldwide. Managed as a global business with regional oversight, GB&M operates a long-term relationship management approach to build a full understanding of clients financial requirements and strategic goals.

Client coverage is centralised in Banking, which contains relationship managers organised by sector, region and country who work to understand client needs and provide holistic solutions by bringing together our broad array of product capabilities and utilising our extensive global network.

Our goal is to be a Top 5 bank to our priority clients. We strive to achieve this goal by assembling client coverage teams across our geographical network who work alongside product specialists in developing individually tailored solutions to meet client needs. Our client coverage and product teams are supported by a unique customer relationship management platform and comprehensive client planning process. Our teams utilise these platforms to better serve global client relationships, which facilitates our ability to connect clients to international growth opportunities.

Global Private Banking

Products and services

Drawing on the strength of HSBC and the most suitable products from the marketplace, we work with our clients to provide solutions to grow, manage and preserve wealth for today and for the future. Our products and services include Private Banking, Investment Management and Private Wealth Solutions.

GPB products and services include:

Private Banking services comprise multicurrency and fiduciary deposits, account services, and credit and specialist lending. GPB also accesses HSBC s universal banking capabilities to offer products and services such as credit cards, internet banking and corporate and investment banking solutions.

Investment Management comprises advisory and discretionary investment services and brokerage across asset classes. This includes a complete range of investment vehicles, portfolio management, securities services and alternatives.

Private Wealth Solutions comprise trusts and estate planning, designed to protect wealth and preserve it for future generations.

Customers

GPB serves the needs of high net worth and ultra-high net worth individuals and their families in our home and priority growth markets.

Within these broad segments, GPB has teams dedicated to serving HSBC s global priority clients, which include our most significant Group relationships, and other clients who benefit from our private banking proposition and services offered by CMB and GB&M. Our aim is to build and grow connectivity with these customers Group-wide, establishing strong relationships across all global businesses to meet clients needs. We aim to build on HSBC s commercial banking heritage to be the leading private bank for high net worth business owners.

Relationship managers are the dedicated points of contact for our clients, tailoring services to meet their individual needs. They develop a thorough understanding of their clients including their family, business, lifestyle and ambitions and introduce them to specialists equipped to help build the best financial strategy. Specialists include:

- investment advisers, who discuss investment ideas in line with a client s investment and risk profile;
- credit advisers, who provide expertise in complex liquidity and lending requirements; and
- wealth planners, who have the knowledge and expertise to manage wealth now and for future generations.

The use of digital platforms continues to grow in line with strong demand from self-directed clients. These platforms enable clients to access account information, investment research and online transactional capabilities directly. We continue to invest in digital systems to better meet clients evolving expectations and needs.

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 complement 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 2014 we had a total workforce of 266,000 full-time and part-time employees compared with 263,000 at the end of 2013 and 270,000 at the end of 2012. Our main centres of employment were as follows (approximate numbers):

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Strategic Report (continued)

Profile of leadership

At the date of this Report, the Executive Management of HSBC consists of four Executive Directors, 11 Group Managing Directors and 60 Group General Managers. Of these, 13 (17%) are female. This leadership team is based in 17 different countries and comprises 13 different nationalities. 71% have served with HSBC for more than 10 years and the total average tenure is 20 years.

HSBC has 13 non-executive Directors.

Employment proposition

HSBC Values

In 2014, education on HSBC Values continued for all levels of employees through induction and other 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 continues to be instilled at every level in the Group. For example, our employee induction programme has been refreshed to further reinforce courageous integrity and meeting the needs of our customers. Also, an assessment of adherence to our values and supporting behaviours has been formalised as part of our performance appraisal process for all employees. In 2014, some 145,000 employees received values training in addition to 135,000 employees in 2013. A further 100,000 employees are expected to receive this training in 2015. 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 consistently high quality experience for customers in all our markets and support the mitigation of current and emerging risks and the Global Standards programme.

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 biennially 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.

Our employees engagement continues to be positive when compared with the financial services industry and sector best-in-class benchmark. The overall engagement score in 2013 was 68%, which was four percentage 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 benchmark), 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 required attention included pride and advocacy, which were 12 and 13 points, respectively, below best in class norms and had fallen from 2011 levels. The next Global People Survey will be conducted in 2015.

HSBC also conducts a regular survey, Snapshot, which is sent to one quarter of our employees every three months. Insights from Snapshot provide a timely indication of employee sentiment towards the organisation, including signifiers of engagement. As at the end of September 2014, the favourable responses to selected questions were: support for HSBC s strategy, 81%; intend to still be working at HSBC in three years time, 74%; pride in working for HSBC, 79%; and willingness to recommend HSBC to other senior professionals as a great place to further their career, 68%. Aspects for further attention include helping employees see the positive effects of HSBC s strategic priorities, 62%.

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 directly align succession planning with talent management, individual development and career planning. The succession plan defines the number, distribution, 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 2014, we assessed 104 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 emerging markets, where in 2014 the representation of those defined as talent was 34%. We closely monitor local nationals identified as short-term and medium-term successors to key leadership roles so as to improve the proportion of local nationals in senior management 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, 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 advancement is based on merit. Our diversity helps us support our increasingly diverse customer base and acquire, develop and retain a secure supply of skilled and committed employees.

Oversight of our diversity and inclusion agenda resides with senior executives on the Group Diversity Committee, complemented by a number of subsidiary 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.

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Strategic Report (continued)

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 2014 was as follows:

Gender balance

	Headcount		
	Male	Female	Total
Executive Directors	4		4
Non-executive Directors	6	6	12
Directors	10	6	16
Senior employees	6,719	2,076	8,795
Other employees	120,496	136,966	257,462
Total	127,225	139,048	266,273
	%		
	Male	Female	Total
Executive Directors	100		100
Non-executive Directors	50.0	50.0	100
Directors	62.5	37.5	100
Senior employees	76.4	23.6	100
Other employees	46.8	53.2	100
Total	47.8	52.2	100

Overall, Group-wide female representation was 52.2% at 31 December 2014, largely unchanged on 2013. Female representation at senior levels rose from 22.7% in 2013 to 23.6% in 2014, and our target is to improve this to 25% by 2015. The proportion of females in our talent pipeline improved from 32.2% in 2013 to 34.0% in December 2014 and female representation on the GMB was 20% (three out of fifteen) in December 2014.

The average age of our employees was 36.2 years and average tenure was 8.5 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 by incorporating inclusive behaviours in our processes and continue to deliver unconscious bias training to 8,700 managers and 18,500 employees in 2014 (8,300 managers and 50,000 employees in 2013).

In 2015, our diversity and inclusion priorities will continue to address unconscious bias through targeted education, encourage the career development of diverse talent with a continued emphasis on gender and local nationals and extend inclusion to cover wider aspects of diversity, for example, sexual orientation, ethnicity and disability. We continue to enhance a bias-free approach to performance management and improve internal and external candidate lists, connecting and utilising our Employee Resource Network Groups globally and maintaining a consistent global framework of governance and sponsorship to drive a diverse and inclusive culture throughout the Group.

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 2014, 96% 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

HSBC 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. Cases are reviewed and referred for appropriate investigation. Whistleblowing cases may also be raised directly with senior executives, line managers, Human Resources and Security and Fraud.

Additional local whistleblowing lines are in place in several countries, operated by Security and Fraud, Human Resources and Regulatory Compliance. Disclosures made on the local whistleblowing lines are escalated 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 or Group Chief Executive as appropriate.

HSBC s policies and procedures for capturing and responding to whistleblowing disclosures relating to accounting or auditing matters are overseen by the Group Audit Committee. Those relating to other whistleblowing disclosures are overseen by the Conduct & Values Committee.

Disclosures and actions taken are reported on a periodic basis to the Conduct & Values Committee, Group Audit Committee and the Financial System Vulnerabilities Committee in respect of matters relating to financial crime compliance.

Strategic Report (continued)

Risk overview

All our activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risk or combinations of risks.

As a provider of banking and financial services, we actively manage risk as a core part of our day-to-day activities. We employ a risk management framework at all levels of the organisation, underpinned by a strong risk culture and reinforced by HSBC Values and our Global Standards. It ensures that our risk profile remains conservative and aligned to our risk appetite, which describes the type and quantum of risk we are willing to accept in achieving our strategic objectives.

Risk and our strategic priorities

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

Grow the business and dividends we ensure risk is maintained at an acceptable and appropriate level while creating value and generating profits.

Implement Global Standards we are transforming how we detect, deter and protect against financial crime through the deployment of Global Standards, which govern how we do business and with whom.

Streamline processes and procedures our disposal programme has made HSBC easier to manage and control. By focusing on streamlining our processes and procedures, we are making HSBC less complex and

complicated to operate, creating capacity for growth.

Our business and operating models are described on page 12. For further information on Global Standards, see page 26.

Risk in 2014

Concerns remained during 2014 over the sustainability of economic growth in both developed and emerging markets, while geopolitical tensions rose or remained high in many parts of the world.

We continued to sustain a conservative risk profile based on our core philosophy of maintaining balance sheet, liquidity and capital strength by reducing exposure to the most likely areas of stress:

- we managed selectively our exposures to sovereign debt and bank counterparties to ensure that the overall quality of the portfolio remained strong;

we regularly assessed higher risk countries and sectors and adjusted our risk appetite, limits and exposures accordingly;

we use stress testing, both internal and regulatory programmes, to assess vulnerabilities and proactively adjust our portfolios, where required;

we continued to reposition and exit certain portfolios through our six filters process (see page 12) 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 geographical 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 2014 as part of our risk appetite process, supported by a limit and control framework.

Risk appetite is discussed on page 25.

Our approach to stress testing is discussed on page 117 and regulatory stress testing programmes on page 125.

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 overleaf 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 114.

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Strategic Report (continued)

Exposure to risks arising from the business activities of global businesses

For footnote, see page 39.

For further information on credit risk, see page 127; capital and risk-weighted assets, see page 238; market risk, including value at risk, see page 175; and operational risk see page 186.

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, global businesses or regions 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 one-year time horizon. We consider an emerging risk to be one with potentially significant but uncertain outcomes which may form and crystallise beyond a year, in the event of which it could have a material effect on our ability to achieve our long-term strategy.

Our top and emerging risk framework enables us to identify and manage current and forward-looking risks to ensure our risk appetite remains appropriate. The ongoing

assessment of our top and emerging risks is informed by a comprehensive suite of risk factors which may result in our risk appetite being revised.

During 2014, senior management paid particular attention to a number of top and emerging risks. Our current ones are summarised overleaf.

We made a number of changes to our top and emerging risks during 2014 to reflect our assessment of their effect on HSBC. Macroeconomic risks arising from an emerging market slowdown was replaced by Economic outlook and government intervention as developed economies demonstrated signs of stress in the second half of 2014. Third party risk management was identified as an emerging risk due to the risks associated with the use of third-party service providers, which may be less transparent and more challenging to manage or influence. While People risk is inherent

within a number of our top and emerging risks, it has now been disclosed as a standalone risk, as the risks in this area continue to heighten.

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

For a detailed account of these risks see page 118 and for a summary of our risk factors, see page 113.

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Strategic Report (continued)

Top and emerging risks /

Risk		Description	Mitigants
Macroeconomic and geopolitical risk			
	Economic outlook and government intervention	Weak economic growth in both developed and emerging market countries could adversely affect global trade and capital flows and our profits from operations in those countries.	We closely monitor economic developments in key markets and appropriate action is taken as circumstances evolve.
	Increased geopolitical 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.	We monitor the geopolitical and economic outlook, particularly in countries where we have material exposures and/or a physical presence.
Macro-prudential, regulatory and legal risks to our business model			
	Regulatory developments affecting our business model and Group profitability	Governments and regulators continue to develop policies which may impose new requirements, particularly in the areas of capital and liquidity management and business structure.	We engage closely with governments and regulators in the countries in which we operate to help ensure that the new requirements are considered properly.
	Regulatory investigations, fines, sanctions, commitments	Financial service providers are at risk of regulatory sanctions or fines	Programmes to enhance the management of conduct are

and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand	related to conduct of business and financial crime.	progressing in all global businesses and functions.
	Breach of the US DPA may allow the US authorities to prosecute HSBC with respect to matters covered thereunder.	We continue to take steps to address the requirements of the US DPA and other consent orders in consultation with the relevant regulatory agencies.
Dispute 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.	We identify and monitor emerging regulatory and judicial trends.
		We are enhancing our financial crime and regulatory compliance controls and resources.
Risks related to our business operations, governance and internal control systems		
Heightened execution risk	The complexity of projects to meet regulatory demands and risks arising from business and portfolio disposals may affect our ability to execute our strategy.	We have strengthened our prioritisation and governance processes for significant projects.
People risk	Significant demands are being placed on the human capital of the Group due to the extent of the regulatory reform agenda.	We have reviewed our remuneration policy to ensure we can remain competitive and retain our key talent and continue to increase the level of specialist resources in key areas.
Third-party risk management	Risks arising from the use of third-party service providers may be less transparent and more challenging to manage or influence.	We are strengthening our risk management processes and procedures in relation to the use and monitoring of third-party service providers.
Internet crime and fraud	HSBC is increasingly exposed to fraudulent and criminal activities as a result of increased usage of internet and mobile channels.	We continually assess these threats as they evolve and adapt our controls and defences to mitigate them.
Information security risk		

	HSBC and other multinational organisations continue to be the targets of cyber attacks.	We have invested significantly in staff training and enhanced multi-layered controls to protect our information and technical infrastructure.
Data management	New regulatory requirements necessitate more frequent and granular data submissions, which must be produced on a consistent, accurate and timely basis.	Our Data Strategy Board is driving consistent data aggregation, reporting and management across the Group.
Model risk	Adverse consequences could result from decisions based on incorrect model outputs or from models that are poorly developed, implemented or used.	Model development, usage and validation are subject to governance and independent review.

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Strategic Report (continued)

How we manage risk

Managing risk effectively is fundamental to the delivery of our strategic priorities.

Our enterprise-wide risk management framework fosters the continuous monitoring of the risk environment and an integrated evaluation of risks and their

interactions. It also ensures that we have a robust and consistent approach to risk management at all levels of the organisation and across all risk types.

This framework is underpinned by a strong risk culture, which is instrumental in aligning the behaviours of individuals with the

Group s attitude to assuming and managing risk and ensuring that our risk profile remains in line with our risk appetite and strategy. It is reinforced by the HSBC Values and our Global Standards.

Our approach to managing risk is summarised below.

Driving our risk culture

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Strategic Report (continued)

Risk appetite

The Group s risk appetite statement (RAS) is a key component in the management of risk. It describes the types and quantum of risks that we are willing to accept in achieving our medium and long-term strategic objectives. The RAS is approved by the Board on the advice of the Group Risk Committee.

Our risk appetite is established and monitored via the Group risk appetite framework, which provides a globally consistent and structured approach to the management, measurement and control of risk in accordance with our core risk principles. The framework outlines the processes, policies, metrics and governance bodies and how to address risk appetite as part of day-to-day business and risk management activities.

The RAS guides the annual planning process by defining the desired forward-looking risk profile of the Group in achieving our strategic objectives and plays an important role in our six filters process. Our risk appetite may be revised in response to our assessment of the top and emerging risks we have identified.

Quantitative and qualitative metrics are assigned to a number of key categories including returns, capital, liquidity and funding, securitisations, cost of risk and intra-Group lending, risk categories such as credit, market and operational risk, risk diversification and concentration, and financial crime compliance. These measures are reviewed annually for continued relevance.

Measurement against the metrics:

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

Risk appetite is embedded in day-to-day risk management decisions through the use of risk tolerances and limits for material risk types. This ensures that our risk profile remains aligned with our risk appetite, balancing risk and returns.

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

Some of the core metrics that were measured, monitored and presented monthly to the Risk Management Meeting of the GMB during 2014 are tabulated below:

Key risk appetite metrics

	2014 target	actual
Common equity tier 1 ratio[1]	≥ 10%	11.1%
Return on equity	Trending upwards to 12-15% by 2016	7.3%
RoRWA[13]	2.2-2.6%	1.5%
Cost efficiency ratio	Mid-50s	67.3%
Advances to customer accounts ratio	Below 90%	72.2%
Cost of risk (loan impairment charges)	Below 15% of operating income	5.4%

For footnotes, see page 39.

In the early part of 2014, we undertook our annual review of our risk appetite statement. It was approved by the Risk Managament Meeting of the GMB in January 2014 and the HSBC Holdings Board in February 2014. The core aspects of the RAS were incorporated into the 2014 scorecards for the Executive Directors, as set out on page 405 of the *Annual Report and Accounts 2013.*

We also strengthened the Group s RAS in 2014 by incorporating into it measures related to the core financial crime compliance principles of deterrence, detection and protection.

Targets for 2015 are discussed on page 32.

For details of requirements under CRD IV, see page 239.

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.

Credit metrics in our retail portfolio benefited from the continued sale of non-strategic portfolios, an improved economic environment across many markets and growth in Asia and in the core business in the US, while our wholesale portfolios remained broadly stable with an overall favourable change in key impairment metrics. Loan impairment charges fell for reasons outlined on page 29.

Operational losses rose, driven by UK customer redress programme charges and settlements relating to legal and regulatory matters. There are many factors which could affect estimated liabilities with respect to legal and regulatory matters and there remains a high degree of uncertainty as to the eventual cost of fines, penalties and redress for these matters.

HSBC is party to legal proceedings, investigations and regulatory matters in a number of jurisdictions arising out of our normal business operations. Our provisions for legal proceedings and regulatory matters and for customer remediation at 31 December 2014 totalled US$4.0bn.

The reported results of HSBC reflect the choice of 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 40 on the Financial Statements on page 446.

Provisions for legal proceedings and regulatory matters and for customer remediation are disclosed in Note 29 on the Financial Statements on page 420.

For details of operational losses, see page 188.

For details of our critical accounting estimates and judgements, see page 62.

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Strategic Report (continued)

We previously defined 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.

Each priority is 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.

In the process, we shall maintain a robust, resilient and environmentally sustainable business in which our customers can have confidence, our employees can take pride and our communities can trust.

Grow the business and dividends

In growing the business and dividends, our targets are to grow risk-weighted assets in line with our organic investment criteria, progressively grow dividends, while reducing the effect of legacy and non-strategic activities on our profit and RWAs.

Our strategy is to take advantage of the continuing growth of international trade and capital flows, and wealth creation, particularly in Asia, the Middle East and Latin America. We aim to achieve growth by leveraging our international network and client franchise to improve HSBC s market position in products aligned to our strategy.

To facilitate this growth, we recycle RWAs from low into high performing businesses within our risk appetite.

In 2014, we launched a number of investment priorities to capitalise on our global network and accelerate organic growth:

- **Global Trade and Receivables Finance:** We are investing in our sales and product capabilities, particularly for high growth products and trade corridors, and expanding in trade hubs as a means of reinforcing HSBC s leading position in trade.
- **Payments and Cash Management:** We aim to deliver improved client coverage and products via investments in better sales coverage and customer proposition and mobile enhancements.

Foreign Exchange: We aim to improve our services to clients and efficiency by improving our electronic trading platforms and capabilities.

Renminbi: Building on our market-leading position, we are investing to roll out our renminbi servicing capabilities internationally, with the aim of capturing a larger share of offshore renminbi foreign exchange and capital markets opportunities.

Industry awards and market share gains have validated our strategy. Our market shares in core international connectivity products such as Payments and Cash Management, Global Trade and Receivables Finance and Foreign Exchange have all improved consistently over the past three years. For three consecutive years, including 2014, HSBC has been voted the top global cash manager for corporate and financial institutions in the *Euromoney* Cash Management survey. In the same survey, HSBC was voted best global cash manager for non-financial institutions for a second consecutive year in 2014. We have also been voted the Best Overall for Products and Services by *Asiamoney* in its Offshore Renminbi Services survey every year since the survey s inception in 2012.

We aim to continue investing in key growth markets and align global resources to city clusters with fast-growing international revenue pools:

UK and Hong Kong as our home markets: Our goal is to strengthen and develop our home market position in key products, such as mortgages and personal lending.

China: Mainland China continues to be of strategic significance for HSBC and presents a structural long-term growth opportunity. We therefore continue to invest in organic growth, particularly in Guangdong and other economically important regions. We strive to invest and be the first to capture opportunities that may arise from regulatory changes such as the introduction of the Shanghai Free-Trade Zone.

US and Germany: We continue to improve our position in the world s largest economy and in Europe s leading trade nation through the expansion of our corporate franchise. In 2014, we broadened our customer base by enhancing our products, widening our geographical coverage and adjusting our risk appetite. International revenues increased through deeper relationships with customers and developing cross-business opportunities.

Our universal banking model enables us to generate revenues across global businesses. In 2014, cross-business collaboration revenues grew in all of our identified opportunities, except for Markets revenue from CMB customers primarily due to lower foreign exchange volatility. Approximately half of the total collaboration revenues for the year came from Markets and Capital Financing products provided to CMB customers. In GPB, net new money resulting from cross-business client referrals doubled from 2013.

Implement Global Standards

At HSBC, we are adopting the highest or most effective financial crime controls and deploying them everywhere we operate.

Two new global policies set out these controls for anti-money laundering (AML) and sanctions. They are our Global Standards.

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. Delivering on this means introducing a more consistent, comprehensive approach to managing financial crime risk from understanding more about our customers, what they do and where and why they do it, to ensuring their banking activity matches what we would expect it to be.

We aim to apply our financial crime risk standards throughout the lifetime of our customer relationships: from selecting and onboarding customers to managing our ongoing relationships and monitoring and assessing the changing risk landscape in the bank.

Our new global AML policy is designed to stop criminals laundering money through HSBC. It sets out global requirements for carrying out customer due diligence, monitoring transactions and escalating concerns about suspicious activity.

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Strategic Report (continued)

Our new global sanctions policy aims to ensure that we comply with local sanctions-related laws and regulations in countries where we operate, as well as with global sanctions imposed by the UN Security Council, European Union, US, UK and Hong Kong governments.

In many cases, our policy extends beyond what we are legally required to do, reflecting the fact that HSBC has no appetite for business with illicit actors.

We expect our Global Standards to underpin our business practices now and in the future, and to provide a source of competitive advantage. Global Standards are expected to 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

Each global business and Financial Crime Compliance have identified where and how they need to enhance existing procedures to meet the Global Standards. They are now in the process of deploying the systems, processes, training and support to put the enhanced procedures into practice in each country of operation.

This is being done in two stages:

- delivering policy components with limited infrastructure dependency according to an accelerated timeline; and
- implementing, in parallel, long-term strategic control enhancements and associated enhancements to infrastructure.

During 2014, we made material progress in a number of areas, including:

- global implementation of customer selection policies and governance;

- first deployment of enhanced customer due diligence procedures for gathering and verifying customer information;
- integration of global sanctions screening lists into our customer and transaction screening tools;
- targeted training for the highest risk roles and all-employee campaigns to raise awareness of financial crime risk and encourage escalation;
- global roll out of financial intelligence and investigations units to follow up on escalations and alerts, and identify emerging trends and issues; and
- the establishment of global procedures and governance to exit business that is outside our financial crime risk appetite.

Governance framework

The global businesses and Financial Crime Compliance, supported by HSBC Technology and Services, are formally accountable for delivering business procedures, controls and the associated operating environment to implement our new policies within each global business and jurisdiction. This accountability is overseen by the Global Standards Execution Committee, which is under the chairmanship of the Group Chief Risk Officer and consists of the Chief Executive Officers of each global business and the Global Head of Financial Crime Compliance.

Correspondingly, and to promote closer integration with business as usual, a report on the implementation of Global Standards is a standing item at the Group s Risk Management Meeting. The Financial System Vulnerabilities Committee and the Board continue to receive regular reports on the Global Standards programme as part of their continued role in providing oversight.

Risk appetite

Financial crime risk controls are a part of our everyday business and they are governed according to our global financial crime risk appetite statement. This aims to ensure sustainability in the long term. Our overarching appetite and approach to financial crime risk is that we will not tolerate operating without the systems and controls in place designed to detect and prevent financial crime and will not conduct business with individuals or entities we believe are engaged in illicit behaviour.

Enterprise-wide risk assessment

We have conducted our second annual enterprise-wide assessment of our risks and controls related to sanctions and AML compliance. The outcome of this assessment has formed the basis for risk management planning, prioritisation and resource allocation for 2015.

The Monitor

Under the agreements entered into with the US Department of Justice (DoJ), the UK FCA (formerly the Financial Services Authority (FSA)) and the US Federal Reserve Board (FRB) in 2012, including the five-year Deferred Prosecution Agreement (US DPA), an independent compliance monitor (the Monitor) was 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 in 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.

HSBC is continuing to take concerted action to remedy AML and sanctions compliance deficiencies and to implement Global Standards. HSBC is also working to implement the agreed recommendations flowing from the Monitor s 2013 review. We recognise we are only part way through a journey, being two years into our five-year US DPA. We look forward to maintaining a strong, collaborative relationship with the Monitor and his team.

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Strategic Report (continued)

Streamline processes and procedures

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

Since 2011, we have changed how HSBC is managed by introducing a leaner reporting structure and establishing an operating model with global businesses and functions. These changes together with improvements in software development productivity, process optimisation and our property portfolio realised US$5.7bn in sustainable savings, equivalent to US$6.1bn on an annualised (run rate) basis. This exceeded our commitment to deliver US$2.5 3.5bn of sustainable savings at the outset of the organisational effectiveness programme included in the first phase of our strategy.

Sustainable savings 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 increase returns to shareholders.

The reorganisation of the Group into four global businesses and eleven global functions further allows us to run globally consistent operating models. This establishes the foundation for our next stage of streamlining.

Going forward, we aim to fund investments into growth and compliance and offset inflation through efficiency gains. This requires net cost reductions. This programme will be applied to:

- improving the end-to-end optimisation of processes and servicing channels;
- technology simplification, reducing the number of applications used across the Group; and
- enhancing infrastructure, including optimising our real estate utilisation and the location where certain activities are carried out.

Streamlining is expected to 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.

Cost efficiency ratio

Our cost efficiency ratio for 2014 was 67.3%, up from 59.6% in 2013. This change was driven by higher legal, regulatory and conduct settlement costs; inflationary pressures; continued investment in strategic initiatives; and a rise in the bank levy. Cost increases were partly offset by realised sustainable savings of US$1.3bn.

Financial performance

Performance reflected lower gains on disposals and the negative effect of other significant items.

Reported results

	2014	2013	2012
	US$m	US$m	US$m
Net interest income	**34,705**	35,539	37,672
Net fee income	**15,957**	16,434	16,430
Other income	**10,586**	12,672	14,228
Net operating income[16]	**61,248**	64,645	68,330
LICs[15]	**(3,851)**	(5,849)	(8,311)
Net operating income	**57,397**	58,796	60,019
Total operating expenses	**(41,249)**	(38,556)	(42,927)
Operating profit	**16,148**	20,240	17,092
Income from associates[16]	**2,532**	2,325	3,557
Profit before tax	**18,680**	22,565	20,649

For footnotes, see page 39.

Profit before tax of US$18.7bn on a reported basis was US$3.9bn or 17% lower than that achieved in 2013. This primarily reflected lower business disposal and reclassification gains and the negative effect, on both revenue and costs, of other significant items including fines, settlements, UK customer redress and associated provisions.

Reported net operating income before loan impairment charges and other credit risk provisions (revenue) of US$61bn was US$3.4bn or 5% lower than in 2013. In 2014 there were lower gains (net of losses) from disposals and reclassifications (2013 included a US$1.1bn accounting gain arising from the reclassification of Industrial Bank Co. Limited (Industrial Bank) as a financial investment following its issue of additional share capital to third parties, and a US$1.1bn gain on the sale of our operations in Panama). In addition, other significant items included adverse fair value movements on non-qualifying hedges of US$0.5bn compared with favourable movements of US$0.5bn in 2013, a US$0.6bn provision arising from the ongoing review of compliance with the Consumer Credit Act in the UK as well as a net adverse movement on debit valuation adjustments on derivative contracts of US$0.4bn. These factors were partially offset by favourable fair value

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Strategic Report (continued)

movements of US$0.4bn on our own debt designated at fair value, which resulted from changes in credit spreads, compared with adverse movements of US$1.2bn in 2013 together with a US$0.4bn gain on the sale of our shareholding in Bank of Shanghai in 2014.

Loan impairment charges and other credit risk provisions (LICs) of US$3.9bn were US$2.0bn or 34% lower than in 2013, notably in North America, Europe and Latin America.

Operating expenses of US$41bn were US$2.7bn or 7% higher than in 2013, primarily as a result of significant items which were US$0.9bn higher than in 2013. These included settlements and provisions in connection with foreign exchange investigations of US$1.2bn and a charge of US$0.6bn in the US relating to a settlement agreement with the Federal Housing Finance Agency.

Income from associates of US$2.5bn was US$0.2bn or 9% higher than 2013, primarily reflecting the non-recurrence of an impairment charge of US$106m on the investment in our banking associate in Vietnam in 2013.

The Board approved a 5% increase in the fourth interim dividend in respect of 2014 to US$0.20 per share, US$0.01 higher than the fourth interim dividend in respect of 2013. Total dividends in respect of 2014 were US$9.6bn (US$0.50 per share), US$0.4bn higher than in 2013.

The transitional CET1 ratio of 10.9% was up from 10.8% at the end of 2013 and our end point basis of 11.1% was up from 10.9% at the end of 2013, as a result of continued capital generation and management actions offset by RWA growth, foreign exchange movements and regulatory changes.

Adjusted performance

For further information on non-GAAP financial measures, see page 40 for adjusted and www.hsbc.com for return on tangible equity.

From reported results to adjusted performance

To arrive at adjusted performance:

- we adjust for the year-on-year effects of foreign currency translation; and
- we adjust for the effect of significant items.

Reconciliations of our reported results to an adjusted basis are set out on page 44.

On an adjusted basis, profit before tax of US$23bn was broadly unchanged compared with 2013. Lower LICs, notably in North America, Europe and Latin

America, together with a marginal rise in revenue was largely offset by higher operating expenses.

The following commentary is on an adjusted basis.

Revenue was broadly unchanged. Growth in CMB, notably in our home markets of Hong Kong and the UK, was offset by decreased revenue in RBWM, GB&M and GPB

Revenue rose by US$0.1bn to US$62bn. Revenue increased in CMB following growth in average lending and deposit balances in Hong Kong, together with rising average deposit balances and wider lending spreads in the UK. Revenue also benefited from higher term lending fees in the UK.

These factors were mostly offset by lower revenue in RBWM, GB&M and GPB. In RBWM, it was primarily driven by the run-off of our US Consumer and Mortgage Lending (CML) portfolio with revenue in Principal RBWM broadly unchanged. In GB&M, revenue was lower due to the introduction of the funding fair value adjustment (FFVA) on certain derivative contracts which resulted in a charge of US$263m, together with a decrease from our Foreign Exchange business, partly offset by an increase in Capital Financing. In GPB, revenue was down reflecting a managed reduction in client assets as we continued to reposition the business, and reduced market volatility.

LICs fell in the majority of our regions, notably in North America, Europe and Latin America

LICs were US$1.8bn or 31% lower than in 2013, primarily in North America and mainly in RBWM, reflecting reduced levels of delinquency and new impaired loans in the CML portfolio, together with decreased lending balances from the continued portfolio run-off and loan sales. LICs were also lower in Europe, mainly reflecting a fall in individually assessed charges in the UK in CMB and GB&M, and higher net releases of credit risk provisions on available-for-sale asset-backed securities (ABS s) in GB&M in the UK. LICs were lower in Latin America too, primarily in Mexico and, to a lesser extent, in Brazil. In Mexico, the decrease in LICs mainly reflected lower individually assessed charges in CMB, while in Brazil LICs were lower in both RBWM and CMB, partly offset by an increase in GB&M.

Adjusted profit before tax

(US$bn)

Reported profit attributable to ordinary shareholders

(US$m)

Reported earnings per share

(US$)

Return on tangible equity

(%)

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Strategic Report (continued)

Operating expenses were higher, in part reflecting increases in Regulatory Programmes and Compliance costs and inflation, partly offset by further sustainable cost savings

Operating expenses were US$38bn, US2.2bn or 6% higher than in 2013. Regulatory Programmes and Compliance costs increased as a result of continued focus on Global Standards and the broader regulatory reform programme being implemented by the industry to build the necessary infrastructure to meet today s enhanced compliance standards.

Operating expenses also increased due to inflationary pressures, including wage inflation, primarily in Asia and Latin America, and an increase in the UK bank levy charge compared with 2013. We continued to invest in strategic initiatives in support of organically growing our business, primarily in CMB. We also increased expenditure on marketing and advertising to support revenue generating initiatives, primarily in RBWM.

These factors were partially offset by further sustainable cost savings in the year of US$1.3bn, primarily by re-engineering certain of our back office processes.

The number of employees expressed in full-time equivalent numbers (FTE s) at the end of 2014 increased by 3,500 or 1%. The average number of FTEs was broadly unchanged as reductions through sustainable savings programmes were offset by the initiatives related to the Regulatory Programmes and Compliance and business growth.

Income from associates rose, mainly in Asia and the Middle East and North Africa

Income from associates increased, primarily reflecting higher contributions from Bank of Communications Co, Limited (BoCom) and The Saudi British Bank, principally reflecting balance sheet growth.

The effective tax rate was 21.3% compared with 21.1% in 2013.

For more details of the Group s financial performance, see page 46.

Balance sheet strength

Total reported assets were US$2.6 trillion, 1% lower than at 31 December 2013. On a constant currency basis, total assets were US$85bn or 3% higher. Our balance sheet remained strong with a ratio of customer advances to customer accounts of 72%. This was a consequence of our business model and of our conservative risk appetite, which is based on funding the growth in customer loans with growth in customer accounts.

On a constant currency basis, loans and advances grew by US$28bn and customer accounts increased by US$47bn.

For further information on the Balance Sheet, see page 57, and on the Group s liquidity and funding, see page 163.

Total assets

(US$bn)

Post-tax return on average total assets

(%)

Loans and advances to customers[17]

(US$bn)

Customer accounts[17]

(US$bn)

Ratio of customer advances to customer deposits[17]

(%)

For footnote, see page 39.

Strategic Report (continued)

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 using capital ratios, which measure capital relative to a regulatory assessment of risks taken, and 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 2014 we managed our capital position to meet an internal target ratio on a CET1 end point basis of greater than 10%. This has since been reviewed and, in 2015, we expect to manage Group capital to meet a medium-term target for return on equity of more than 10%. This is modelled on a CET1 ratio on an end point basis in the range of 12% to 13%.

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 EU delegated act published in January 2015 (which is based on the Basel III 2014 revised definition).

Estimated leverage ratio

	2014 US$bn
At 31 December	
Tier 1 capital under CRD IV (end point)	**142**
Exposures after regulatory adjustment	**2,953**
Estimated leverage ratio (end point)	**4.8%**

For further details of the leverage ratio, see page 251.

For further information on the Group s capital and our risk-weighted assets, see page 239.

Capital ratios and risk-weighted assets

CRD IV[1]

Common equity tier 1 ratio (transitional)	**Total capital ratio (transitional)**	**Common equity tier 1 ratio (end point)**	**Risk-weighted assets (RWA s)**
(%)	(%)	(%)	(US$bn)

Basel 2.5[1]

Core tier 1 ratio	**Total capital ratio**	**Risk-weighted assets**
(%)	(%)	(US$bn)

For footnote, see page 39.

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Strategic Report (continued)

Meeting our targets

We set financial targets against which we measure our performance.

In 2011, we articulated our ambition to be the leading international bank and specified financial metrics against which we would measure performance through 2013. Targets were set under our understanding at the time of capital requirements and included a CET1 ratio of 9.5-10.5% under Basel III; return on equity (ROE) of 12-15%; and a cost efficiency ratio (CER) of 48-52% supported by US$2.5-3.5bn in sustainable cost savings over three years. Over the period to 2013, we strengthened our capital position, realised US$4.9bn in sustainable savings and increased dividend pay-outs to shareholders in line with targets.

In May 2013, we defined our strategic priorities for the period from 2014 to 2016 and revisited the financial metrics used to track performance. We continued to target an ROE of 12-15% and added a further target of US$2-3bn in sustainable savings. To allow for investment in growth initiatives and to reflect the increasing requirements involved in operating as a global bank, we revised the CER target to the mid-50s, adding that revenues must grow faster than costs (positive jaws). We defined a target CET1 ratio, on an end point basis, as greater than 10% and continued to seek progressive dividends for shareholders. We also set a cap on our loans to deposits ratio of 90%.

During 2014, we achieved a CET1 ratio on an end point basis of 11.1% and declared US$9.6bn of total dividends in respect of the year. We realised incremental sustainable savings of US$1.3bn and maintained a loans-to-deposits ratio of 72%. The ROE of 7.3% and the CER of 67.3% fell short of our target.

Changing regulatory and operating environment

When we set our targets in 2011, we did so based on a CET1 ratio on an end point basis of greater than 10%. Whilst this factored in foreseeable capital requirements, it did not anticipate, and could not have anticipated, the full extent of capital commitments and additional costs asked of us in the years to come. These factors have included:

- Progressively strengthening our capital levels in response to increasing capital requirements;
- The stepped increase in costs due to the implementation of regulatory change and enhancing risk controls, notably around financial system integrity and conduct;
- An increase in the bank levy;
- The continuing low interest rate environment; and
- The impact of significant items, notably the high level of fines, settlements, UK customer redress and associated provisions.

As a consequence, we are setting new targets that better reflect the present and ongoing operating environment.

From 2015, our return on equity target will therefore be replaced with a medium-term target of more than 10%. This is modelled on a CET1 ratio on an end point basis in the range of 12% to 13%.

At the same time, we are reaffirming our target of growing business revenues faster than operating expenses (on an adjusted basis).

We also remain committed to delivering a progressive dividend. The progression of dividends will be consistent with the growth of the overall profitability of the Group and is predicated on our continued ability to meet regulatory capital requirements.

We remain strongly capitalised, providing capacity for both organic growth and dividend return to shareholders.

Brand value

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

This is our fourth year of using the Brand Finance valuation method reported in *The Banker* magazine as our brand value 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$27.3bn

Pre-tax return on risk-weighted assets[13]

(%)

Dividend payout ratio

(%)

Brand value

(US$bn)

For footnote, see page 39.

(up 2% from 2014), placing us third. We maintain an AAA rating for our brand in this year s report.

In addition to the Brand Finance measure, we have reviewed our performance in the *Interbrand* Annual Best Global Brands report, published in September 2014. This showed HSBC as the top ranked banking brand with a valuation of US$13.1bn (up from US$12bn in 2013) and in second place when all financial services brands are considered.

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Strategic Report (continued)

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 2014.

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 s net tax paid[18]

	2014 US$bn	2013 US$bn
Tax on profits	**3.6**	4.7
Employer taxes	**1.6**	1.6
UK bank levy[19]	**1.0**	0.7
Irrecoverable value-added tax	**0.9**	0.8
Other duties and levies	**0.8**	0.8
Year ended 31 December	**7.9**	8.6

For footnotes, see page 39.

Taxes collected for government[20]

	2014 US$bn	2013 US$bn
Region		
UK	**1.7**	1.5
Rest of Europe	**1.1**	1.3
Asia	**2.0**	1.5
North America	**1.0**	1.0
Latin America	**3.3**	3.5
Year ended 31 December	**9.1**	8.8

For footnote, see page 39.

Distribution of economic benefits

	2014	2013	2012
	US$bn	US$bn	US$bn
Net cash tax outflow	**7.9**	8.6	9.3
Distributions to shareholders and non-controlling interests	**10.6**	10.2	8.7
Employee compensation and benefits	**20.4**	19.2	20.5
General administrative expenses including premises and procurement	**18.6**	17.1	20.0

Pro-forma post-tax profit allocation[21]

	2014	2013
	%	%
Retained earnings/capital	**32**	53
Dividends	**53**	35
Variable pay	**15**	12
Year ended 31 December	**100**	100

For footnote, see page 39.

Market capitalisation and total shareholder return

US$0.50 ordinary shares in issue	Market capitalisation	Closing market price London	Hong Kong	American Depositary Share[22]
19,218m	US$182bn	£6.09	HK$74.0	US$47.23
2013: 18,830m	2013: US$207bn	2013: £6.62	2013: HK$84.15	2013: US$55.13
2012: 18,476m	2012: US$194bn	2012: £6.47	2012: HK$81.30	2012: US$53.07

	Total shareholder return[23] Over 1 year	Over 3 years	Over 5 years
To 31 December 2014	97	144	109
Benchmarks:	100	160	132

MSCI Banks[24]

For footnotes, see page 39.

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Strategic Report (continued)

Remuneration

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

The quality of our people and their 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 a long-term career with HSBC in the long-term interests of shareholders.

Employee remuneration

Our remuneration strategy is designed to reward competitively the achievement of long-term sustainable performance. HSBC s reward package comprises four key elements of remuneration:

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

The governance of our remuneration principles and oversight of their implementation by the Group Remuneration Committee ensures what we pay our people is aligned to our business strategy and performance is 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 contributes to the long-term sustainability of the business.

Full details of our remuneration policy may be found under Remuneration Policy on our website (http://www.hsbc.com/investor-relations/governance).

Industry changes and key challenges

New regulatory requirements such as the bonus cap have influenced how we pay our senior executives and those of our employees identified by the PRA as having a material impact on the institution s risk profile, being what are termed material risk takers (MRTs). This year, a new requirement has been introduced for firms to ensure that clawback (i.e. a firm s ability

to recoup paid and/or vested awards) can be applied to all variable pay awards granted on or after 1 January 2015 for a period of at least seven years from the date of award. These requirements present challenges for HSBC in ensuring that the total compensation package for our employees in all of the markets in which we operate around the world remains competitive, in particular, relative to other banks not subject to these requirements.

Looking ahead to 2015/2016, further significant regulatory changes to executive remuneration are expected and it is possible that we will need to make changes to our remuneration policy in 2016. The number and volume of changes that have been and are being proposed hinders our ability to communicate with any certainty to our current and potential employees the remuneration policies and structures that would apply to them. It also contributes to a general misunderstanding about how our policies work and the effect of those policies on employee performance.

For full details of industry changes and key challenges, see page 300.

Variable pay pool

The total variable pay pool for 2014 was US$3.7bn, down from US$3.9bn in 2013:

	Group	
	2014	2013
	US$m	US$m
Variable pay pool[25]		
total	**3,660**	3,920
as a percentage of pre-tax profit (pre-variable pay)	**16%**	15%
percentage of pool deferred	**14%**	18%

For footnote, see page 39.

The Group Remuneration Committee considers many factors in determining HSBC s variable pay pool, including the performance of the Group considered in the context of our risk appetite statement.

This ensures that the variable pay pool is shaped by risk considerations and by an integrated approach to business, risk and capital management which supports achievement of our strategic objectives.

The Group Remuneration Committee also takes into account Group profitability, capital strength, shareholder returns, the distribution of profits between capital, dividends and variable pay, the commercial requirement to remain market competitive and overall affordability.

For full details of variable pay pool determination, see pages 309.

Relative importance of expenditure on pay

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

Relative importance of expenditure on pay

(US$m)

For footnotes, see page 39.

Directors remuneration

The remuneration policy for our executive and non-executive Directors was approved at the Annual General Meeting on 23 May 2014. The full policy is available in the Directors Remuneration Report in the *Annual Report and Accounts 2013*, a copy of which can be obtained by visiting the following website: http://www.hsbc.com/investor-relations/financial-and-regulatory-reports.

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:

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Strategic Report (continued)

Executive Directors

	Douglas Flint		Stuart Gulliver		Iain Mackay		Marc Moses	
	2014	2013	**2014**	2013	**2014**	2013	**2014**	2013
	£000	£000	**£000**	£000	**£000**	£000	**£000**	£000
Fixed pay								
Base salary	**1,500**	1,500	**1,250**	1,250	**700**	700	**700**	
Fixed pay allowance			**1,700**		**950**		**950**	
Pension	**750**	750	**625**	625	**350**	350	**350**	
	2,250	2,250	**3,575**	1,875	**2,000**	1,050	**2,000**	
Variable pay								
Annual incentive			**1,290**	1,833	**867**	1,074	**1,033**	
GPSP			**2,112**	3,667	**1,131**	2,148	**1,131**	
			3,402	5,500	**1,998**	3,222	**2,164**	
Total fixed and variable pay	**2,250**	2,250	**6,977**	7,375	**3,998**	4,272	**4,164**	
Benefits	**136**	48	**589**	591	**43**	33	**6**	
Non-taxable benefits	**105**	102	**53**	67	**28**	53	**33**	
Notional return on deferred cash	**41**	27			**11**	7	**36**	
Total single figure of remuneration	**2,532**	2,427	**7,619**	8,033	**4,080**	4,365	**4,239**	

Douglas Flint, as Group Chairman, is not eligible for an annual incentive but was eligible under the policy to receive a one-time GPSP award for 2014.

Marc Moses, the Group Chief Risk Officer, 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. His 2013 figures have not been disclosed.

For full details of Directors remuneration, see page 307.

Remuneration policy going forward

Our remuneration policy was approved by shareholders at the 2014 Annual General

Meeting and will apply for performance year 2015. The table below summarises how each element of pay will be implemented in 2015.

External reporting

The required remuneration disclosures for Directors, MRTs and highest paid employees in the Group are made in the Directors Remuneration Report on pages 300 to 323.

Purpose and link to strategy	Operation and planned changes to policy
Fixed pay	
Base salary	Base salary levels will remain unchanged from their 2014 levels as follows: Douglas Flint: £1,500,000 Stuart Gulliver: £1,250,000 Iain Mackay: £700,000 Marc Moses: £700,000
Fixed pay allowance[28]	Fixed pay allowances will remain unchanged from their 2014 levels as follows: Douglas Flint: Nil Stuart Gulliver: £1,700,000 Iain Mackay: £950,000 Marc Moses: £950,000
Pension	Pension allowances to apply in 2015 as a percentage of base salary will remain unchanged as follows: Douglas Flint: 50% Stuart Gulliver: 50% Iain Mackay: 50% Marc Moses: 50%
Benefits	
Benefits	No changes are proposed to the benefits package for 2015.

Variable pay	
Annual incentive[28]	No changes are proposed to the annual incentive.
GPSP	No changes are proposed to the GPSP.

For footnote, see page 39.

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Strategic Report (continued)

Sustainability

Sustainability underpins our strategic priorities and enables us to fulfil our purpose as an international bank.

At HSBC, how we do business is as important as what we do. For us, sustainability means building our business for the long term by balancing social, environmental and economic considerations in the decisions we make. This enables us to help businesses thrive and contribute to the health and growth of communities.

Approach to corporate sustainability

Corporate sustainability is governed by the Conduct & Values Committee, a sub-committee of the Board which oversees and advises on a range of issues including adherence to HSBC s values and ensuring we respond to the changing expectations of society and key stakeholders.

Sustainability priorities are set and programmes are led by the Global Corporate Sustainability function. HSBC s country operations, global functions and global businesses work together to ensure sustainability is embedded into the Group s business and operations and properly implemented. Executives within the Risk and the HSBC Technology and Services functions hold a specific remit to deliver aspects of the sustainability programme for the Group.

Our sustainability programme focuses on three areas: sustainable finance; sustainable operations, and sustainable communities.

Sustainable finance

We anticipate and manage the risks and opportunities associated with a changing climate, environment and economy. In a rapidly changing world, we must ensure our business anticipates and prepares for shifts in environmental priorities and societal expectations.

Sustainability risk framework

We manage the risk that the financial services which we provide to customers may have unacceptable effects on people or the environment. Sustainability risk can also lead to commercial risk for customers, credit risk for HSBC and significant reputational risk.

For over 10 years we have been working with our business customers to help them

understand and manage their environmental and social impact in relation to sensitive sectors and themes. We assess and support customers using our own policies which we regularly review and refine. We have policies covering agricultural commodities, chemicals, defence, energy, forestry, freshwater infrastructure, mining and metals, World Heritage Sites and Ramsar Wetlands. We also apply the Equator Principles.

We welcome constructive feedback from non-governmental organisations and campaign groups and regularly discuss matters of shared interest with them.

Our sustainability risk framework is based on robust policies, formal processes and well-trained, empowered people.

In 2014, we trained risk and relationship managers in sustainability risk, focusing on the recent policy updates and revised processes. Our designated Sustainability Risk Managers provided training to executives from Risk, GB&M and CMB in every geographical region.

We have used the Equator Principles since 2003. A new version of the Equator Principles EP3 was launched in 2013, and HSBC introduced these changes on 1 January 2014 following training and the development of clear templates to ensure the transition was smooth.

Data and the independent assurance of our application of the Equator Principles will be available at hsbc.com in April 2015.

Policy reviews and updates in 2014

In 2014, we published the reports of two independent reviews into the content and implementation of our Forest Land and Forest Products Sector Policy, by Proforest and PricewaterhouseCoopers LLP, respectively. We also issued new policies on forestry, agricultural commodities and World Heritage Sites and Ramsar Wetlands, reflecting the recommendations. These documents can be found online at hsbc.com/sus-risk.

Forestry policy

The new forestry policy, issued in March 2014, requires forestry customers to gain 100% certification by the Forest Stewardship Council (FSC) or the Programme for the Endorsement of Forest Certification (PEFC) in high risk countries by 31 December 2014. Certification requires that customers are operating legally and sustainably.

Feedback from stakeholders on the new policy was positive. Timber customers from affected countries such as Turkey and Mexico

were receptive to the new standards, gained certification as a result of the new requirement and benefited from advice. Other customer relationships will end as soon as contractual terms allow, in cases where customers have been unable or unwilling to meet the new standards.

Agricultural commodities policy

The new agricultural commodities policy requires palm oil customers to become members of the Roundtable on Sustainable Palm Oil (RSPO) by 30 June 2014, to have at least one operation certified by the end of 2014 and all operations by the end of 2018.

A number of customer relationships will be closed where the deadline has not been met. Other customers have succeeded in joining the RSPO and having at least one operation certified by the end of 2014. One example is an Indonesian processing, refining and export company. HSBC started to engage with this and other companies in January 2014 on the changes and continued to offer advice. The management of the company sought expert advice from third parties to understand more about RSPO certification, which they found was less complex than they had imagined. Two units of the company obtained RSPO certification in June 2014, and one further is planned.

In order to encourage the shift towards sustainable palm oil we have introduced a discounted prepayment export finance product for trade flows of certified sustainable palm oil. This structured, bespoke financing was launched in Singapore and Indonesia in 2014 and in Malaysia in early 2015.

The inaugural financing using this product was for a major palm oil exporter which has been a member of the RSPO for ten years and is now fully certified. The product is available to both existing and future clients and is hoped to encourage an expansion in the proportion of palm oil that is certified sustainable.

Customers in Malaysia, Indonesia, mainland China, Taiwan, South Korea, Thailand, Turkey and Mexico have decided to certify their operations as a result of HSBC s new policies and deadlines. A number of others were already certified. Fuller reporting on the effect of these new policies will be available in April 2015 at hsbc.com.

Strategic Report (continued)

The World Heritage Sites and Ramsar Wetlands policy

This is designed to protect unique sites of outstanding international significance as listed by the UN and wetlands of international importance. The policy relates to all business customers involved in major projects, particularly in sectors such as forestry, agriculture, mining, energy, property and infrastructure development.

The policy helps HSBC to make balanced and clear decisions on whether or not to finance projects which could have an effect on these sites or wetlands. HSBC has avoided financing projects in light of the policy.

Our approach to managing sustainability risk is described on page 237.

Climate business

We understand that in response to climate change there is a shift required towards a lower-carbon economy. We are committed to accelerating that shift by supporting customers involved in climate business by seeking long-term low-carbon commercial business opportunities. Our climate business includes clients in the solar, wind, biomass, energy efficiency, low-carbon transport and water sectors. In 2014, our Climate Change Research team was recognised as the top team in the industry. We were also a leader in public markets equity-related wind financings for international companies, including the largest wind turbine equity raising since 2010 as part of the 1.4bn Vestas refinancing.

Green bonds are any type of bond instruments where the proceeds will be exclusively applied to finance climate or environmental projects. In April 2014, HSBC became a member of the International Capital Market Association Executive Committee for the Green Bond Principles. The Green Bond Principles are voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance of a green bond.

In 2014, we commissioned a report, Bonds and Climate Change: the state of the market in 2014 from the Climate Bonds Initiative to help raise awareness of climate financing.

HSBC has been at the forefront of this fast-developing area. In 2014, we were the sole global coordinator and joint leader, manager and bookrunner for the first green bond issue by an Asian corporate issuer, Advanced Semiconductor Engineering Inc. We also acted as sole global coordinator on the first green bond issued by Abengoa, the first high-yield green bond to be issued in Europe as well as the being a joint lead manager and bookrunner for the first government issuer in the Canadian market for the Province of Ontario.

UN Environment Programme Finance Initiative Principles for Sustainable Insurance

As a signatory to the Principles for Sustainable Insurance (PSI), a global sustainability framework, HSBC s Insurance business has committed to integrating environmental, social and governance issues across its processes, and to publicly disclosing its progress in doing so on an annual basis. A global programme manager has been appointed to provide leadership, co-ordination and control of Insurance sustainability initiatives world-wide and ensure alignment with the Group s approach and the requirements of the PSI initiative. This includes driving appropriate activities both within the Insurance business and with partners, regulators and other industry players; disseminating industry best practice, and developing global insurance sustainability initiatives.

Sustainable operations

Managing our own environmental footprint supports business efficiency and is part of our long-term contribution to society. We work together and with our suppliers to find new ways to reduce the impact of our operations on the environment. We are purchasing renewable energy, designing and operating our buildings and data centres more efficiently and reducing waste. We have committed to cut our annual per employee carbon emissions from 3.5 to 2.5 tonnes by 2020.

Sustainability Leadership Programme

To deliver our ten sustainability goals we have trained 847 senior managers through HSBC s Sustainability Leadership Programme since 2009. The programme is a mix of hands-on learning and leadership development sessions and is aligned to the HSBC Values agenda. The programme participants are expected to embed sustainability into decision-making and project delivery in the businesses and functions where they work.

Renewable energy procurement

In 2014, we signed three power purchase agreements with renewable energy generators in the UK and India. This is expected to provide 9% of HSBC s energy. In August, a 10-megawatt solar power plant in Hyderabad, India came online to provide the Group with clean energy. This is expected to power three Global Service Centres and a Technology Centre in India. HSBC played a key role in facilitating the project by agreeing to purchase the plant s energy at a government backed fixed price for the next ten years. The plant will provide a clean and reliable source of energy. In addition, we have redefined our renewables target only to count energy from newly constructed renewable energy sources which have been commissioned by HSBC.

Paper use

Our paper goal is being achieved in three ways: ensuring that the paper we buy is from a sustainable source in accordance with our paper sourcing policy, reducing the volume of paper consumed by our offices and branches and providing paperless banking for all retail and commercial customers. We have continued to reduce the total amount of paper purchased and to increase the proportion of paper we use that is certified as sustainably sourced by the FSC and PEFC. Since 2011, we have achieved a 53% reduction in paper purchased. Certified sustainably sourced paper reached 92% of all paper used by the end of 2014.

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Strategic Report (continued)

Our 10-point sustainable operations strategy

1. Sustainability engagement: encourage employees to deliver improved efficiency by 2020
2. Supply chain collaboration: sustainable savings through efficiency and innovation
3. HSBC Eco-efficiency fund: US$50m annually to develop new ways of working, based on employee innovations
4. Energy: reduce annual energy consumption per employee by 1MWh by 2020, compared to 6.2MWh in 2011
5. Waste: use less, and recycle 100% of our office waste and electronic waste
6. Renewables: aim to increase energy consumption from renewables to 25% by 2020 from zero
7. Green buildings: design, build and run energy efficient, sustainable buildings to the highest international standards
8. Data centres: achieve an energy efficiency (power usage effectiveness) rating of 1.5 by 2020
9. Travel: reduce travel emissions per employee
10. Paper: paperless banking available for all retail and commercial customers and 100% sustainably sourced paper

by 2020

Carbon emissions

HSBC s carbon dioxide emissions are calculated on the basis of the energy used in our buildings and employee business travel from over 28 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 our internal analysis of data coverage and quality.

Carbon dioxide emissions in tonnes

	2014	2013
Total	**752,000**	889,000
From energy	**633,000**	755,000
From travel	**119,000**	134,000

Carbon dioxide emissions in tonnes per FTE

	2014	2013
Total	**2.92**	3.43
From energy	**2.46**	2.91
From travel	**0.46**	0.52

Our greenhouse gas reporting year runs from October to September. For the year ended 30 September 2014, carbon dioxide emissions from our global operations were 752,000 tonnes.

Sustainable communities

We believe that education and resources such as safe water and sanitation are essential to resilient communities which are, in turn, the basis of thriving economies and businesses.

We provide financial contributions to community projects, and thousands of employees across the world get involved by volunteering their time and sharing their skills.

Volunteering and donations

Thousands of HSBC employees globally are involved every year in volunteering for our Community Investment programmes. Further details on our programmes are available at hsbc.com and will be updated with information for 2014 in April 2015.

In 2014, we donated a total of US$114m to community projects (2013: US$117m). Of this, US$66m was donated in Europe (2013: US$64m); US$28m was donated in Asia-Pacific (2013: US$24m); US$3m was donated in the Middle East (2013: US$5m); US$10m was donated in North America (2013: US$11m); and US$7m was donated in Latin America (2013: US$12m).

Employees gave 303,922 hours of their time to volunteer during the working day (2013: 255,925 hours).

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 and sustainability risk policies. 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 and HSBC Values, 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.

Further detail on our 2014 performance will be available from the end of April 2015 on our website, along with independent assurance of our application of the Equator Principles and carbon emissions.

On behalf of the Board

D J Flint

Group Chairman

HSBC Holdings plc

23 February 2015

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Strategic Report (continued)

Footnotes to Strategic Report

1 *On 1 January 2014, CRD IV came into force and capital and RWAs at 31 December 2014 are calculated and presented on this basis. Prior to this, capital and RWAs were calculated and presented on a Basel 2.5 basis. In addition, capital and RWAs at 31 December 2013 were also estimated based on the Group s interpretation of final CRD IV legislation and final rules issued by the PRA. At 31 December 2012, the CRD IV estimated capital and RWAs were based on the July 2011 draft CRD IV text.*

2 *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 2013 of US$0.10 was paid on 11 December 2013. The fourth interim dividend for 2013 of US$0.19 was paid on 30 April 2014. First, second and third interim dividends for 2014, each of US$0.10 per ordinary share, were paid on 10 July 2014, 9 October 2014 and 10 December 2014, respectively. Note 9 on the Financial Statements provides more information on the dividends declared in 2014. On 23 February 2015, the Directors declared a fourth interim dividend for 2014 of US$0.20 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 30 April 2015 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 20 April 2015, with a scrip dividend alternative. The reserves available for distribution at 31 December 2014 were US$48,883m.*

Quarterly dividends of US$15.5 per 6.20% 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 17 March 2014, 16 June 2014, 15 September 2014 and 15 December 2014.

Quarterly coupons of US$0.508 per security were paid with respect to 8.125% capital securities on 15 January 2014, 15 April 2014, 15 July 2014 and 15 October 2014.

Quarterly coupons of US$0.50 per security were paid with respect to 8% capital securities on 17 March 2014, 16 June 2014, 15 September 2014 and 15 December 2014.

3 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*

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 *Established on 5 December 2014.*

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 *The sum of balances presented does not agree to consolidated amounts because inter-company eliminations are not presented here.*

13 *Pre-tax return on average risk-weighted assets is calculated using average RWAs based on a Basel 2.5 basis for all periods up to and including 31 December 2013 and on a CRD IV end point basis for all periods from 1 January 2014.*

14 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue .*

15 *Loan impairment charges and other credit risk provisions.*

16 *Share of profit in associates and joint ventures.*

17 *From 1 January 2014, non-trading reverse repos and repos are presented as separate lines in the balance sheet. Previously, non-trading reverse repos were included within Loans and advances to banks and Loans and advances to customers and non-trading repos were included within Deposits by banks and Customer accounts . Comparative data have been re-presented accordingly. Non-trading reverse repos and repos have been presented as separate lines in the balance sheet to align disclosure with market practice and provide more meaningful information in relation to loans and advances. The extent to which reverse repos and repos represent loans to/from customers and banks is set out in Note 17 on the Financial Statements.*

18 *Taxes paid by HSBC relate to HSBC s own tax liabilities and is reported on a cash flow basis.*

19 *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.*

20 *Taxes collected relate to those taxes which HSBC is liable to pay as agent for taxation authorities across the world and include all employee-related taxes, together with taxes withheld from payments of interest and charged on the provision of goods and services to its customers. Taxes collected are reported on a cash flow basis.*

21 *Excludes movements in the fair value of own debt and before variable pay distributions.*

22 Each American Depositary Share represents five ordinary shares.

23 *Total shareholder return is defined as the growth in share value and declared dividend income during the relevant period.*

24 *The Morgan Stanley Capital International World Bank Index.*

25 *The 2014 Group pre-tax pre-variable pay profit calculation as described in Directors Remuneration Report page 309 .The percentage of variable pay deferred for the Code Staff population was 50%.*

26 *Dividends per ordinary share in respect of that year. For 2014, this includes the first, second and third interim dividends paid in 2014 of US$5.8bn (gross of scrip) and a fourth interim dividend of US$3.8bn.*

27 *Employee compensation and benefits in 2013 totalled US$19,196m which included an accounting gain arising from a change in the basis of delivering ill-health benefits in the UK of US$430m. Excluding this accounting gain, 2013 employee compensation and benefits totalled US$19,626m.*

28 *This approach applies to all executive Directors with the exception of the Group Chairman, Douglas Flint, who is not eligible for a fixed pay allowance or variable pay awards.*

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Report of the Directors: Financial Review

Financial summary

The management commentary included in the Report of the Directors: Financial Review , together with the Employees and Corporate sustainability sections of Corporate Governance and the Directors Remuneration Report is presented in compliance with the IFRSs Practice Statement Management Commentary issued by the IASB.

Use of non-GAAP financial measures

Our reported results are prepared in accordance with IFRSs as detailed in the Financial Statements on page 334. In measuring our performance, the financial measures that we use include those which have been derived from our reported results in order to eliminate factors which distort year-on-year comparisons. These are considered non-GAAP financial measures. The primary non-GAAP financial measure we use is adjusted

performance . Other non-GAAP financial measures are described and reconciled to the most relevant reported financial measure when used.

Adjusted performance

Adjusted performance is computed by adjusting reported results for the year-on-year effects of foreign currency translation differences and significant items which distort year-on-year comparisons.

Previously we used the non-GAAP financial measure of underlying performance , which was calculated by adjusting reported results for the year-on-year effects of currency translation differences, own credit spread and acquisitions, disposals and dilutions. In 2014, we modified our approach to better align it with the way we view our performance internally and with feedback received from investors. Adjusted performance builds on underlying performance by maintaining the adjustment for currency translation differences and incorporating the adjustments for own credit spread and acquisitions, disposals and dilutions into the definition of significant items. We use the term significant items to collectively describe the group of individual adjustments which are excluded from reported results when arriving at adjusted performance. Significant items, which are detailed below, are those items which management and investors would ordinarily identify and consider separately when assessing performance in order to better understand the underlying trends in the business.

We believe adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and quantifying items management believe to be significant and providing insight into how management assesses year-on-year performance.

We arrive at adjusted performance by excluding from our reported results:

- the year-on-year effects of foreign currency translation differences. This is done by comparing reported results for 2014 with reported results for 2013 retranslated at 2014 exchange rates. The foreign currency translation differences reflect the movements of the US dollar against most major currencies; and

- significant items which distort the year-on-year comparison of reported results by obscuring the underlying factors and trends which affect operations. Significant items include adjustments for own credit spread and acquisitions, disposals and dilutions which were previously part of our underlying measure. The following pages provide further details, including a reconciliation from reported to adjusted results.

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Report of the Directors: Financial Review (continued)

For acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses, we eliminate the gain or loss on disposal or dilution and any associated gain or loss on reclassification or impairment recognised in the year incurred, and remove the operating profit or loss of the acquired, disposed of or diluted subsidiaries, associates,

joint ventures and businesses from all the years presented so we can view results on a like-for-like basis. Disposal of strategic investments other than those included in the above definition would be included in other significant items if material.

The following acquisitions, disposals and changes to ownership levels affected adjusted performance:

Disposal gains/(losses) affecting adjusted performance

	Date	Disposal gain/(loss) US$m
Reclassification gain in respect of our holding in Industrial Bank Co., Limited following the issue of additional share capital to third parties[1]	Jan 2013	1,089
HSBC Insurance (Asia-Pacific) Holdings Limited s disposal of its shareholding in Bao Viet Holdings[1]	Mar 2013	104
Household Insurance Group Holding company s disposal of its insurance manufacturing business[1]	Mar 2013	(99)
HSBC Seguros, S.A. de C.V., Grupo Financiero HSBC s disposal of its property and Casualty Insurance business in Mexico[1]	Apr 2013	20
HSBC Bank plc s disposal of its shareholding in HSBC (Hellas) Mutual Funds Management SA[2]	Apr 2013	(7)
HSBC Insurance (Asia-Pacific) Holdings Limited disposal of its shareholding in Hana HSBC Life Insurance Company Limited[1]	May 2013	28
HSBC Bank plc s disposal of HSBC Assurances IARD[2]	May 2013	(4)
The Hongkong and Shanghai Banking Corporation Limited s disposal of HSBC Life (International) Limited s Taiwan branch operations[2]	June 2013	(36)
HSBC Markets (USA) Inc. s disposal of its subsidiary, Rutland Plastic Technologies[2]	Aug 2013	17
HSBC Insurance (Singapore) Pte Ltd s disposal of its Employee Benefits Insurance business in Singapore[2]	Aug 2013	(8)
HSBC Investment Bank Holdings plc s disposal of its investment in associate FIP Colorado[2]	Aug 2013	(5)

HSBC Investment Bank Holdings plc group s disposal of its investment in subsidiary, Viking Sea Tech[1]	Aug 2013	54
HSBC Latin America Holdings UK Limited s disposal of HSBC Bank (Panama) S.A.[2]	Oct 2013	1,107
HSBC Latin America Holdings UK Limited s disposal of HSBC Bank (Peru) S.A.[2]	Nov 2013	(18)
HSBC Latin America Holdings UK Limited s disposal of HSBC Bank (Paraguay) S.A.[2]	Nov 2013	(21)
Reclassification loss in respect of our holding in Yantai Bank Co., Limited following an increase in its registered share capital[1]	Dec 2013	(38)
HSBC Latin America Holdings UK Limited s disposal of HSBC Bank (Colombia) S.A.[1]	Feb 2014	18
Reclassification loss in respect of our holding in Vietnam Technological & Commercial Joint Stock Bank following the loss of significant influence[1]	Jun 2014	(32)
HSBC Bank Middle East Limited s disposal of its operations in Pakistan[1]	Oct 2014	(27)

For footnotes, see page 109.

Foreign currency translation differences
(constant currency)

Foreign currency translation differences reflect the movements of the US dollar against most major currencies during 2014. We exclude the translation differences when using constant currency because it allows us to assess balance sheet and income statement performance on a like-for-like basis to better understand the underlying trends in the business.

Foreign currency translation differences

Foreign currency translation differences for 2013 are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

- the income statements for 2013 at the average rates of exchange for 2014; and
- the balance sheet at 31 December 2013 at the prevailing rates of exchange on 31 December 2014.

Foreign currency translation differences for 2012 referred to in the 2013 commentaries are computed on the same basis, by applying average rates of exchange for 2013 to the 2012 income and rates of exchange on 31 December 2013 to the balance sheet at 31 December 2012.

No adjustment has been made to the exchange rates used to translate foreign currency denominated assets and liabilities into the functional currencies of any HSBC branches, subsidiaries, joint ventures or associates. When reference is made to foreign currency translation differences in tables or commentaries, comparative data reported in the functional currencies of HSBC s operations have been translated at the appropriate exchange rates applied in the current year on the basis described above.

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Report of the Directors: Financial Review (continued)

Other significant items

The following tables detail the effect of other significant items in 2014 and 2013 on each of our geographical segments and global businesses.

Other significant items affecting adjusted performance Losses/(gains)

	2014					
	Europe US$m	Asia US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Revenue						
Debit valuation adjustment on derivative contracts	234	69	5	16	8	332
Fair value movements on non-qualifying hedges[3]	235	4		302		541
Gain on sale of several tranches of real estate secured accounts in the US				(168)		(168)
Gain on sale of shareholding in Bank of Shanghai		(428)				(428)
Impairment of our investment in Industrial Bank		271				271
Provisions arising from the ongoing review of compliance with the Consumer Credit Act in the UK	632					632
	1,101	(84)	5	150	8	1,180
Operating expenses						
Charge in relation to the settlement agreement with Federal Housing Finance Authority				550		550
Settlements and provisions in connection with foreign exchange investigations	1,187					1,187
Restructuring and other related costs	123	9	2	28	116	278

Regulatory provisions in GPB	**16**	**49**				**65**
UK customer redress programmes	**1,275**					**1,275**
	2,601	**58**	**2**	**578**	**116**	**3,355**

	RBWM US$m	CMB US$m	GB&M US$m	GPB US$m	Other US$m	Total US$m
Revenue						
Debit valuation adjustment on derivative contracts			**332**			**332**
Fair value movements on non-qualifying hedges[3]	**493**	**(1)**	**8**	**1**	**40**	**541**
Gain on sale of several tranches of real estate secured accounts in the US	**(168)**					**(168)**
Gain on sale of shareholding in Bank of Shanghai					**(428)**	**(428)**
Impairment of our investment in Industrial Bank					**271**	**271**
Provisions arising from the ongoing review of compliance with the Consumer Credit Act in the UK	**568**	**24**		**40**		**632**
	893	**23**	**340**	**41**	**(117)**	**1,180**
Operating expenses						
Charge in relation to the settlement agreement with Federal Housing Finance Authority	**17**		**533**			**550**
Settlements and provisions in connection with foreign exchange investigations			**1,187**			**1,187**
Restructuring and other related costs	**88**	**37**	**27**	**6**	**120**	**278**
Regulatory provisions in GPB				**65**		**65**
UK customer redress programmes	**992**	**138**	**145**			**1,275**
	1,097	**175**	**1,892**	**71**	**120**	**3,355**

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Report of the Directors: Financial Review (continued)

	2013					
	Europe US$m	Asia US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Revenue						
Net gain on completion of Ping An disposal		(553)				(553)
Debit valuation adjustment on derivative contracts	(65)	(40)	(2)	14	(13)	(106)
Fair value movements on non-qualifying hedges[3]	(297)	32		(246)		(511)
FX gains relating to sterling debt issued by HSBC Holdings	(442)					(442)
Write-off of allocated goodwill relating to the GPB Monaco business	279					279
Loss on sale of several tranches of real estate secured accounts in the US				123		123
Loss on sale of non-real estate secured accounts in the US				271		271
Loss on early termination of cash flow hedges in the US run-off portfolio				199		199
Loss on sale of an HFC Bank UK secured loan portfolio	146					146
	(379)	(561)	(2)	361	(13)	(594)
Operating expenses						
Restructuring and other related costs	217	86	4	101	75	483
UK customer redress programmes	1,235					1,235
Madoff-related litigation	298					298

costs						
Regulatory provisions in GPB	317	35				352
US customer remediation provisions relating to CRS				100		100
Accounting gain arising from change in basis of delivering ill-health benefits in the UK	(430)					(430)
	1,637	121	4	201	75	2,038

	RBWM US$m	CMB US$m	GB&M US$m	GPB US$m	Other US$m	Total US$m
Revenue						
Net gain on completion of Ping An disposal					(553)	(553)
Debit valuation adjustment on derivative contracts			(106)			(106)
Fair value movements on non-qualifying hedges[3]	(262)		18		(267)	(511)
FX gains relating to sterling debt issued by HSBC Holdings					(442)	(442)
Write-off of allocated goodwill relating to the GPB Monaco business				279		279
Loss on sale of several tranches of real estate secured accounts in the US	123					123
Loss on sale of non-real estate secured accounts in the US	271					271
Loss on early termination of cash flow hedges in the US run-off portfolio	199					199
Loss on sale of an HFC Bank UK secured loan portfolio	146					146
	477		(88)	279	(1,262)	(594)
Operating expenses						
Restructuring and other related costs	167	31	13	73	199	483
UK customer redress programmes	953	148	134			1,235
			298			298

Madoff-related litigation costs						
Regulatory provisions in GPB				352		352
US customer remediation provisions relating to CRS	100					100
Accounting gain arising from change in basis of delivering ill-health benefits in the UK	(189)	(160)	(81)			(430)
	1,031	19	364	425	199	2,038

For footnote, see page 109

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Report of the Directors: Financial Review (continued)

The following table reconciles selected reported items for 2014 and 2013 to adjusted items. Equivalent tables are provided for each of our global businesses and geographical segments on www.hsbc.com.

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[5] %
Revenue[4]			
Reported	**61,248**	64,645	(5)
Currency translation adjustment[6]		(686)	
Own credit spread[7]	**(417)**	1,246	
Acquisitions, disposals and dilutions	**(9)**	(2,757)	
Other significant items	**1,180**	(594)	
Adjusted	**62,002**	61,854	
Loan impairment charges and other credit risk provisions			
Reported	**(3,851)**	(5,849)	34
Currency translation adjustment[6]		168	
Acquisitions, disposals and dilutions		67	
Other significant items			
Adjusted	**(3,851)**	(5,614)	31
Total operating expenses			
Reported	**(41,249)**	(38,556)	(7)
Currency translation adjustment[6]		348	
Acquisitions, disposals and dilutions	**40**	488	
Other significant items	**3,355**	2,038	
Adjusted	**(37,854)**	(35,682)	(6)
Adjusted cost efficiency ratio	**61.1%**	57.7%	
Share of profit in associates and joint ventures			
Reported	**2,532**	2,325	9
Currency translation adjustment[6]		11	
Acquisitions, disposals and dilutions		87	
Other significant items			
Adjusted	**2,532**	2,423	4

Profit before tax			
Reported	**18,680**	22,565	(17)
Currency translation adjustment[6]		(159)	
Own credit spread[7]	**(417)**	1,246	
Acquisitions, disposals and dilutions	**31**	(2,115)	
Other significant items	**4,535**	1,444	
Adjusted	**22,829**	22,981	(1)

For footnotes, see page 109.

Adjusted profit before tax

	2014 US$m	2013 US$m	Change[5] %
By global business			
Retail Banking and Wealth Management	**7,648**	7,959	(4)
Commercial Banking	**8,940**	7,910	13
Global Banking and Markets	**8,114**	9,208	(12)
Global Private Banking	**738**	900	(18)
Other	**(2,611)**	(2,996)	13
Year ended 31 December	**22,829**	22,981	(1)
By geographical region			
Europe	**3,905**	4,301	(9)
Asia[8]	**14,635**	14,309	2
Middle East and North Africa	**1,854**	1,673	11
North America	**2,111**	2,048	3
Latin America	**324**	650	(50)
Year ended 31 December	**22,829**	22,981	(1)

For footnotes, see page 109.

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Report of the Directors: Financial Review (continued)

Return on Equity and Return on Tangible Equity

ROTE is computed by adjusting reported results for the movements in the present value of in-force long-term insurance business (PVIF), impairments of goodwill, and adjusting the reported equity for goodwill, intangibles and PVIF. The adjustment to reported results and reported equity excludes amounts

attributable to non-controlling interests.

We provide ROTE as an additional measure to ROE to provide a way to look at our performance which is closely aligned to our capital position.

The following table details the adjustments made to the reported results and equity:

	2014 US$m	2013 US$m	2012 US$m
Profit			
Profit attributable to the ordinary shareholders of the parent company	**13,115**	15,631	13,454
Goodwill impairment (net of tax)		279	
Increase in PVIF (net of tax)	**(213)**	(397)	(537)
Profit attributable to the ordinary shareholders, excl. goodwill impairment and PVIF	**12,901**	15,513	12,917
Equity			
Average ordinary shareholders equity	**178,898**	169,260	159,564
Effect of Goodwill and intangibles (net of deferred tax)	**(23,423)**	(24,042)	(24,859)
Effect of PVIF (net of deferred tax)	**(4,317)**	(3,982)	(3,557)
Average tangible equity	**151,158**	141,236	131,148
	%	%	%
Ratio			
Return on equity	**7.3**	9.2	8.4
Return on tangible equity	**8.5**	11.0	9.8

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Report of the Directors: Financial Review (continued)

Consolidated income statement

Five-year summary consolidated income statement

	2014 US$m	2013 US$m	2012 US$m	2011 US$m	2010 US$m
Net interest income	**34,705**	35,539	37,672	40,662	39,441
Net fee income	**15,957**	16,434	16,430	17,160	17,355
Net trading income	**6,760**	8,690	7,091	6,506	7,210
Net income/(expense) from financial instruments designated at fair value	**2,473**	768	(2,226)	3,439	1,220
Gains less losses from financial investments	**1,335**	2,012	1,189	907	968
Dividend income	**311**	322	221	149	112
Net insurance premium income	**11,921**	11,940	13,044	12,872	11,146
Gains on disposal of US branch network, US cards business and Ping An Insurance (Group) Company of China, Ltd			7,024		
Other operating income	**1,131**	2,632	2,100	1,766	2,562
Total operating income	**74,593**	78,337	82,545	83,461	80,014
Net insurance claims and benefits paid and movement in liabilities to policyholders	**(13,345)**	(13,692)	(14,215)	(11,181)	(11,767)
Net operating income before loan impairment charges and other credit risk provisions	**61,248**	64,645	68,330	72,280	68,247
Loan impairment charges and other credit risk provisions	**(3,851)**	(5,849)	(8,311)	(12,127)	(14,039)
Net operating income	**57,397**	58,796	60,019	60,153	54,208
Total operating expenses	**(41,249)**	(38,556)	(42,927)	(41,545)	(37,688)
Operating profit	**16,148**	20,240	17,092	18,608	16,520
Share of profit in associates and joint ventures	**2,532**	2,325	3,557	3,264	2,517
Profit before tax	**18,680**	22,565	20,649	21,872	19,037
Tax expense	**(3,975)**	(4,765)	(5,315)	(3,928)	(4,846)
Profit for the year	**14,705**	17,800	15,334	17,944	14,191
Profit attributable to shareholders of the parent company	**13,688**	16,204	14,027	16,797	13,159
Profit attributable to non-controlling interests	**1,017**	1,596	1,307	1,147	1,032

Five-year financial information

	2014	2013	2012	2011	2010
	US$	US$	US$	US$	US$
Basic earnings per share	**0.69**	0.84	0.74	0.92	0.73
Diluted earnings per share	**0.69**	0.84	0.74	0.91	0.72
Dividends per ordinary share[9]	**0.49**	0.48	0.41	0.39	0.34
	%	%	%	%	%
Dividend payout ratio[10]	**71.0**	57.1	55.4	42.4	46.6
Post-tax return on average total assets	**0.5**	0.7	0.6	0.6	0.6
Return on average ordinary shareholders equity	**7.3**	9.2	8.4	10.9	9.5
Average foreign exchange translation rates to US$:					
US$1: £	**0.607**	0.639	0.631	0.624	0.648
US$1:	**0.754**	0.753	0.778	0.719	0.755

For footnotes, see page 109.

Unless stated otherwise, all tables in the Annual Report and Accounts 2014 are presented on a reported basis.

For a summary of our financial performance in 2014, see page 28.

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Group performance by income and expense item

Net interest income

	2014	2013	2012
	US$m	US$m	US$m
Interest income	**50,955**	51,192	56,702
Interest expense	**(16,250)**	(15,653)	(19,030)
Net interest income[11]	**34,705**	35,539	37,672
Average interest-earning assets	**1,786,536**	1,669,368	1,625,068
Gross interest yield[12]	**2.85%**	3.07%	3.49%
Less: cost of funds	**(1.05%)**	(1.10%)	(1.36%)
Net interest spread[13]	**1.80%**	1.97%	2.13%
Net interest margin[14]	**1.94%**	2.13%	2.32%

For footnotes, see page 109.

Summary of interest income by type of asset

	2014			2013			2012		
	Average balance	**Interest income**	**Yield**	Average balance	Interest income	Yield	Average balance	Interest income	Yield
	US$m	**US$m**	**%**	US$m	US$m	%	US$m	US$m	%
Short-term funds and loans and advances to banks[27]	**237,148**	**3,068**	**1.29**	236,377	2,851	1.21	235,831	3,505	1.49
Loans and advances to customers[27]	**931,311**	**37,429**	**4.02**	897,322	38,529	4.29	891,699	40,870	4.58
Reverse repurchase agreements non-trading[26,27]	**198,273**	**1,800**	**0.91**	114,324	995	0.87	83,105	975	1.17
Financial investments	**399,816**	**8,323**	**2.08**	393,309	8,002	2.03	387,329	9,078	2.34
	19,988	**335**	**1.68**	28,036	815	2.91	27,104	2,274	8.39

	2014 Average balance US$m	2014 Interest income US$m	2014 Yield %	2013 Average balance US$m	2013 Interest income US$m	2013 Yield %	2012 Average balance US$m	2012 Interest income US$m	2012 Yield %
Other interest-earning assets									
Total interest-earning assets	**1,786,536**	**50,955**	**2.85**	1,669,368	51,192	3.07	1,625,068	56,702	3.49
Trading assets and financial assets designated at fair value[15,16,26]	**238,958**	**5,596**	**2.34**	354,817	5,763	1.62	368,406	6,931	1.88
Impairment provisions	**(14,015)**			(15,954)			(17,421)		
Non-interest-earning assets	**668,564**			683,785			730,901		
Year ended 31 December	**2,680,043**	**56,551**	**2.11**	2,692,016	56,955	2.12	2,706,954	63,633	2.35

For footnotes, see page 109.

Summary of interest expense by type of liability and equity

	2014 Average balance US$m	**2014** Interest expense US$m	**2014** Cost %	2013 Average balance US$m	2013 Interest expense US$m	2013 Cost %	2012 Average balance US$m	2012 Interest expense US$m	2012 Cost %
Deposits by banks[17,27]	**61,217**	**481**	**0.79**	61,616	555	0.90	78,023	1,001	1.28
Financial liabilities designated at fair value own debt issued[18]	**66,374**	**837**	**1.26**	72,333	967	1.34	75,016	1,325	1.77
Customer accounts[19,27]	**1,088,493**	**9,131**	**0.84**	1,035,500	8,794	0.85	1,012,056	10,650	1.05
Repurchase agreements non-trading[26,27]	**190,705**	**652**	**0.34**	94,410	405	0.43	55,536	387	0.70
Debt securities in issue	**129,724**	**4,554**	**3.51**	150,976	4,182	2.77	161,348	4,755	2.95
Other interest-bearing liabilities	**10,120**	**595**	**5.88**	11,345	750	6.61	19,275	912	4.73
Total interest-bearing	**1,546,633**	**16,250**	**1.05**	1,426,180	15,653	1.10	1,401,254	19,030	1.36

liabilities									
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued)[26]	**178,518**	**2,856**	**1.60**	301,353	3,027	1.00	318,883	3,445	1.08
Non-interest bearing current accounts	**185,990**			184,370			177,085		
Total equity and other non-interest bearing liabilities	**768,902**			780,113			809,732		
Year ended 31 December	**2,680,043**	**19,106**	**0.71**	2,692,016	18,680	0.69	2,706,954	22,475	0.83

For footnotes, see page 109.

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Report of the Directors: Financial Review (continued)

Reported net interest income of US$35bn decreased by US$834m or 2% compared with 2013. This included the significant items and currency translation summarised in the table below.

Significant items and currency translation

	2014	2013
	US$m	US$m
Significant items		
Provisions arising from the ongoing review of compliance with the Consumer Credit Act in the UK	**(632)**	
Acquisitions, disposals and dilutions	**38**	386
	(594)	386
Currency translation		518
Year ended 31 December	**(594)**	904

On a reported basis, net interest spread and margin both fell, reflecting lower yields on customer lending in North America and Europe. In North America, this was due to changes in the composition of the lending portfolios towards lower yielding secured assets and to the run-off of the CML portfolio. In Europe, it was principally due to a significant item, namely provisions arising from the ongoing review of compliance with the Consumer Credit Act (CCA) in the UK. These factors were partially offset by a lower cost of funds.

Excluding the significant items and currency translation tabulated above, net interest income rose by US$664m or 2% from 2013, driven by increases in Asia, partly reflecting growth in customer lending volumes.

Interest income

Reported interest income was broadly unchanged, as decreases in interest income from customer lending (which included the effect of the CCA provisions) were offset by increases in income from short-term funds, as well as a rise due to the change in the management of reverse repo transactions (see page 48).

Interest income on loans and advances to customers decreased, principally in North America and Latin America, partially offset by increases in Asia. In North America, this was a consequence of the disposal of the higher yielding non-real estate loan portfolio and the reduction in the CML portfolio from run-off and sales. In addition, new lending to customers in RBWM and CMB was at lower yields, reflecting a shift in the portfolio towards higher levels of lower yielding first lien real estate secured loans. In Latin America, interest income on customer lending also decreased, reflecting a fall in yields in both Brazil and Mexico, despite the rise in average balances in term lending in both countries. In Brazil, the falling yield reflected the shift in product and client mix to more secured, relationship-led lending while, in Mexico, it was driven by reductions in Central Bank interest rates. The region was also affected by the disposal of non-strategic businesses.

By contrast, we recorded increased interest income on customer lending in Asia, driven by growth in term lending volumes and, to a lesser extent, residential mortgages during the year. This increase in balances

was partially offset by compressed yields. In Europe, excluding the effect of the CCA provisions noted above, interest income on customer lending rose due to increases in mortgage and term lending balances.

Interest income on short-term funds and financial investments increased both in Latin America and Asia, as interest rates rose in certain countries in these regions (notably in Brazil, Argentina and mainland China) and average balances grew. However, in Europe, interest income on short-term funds and financial investments fell as maturing positions were replaced by longer-term but lower-yielding bonds.

Interest expense

Reported interest expense increased in the year. We recorded increased interest expense on customer accounts in Asia and Latin America, partly offset by a reduction in North America. In Asia, the growth was principally from an increase in the average balances of customer accounts. In Latin America, interest expense on customer accounts rose as reductions in average balances were more than offset by the increase in the cost of funds due to interest rate rises, notably in Brazil. However, the effects of this were partly offset by a fall in the cost of funds in Mexico as Central Bank rates fell, and the disposal of non-strategic businesses. Conversely, in North America, interest expense on customer deposits declined as a result of a strategic decision to re-price deposits downwards. In addition, other interest expense decreased due to a release of accrued interest associated with an uncertain tax position.

Interest expense on debt issued rose. We recorded an increase in the cost of funds which was partly offset by decreased overall balances. Interest expense rose in Latin America, notably in Brazil, in line with interest rate rises and increased medium-term loan note balances. By contrast, in North America the business disposals led to a decline in our funding requirements. The cost of funds also fell as higher coupon debt matured and was repaid. In Europe, interest expense on debt also decreased, as average outstanding balances fell as a result of net redemptions and the cost of funds reduced.

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Report of the Directors: Financial Review (continued)

Repos and reverse repos

During the final quarter of 2013, GB&M changed the way it managed reverse repurchase (reverse repo) and repurchase (repo) activities. This had the effect of reducing the net interest margin as average interest earning assets and interest bearing liabilities increased significantly. These reverse repo and repo agreements have a lower gross yield and cost of funds, respectively, than the remainder of our portfolio.

Net interest income includes the expense of internally funded trading assets, while related revenue is reported in Net trading income . The internal cost of funding these assets decreased, as average trading asset balances fell to a greater extent than trading liabilities. In reporting our global business results, this cost is included within Net trading income .

Net fee income

	2014	2013	2012
	US$m	US$m	US$m
Account services	**3,407**	3,581	3,563
Funds under management	**2,658**	2,673	2,561
Cards	**2,460**	2,455	3,030
Credit facilities	**1,890**	1,907	1,761
Broking income	**1,371**	1,388	1,350
Imports/exports	**1,115**	1,157	1,196
Unit trusts	**1,005**	891	739
Underwriting	**872**	866	739
Remittances	**833**	849	819
Global custody	**726**	698	737
Insurance	**516**	551	696
Other	**2,692**	2,957	2,958
Fee income	**19,545**	19,973	20,149
Less: fee expense	**(3,588)**	(3,539)	(3,719)
Year ended 31 December	**15,957**	16,434	16,430

Reported net fee income fell by US$477m, primarily in Latin America and North America. In Latin America, the decrease included the effect of currency translation and the continued repositioning and disposal of businesses, notably the sale of our Panama operations in 2013. In North America, net fee income was lower following the expiry of the Transition Servicing Agreements we entered into with the buyer of the Card and Retail Services (CRS) business, and adverse adjustments to mortgage servicing rights valuations.

Account services fee income decreased, notably in Latin America and Europe. In Latin America, the fall was due to a reduction in customer numbers in Mexico, as we continued to reposition the business, and in Brazil, due to strong market competition. In Europe, account services fees were lower, primarily in Switzerland due

to the repositioning of our GPB business, and in the UK, in part reflecting the implementation of the Retail Distribution Review in 2013.

By contrast, unit trust fees rose, primarily in Asia, due to increased sales of equity funds in Hong Kong.

Other fee income declined in North America due to the expiry of the Transition Servicing Agreements and in Latin America following the sale of our operations in Panama in 2013 and the continued repositioning of the business in Mexico.

In addition, fee expenses were higher due to adverse adjustments to mortgage servicing rights valuations in North America, reflecting mortgage interest rate decreases in 2014 which compared with increases in 2013.

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Net trading income

	2014	2013	2012
	US$m	US$m	US$m
Trading activities[20]	**5,419**	6,921	5,249
Ping An contingent forward sale contract		(682)	(553)
Net interest income on trading activities	**1,907**	2,047	2,683
Gain/(loss) on termination of hedges	**1**	(194)	
Other trading income hedge ineffectiveness:			
on cash flow hedges	**34**	22	35
on fair value hedges	**19**	65	(27)
Fair value movement on non-qualifying hedges[21]	**(620)**	511	(296)
Year ended 31 December	**6,760**	8,690	7,091

For footnotes, see page 109.

Reported net trading income of US$6.8bn was US$1.9bn lower, predominantly in Europe. The reduction in net trading income was partly driven by the significant items summarised in the table below.

Significant items and currency translation

	2014	2013
	US$m	US$m
Significant items		
Included within trading activities:	**(332)**	548
Debit valuation adjustment on derivative contracts	**(332)**	106
FX gains relating to sterling debt issued by HSBC Holdings		442
Included in other net trading income:	**(539)**	(346)
Ping An contingent forward sale contract[22]		(682)
Loss on early termination of cash flow hedges in the US run-off portfolio		(199)

Fair value movement on non-qualifying hedges	**(541)**	511
Acquisitions, disposals and dilutions	**2**	24
	(871)	202
Currency translation		(11)
Year ended 31 December	**(871)**	191

For footnote, see page 109.

Excluding the significant items and currency translation tabulated above, net trading income from trading activities decreased by US$0.6bn, notably in Markets within GB&M. This was predominantly driven by our Foreign Exchange business, which was affected by lower volatility and reduced client flows. In Equities, revenue decreased, as 2013 benefited from higher revaluation gains which more than offset a rise in 2014 in revenue from increased client flows and higher derivatives income.

In 2014, we revised our estimation methodology for valuing uncollateralised derivative portfolios by introducing the funding fair value adjustment (FFVA), resulting in a reduction in net trading income of US$263m, primarily in Rates (US$164m) and Credit (US$97m). Excluding the FFVA, Credit was also affected by adverse movements on credit spreads and a reduction in revenue in Legacy Credit. By contrast, Rates was affected by favourable market movements, notably in

Asia, along with minimal fair value movements on our own credit spread on structured liabilities compared with adverse movements in 2013. These factors were partly offset by a fall in Rates in Europe.

Included within net trading income from trading activities, there were favourable foreign exchange movements on assets held as economic hedges of foreign currency debt designated at fair value, compared with adverse movements in 2013. These movements offset fair value movements on the foreign currency debt which are reported in Net income/(expense) from financial instruments designated at fair value .

In addition, net interest income from trading activities fell due to lower average balances, notably relating to reverse repo and repo agreements, in line with the change in the way GB&M manages these agreements. The net interest income from these activities is now recorded in Net interest income .

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Net income/(expense) from financial instruments designated at fair value

	2014 US$m	2013 US$m	2012 US$m
Net income/(expense) arising from:			
financial assets held to meet liabilities under insurance and investment contracts	**2,300**	3,170	2,980
liabilities to customers under investment contracts	**(435)**	(1,237)	(996)
HSBC s long-term debt issued and related derivatives	**508**	(1,228)	(4,327)
change in own credit spread on long-term debt (significant item)	**417**	(1,246)	(5,215)
other changes in fair value[22]	**91**	18	888
other instruments designated at fair value and related derivatives	**100**	63	117
Year ended 31 December	**2,473**	768	(2,226)

For footnote, see page 109.

Assets and liabilities from which net income/(expense) from financial instruments designated at fair value arose

	2014 US$m	2013 US$m	2012 US$m
Financial assets designated at fair value at 31 December	**29,037**	38,430	33,582
Financial liabilities designated at fair value at 31 December	**76,153**	89,084	87,720
Including:			
Financial assets held to meet liabilities under:			
insurance contracts and investment contracts with DPF	**10,650**	10,717	8,376
unit-linked insurance and other insurance and investment contracts	**16,333**	25,423	23,655
Long-term debt issues designated at fair value	**69,681**	75,278	74,768

The accounting policies for the designation of financial instruments at fair value and the treatment of the associated income and expenses are described in Note 2 on the Financial Statements.

The majority of the financial liabilities designated at fair value are fixed-rate long-term debt issues, the interest rate profile of which has been changed to floating through swaps as part of a documented interest rate management strategy. The movement in fair value of these long-term debt issues and the related hedges includes the effect of our credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. The size and direction of the changes in the credit spread on our debt and ineffectiveness, which are recognised in the income statement, can be volatile from year to year, but do not alter the cash flows expected as part of the documented interest rate management strategy. As a consequence, fair value movements arising from changes in our own credit spread on long-term debt and other fair value movements on the debt and related derivatives are not regarded internally as part of managed performance and are therefore not allocated to global businesses, but are reported in Other . Credit spread movements on own debt designated at fair value are excluded from adjusted results, and related fair value movements are not included in the calculation of regulatory capital.

Reported net income from financial instruments designated at fair value was US$2.5bn in 2014, compared with US$768m in 2013. The former included favourable movements in the fair value of our own long-term debt of US$417m due to changes in credit spread, compared with adverse movements of US$1.2bn in 2013. Excluding

this significant item, net income from financial instruments designated at fair value increased by US$42m.

Net income arising from financial assets held to meet liabilities under insurance and investment contracts of US$2.3bn was US$870m lower than in 2013. This was driven by weaker equity market performance in the UK and France, partly offset by improved equity market performance in Hong Kong and higher net income on the bonds portfolio in Brazil.

Investment gains or losses arising from equity markets result in a corresponding movement in liabilities to customers, reflecting the extent to which unit-linked policyholders, in particular, participate in the investment performance of the associated asset portfolio. Where these relate to assets held to back investment contracts, the corresponding movement in liabilities to customers is also recorded under Net income/(expense) from financial instruments designated at fair value . This is in contrast to gains or losses related to assets held to back insurance contracts or investment contracts with discretionary participation features (DPF), where the corresponding movement in liabilities to customers is recorded under Net insurance claims and benefits paid and movement in liabilities to policyholders .

Other changes in fair value reflected a net favourable movement due to interest and exchange rate hedging ineffectiveness. This was partly offset by net adverse foreign exchange movements on foreign currency debt designated at fair value and issued as part of our overall funding strategy (offset from assets held as economic hedges in Net trading income).

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Gains less losses from financial investments

	2014 US$m	2013 US$m	2012 US$m
Net gains/(losses) from disposal of:			
debt securities	**665**	491	781
equity securities	**1,037**	1,697	823
other financial investments	**6**	(1)	5
	1,708	2,187	1,609
Impairment of available-for-sale equity securities	**(373)**	(175)	(420)
Year ended 31 December	**1,335**	2,012	1,189

Reported gains less losses from financial investments were US$1.3bn, a decrease of US$677m from 2013. The decrease

primarily reflected the significant items summarised below.

Significant items and currency translation

	2014 US$m	2013 US$m
Significant items		
Gain on sale of shareholding in Bank of Shanghai	**428**	
Impairment on our investment in Industrial Bank	**(271)**	
Net gain on completion of Ping An disposal[22]		1,235
Acquisitions, disposals and dilutions		5
	157	1,240
Currency translation		(10)
Year ended 31 December	**157**	1,230

For footnote, see page 109.

Excluding the significant items and currency translation noted above, gains less losses from financial investments increased by US$396m, primarily driven by higher net gains on the disposal of debt securities as we actively managed the Legacy Credit portfolio. In addition, we

reported higher gains on sale of available-for-sale equity securities and lower impairments on available-for-sale equity securities from improved market conditions and business performance of the underlying portfolio.

Net insurance premium income

	2014	2013	2012
	US$m	US$m	US$m
Gross insurance premium income	**12,370**	12,398	13,602
Reinsurance premiums	**(449)**	(458)	(558)
Year ended 31 December	**11,921**	11,940	13,044

Reported net insurance premium income was broadly unchanged, with reductions in Europe and Latin America largely offset by higher premium income in Asia.

In Asia, premium income rose, primarily in Hong Kong, due to increased new business from deferred annuity, universal life and endowment contracts. This was partly offset by lower new business from unit-linked contracts.

In Europe, premium income decreased, mainly in the UK, reflecting lower sales following the withdrawal of

external independent financial adviser distribution channels for certain linked insurance contracts in the second half of 2013. This was partly offset by increases in France, mainly reflecting higher sales of investment contracts with DPF.

Net insurance premium income also fell in Latin America, primarily in Brazil, reflecting lower sales, in part due to changes in our distribution channel.

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Other operating income

	2014 US$m	2013 US$m	2012 US$m
Rent received	**162**	155	210
Gains/(losses) recognised on assets held for sale	**220**	(729)	485
Gains on investment properties	**120**	113	72
Gain on disposal of property, plant and equipment, intangible assets and non-financial investments	**32**	178	187
Gains/(losses) arising from dilution of interest in Industrial Bank and other associates and joint ventures	**(32)**	1,051	
Gain on disposal of HSBC Bank (Panama) S.A.		1,107	
Change in present value of in-force long-term insurance business	**261**	525	737
Other	**368**	232	409
Year ended 31 December	**1,131**	2,632	2,100

Change in present value of in-force long-term insurance business

	2014 US$m	2013 US$m	2012 US$m
Value of new business	**870**	924	1,027
Expected return	**(545)**	(505)	(420)
Assumption changes and experience variances	**(116)**	88	69
Other adjustments	**52**	18	61
Year ended 31 December	**261**	525	737

Reported other operating income of US$1.1bn decreased by US$1.5bn from 2013. This was largely due to the significant items summarised in the table below.

Significant items and currency translation

	2014 US$m	2013 US$m
Significant items		
Included within gains/(losses) recognised on assets held for sale:	**168**	(772)
write-off of allocated goodwill relating to the GPB Monaco business		(279)
gain/(loss) on sale of the non-real estate portfolio in the US		(271)
gain/(loss) on sale of several tranches of real estate secured accounts in the US	**168**	(123)
Household Insurance Group Holding company s disposal of its insurance manufacturing business[2]		(99)
Included within the remaining line items:	**(41)**	2,193
reclassification gain in respect of our holding in Industrial Bank Co., Limited following the issue of additional share capital to third parties[2]		1,089
HSBC Latin America Holdings UK Limited s disposal of HSBC Bank (Panama) S.A.[3]		1,107
HSBC Insurance (Asia-Pacific) Holdings Limited s disposal of its shareholding in Bao Viet Holdings[2]		104
loss on sale of an HFC Bank UK secured loan portfolio		(146)
acquisitions, disposals and dilutions	**(41)**	39
Currency translation		(18)
Year ended 31 December	**127**	1,403

Excluding the significant items and currency translation tabulated above, other operating income decreased by US$0.2bn compared with 2013. This was primarily from lower favourable movements in 2014 in present value of in-force (PVIF) long-term insurance business, and lower disposal and revaluation gains on investment properties, mainly in Hong Kong. The decrease was partly offset by gains reported in Legacy Credit in GB&M in the UK as we actively managed the portfolio.

Lower favourable movements in the PVIF long-term insurance business asset in 2014 were mainly due to the following factors:

- a reduction in the value of new business, mainly in Brazil, due to higher interest rates and lower volumes; and

- adverse assumption changes and experience variances in 2014 compared with favourable movements in 2013. This was mainly driven by falling interest rates in France and adverse actuarial assumption updates in Hong Kong, partly offset by the favourable effects of interest rate fluctuations, mainly in Asia and Brazil.

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Net insurance claims and benefits paid and movement in liabilities to policyholders

	2014 US$m	2013 US$m	2012 US$m
Net insurance claims and benefits paid and movement in liabilities to policyholders:			
gross	**13,723**	13,948	14,529
less reinsurers share	**(378)**	(256)	(314)
Year ended 31 December[24]	**13,345**	13,692	14,215

For footnote, see page 109.

Reported net insurance claims and benefits paid and movement in liabilities to policyholders were US$347m lower than in 2013.

Movements in claims resulting from investment returns on the assets held to support policyholder contracts, where the policyholder bears investment risk, decreased. This reflected weaker equity market performance in the UK and France, partly offset by improved equity market performance in Hong Kong and higher net income on the

bonds portfolio in Brazil. The gains or losses recognised on the financial assets designated at fair value held to support these insurance and investment contract liabilities are reported in Net income from financial instruments designated at fair value .

Reductions in claims resulting from a decrease in new business written in Europe and Latin America were mostly offset by increases in Hong Kong as explained under Net earned insurance premiums .

Loan impairment charges and other credit risk provisions

	2014 US$m	2013 US$m	2012 US$m
Loan impairment charges:			
new allowances net of allowance releases	**5,010**	7,344	9,306
recoveries of amounts previously written off	**(955)**	(1,296)	(1,146)

	4,055	6,048	8,160
Individually assessed allowances	**1,780**	2,320	2,139
Collectively assessed allowances	**2,275**	3,728	6,021
Impairment/(releases of impairment) on available-for-sale debt securities	**(319)**	(211)	99
Other credit risk provisions	**115**	12	52
Year ended 31 December	**3,851**	5,849	8,311
Impairment charges on loans and advances to customers as a percentage of average gross loans and advances to customers[27]	**0.4%**	0.7%	0.9%

For footnote, see page 109.

Reported loan impairment charges and other credit risk provisions (LICs) of US$3.9bn were US$2.0bn lower than in 2013, primarily in North America, Europe and Latin America. The percentage of impairment charges to average gross loans and advances fell to 0.4% at 31 December 2014 from 0.7% at 31 December 2013.

Individually assessed charges decreased by US$540m, primarily in Europe, partly offset by an increase in Asia and the Middle East and North Africa. In Europe, they were lower, mainly in CMB in the UK, reflecting improved quality in the portfolio and the economic environment, as well as in GB&M. In Asia, the increase was on a small number of exposures in Hong Kong and in mainland China, primarily in CMB and GB&M, while in the Middle East and North Africa we recorded net charges compared with net releases in 2013, mainly due to lower releases on a particular UAE-related exposure in GB&M.

Collectively assessed charges declined by US$1.5bn, primarily due to decreases in North America and Latin America. In North America, the reduction was mainly in RBWM, reflecting reduced levels of delinquency and new impaired loans in the CML portfolio. A decrease in

lending balances from continued portfolio run-off and loan sales was partly offset by an increase relating to less favourable market value adjustments of underlying properties as improvements in housing market conditions were less pronounced in 2014 than in 2013. In Latin America, the reduction in collectively assessed charges was driven by the adverse effect of changes to the impairment model and assumption revisions for restructured loan portfolios in Brazil which occurred in 2013, both in RBWM and CMB. Charges were also lower due to reduced Business Banking provisions reflecting improved delinquency rates and the effect of the disposal of non-strategic businesses.

Net releases of credit risk provisions of US$204m were broadly unchanged, as higher releases on available-for-sale ABSs in GB&M in Europe were offset by provisions in Latin America and North America. In Latin America, a provision was made in Brazil against a guarantee in GB&M. In North America we recorded provisions in Canada, compared with releases in 2013, and in the US reflecting a deterioration in the underlying asset values of a specific GB&M exposure.

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Operating expenses

	2014 US$m	2013 US$m	2012 US$m
By expense category			
Employee compensation and benefits	**20,366**	19,196	20,491
Premises and equipment (excluding depreciation and impairment)	**4,204**	4,183	4,326
General and administrative expenses	**14,361**	12,882	15,657
Administrative expenses	**38,931**	36,261	40,474
Depreciation and impairment of property, plant and equipment	**1,382**	1,364	1,484
Amortisation and impairment of intangible assets	**936**	931	969
Year ended 31 December	**41,249**	38,556	42,927

Staff numbers (full-time equivalents)

	2014	2013	2012
Geographical regions			
Europe	**69,363**	68,334	70,061
Asia[8]	**118,322**	113,701	112,766
Middle East and North Africa	**8,305**	8,618	8,765
North America	**20,412**	20,871	22,443
Latin America	**41,201**	42,542	46,556
At 31 December	**257,603**	254,066	260,591

For footnote, see page 109.

Reported operating expenses of US$41bn were US$2.7bn or 7% higher than in 2013. The increase in operating expenses was partly driven by the significant items noted in the table below, including settlements

and provisions in connection with foreign exchange investigations, of which US$809m was recorded in the fourth quarter of 2014 (see Note 40 on the Financial Statements for further details).

Significant items and currency translation

	2014 US$m	2013 US$m
Significant items		
Accounting gain arising from change in basis of delivering ill-health benefits in the UK		(430)
Charge in relation to settlement agreement with Federal Housing Finance Authority	**550**	
Madoff-related litigation costs		298
Settlements and provisions in connection with foreign exchange investigations	**1,187**	
Regulatory provisions in GPB	**65**	352
UK customer redress programmes	**1,275**	1,235
US customer remediation provision relating to CRS		100
Restructuring and other related costs	**278**	483
Acquisitions, disposals and dilutions	**40**	488
	3,395	2,526
Currency translation		348
Year ended 31 December	**3,395**	2,874

Excluding significant items and currency translation, operating expenses were US$2.2bn or 6% higher than in 2013.

Regulatory Programmes and Compliance costs increased as a result of the continued focus on Global Standards and the broader regulatory reform programme being implemented by the industry to build the necessary infrastructure to meet today s enhanced compliance standards, along with implementation costs to meet obligations such as stress tests in different jurisdictions and structural reform.

During 2014, we accelerated the deployment of Global Standards throughout the Group. Our global businesses and Compliance function have developed operating procedures to meet our new global AML and sanctions policies and these are now being implemented in every

country, encompassing local requirements as necessary. During 2014, we invested in developing our financial crime compliance expertise and building strategic infrastructure solutions for customer due diligence, transaction monitoring and sanctions screening.

We continued to invest in strategic initiatives in support of organically growing our business, primarily in CMB in both Asia, in Business Banking and Global Trade and Receivables Finance and, to a lesser extent, in Europe. We also increased expenditure on marketing and advertising to support revenue generating initiatives, primarily in RBWM s core propositions of Premier and Advance and personal lending products.

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The increase in costs also reflected:

- inflationary pressures, including wage inflation, primarily in Asia and Latin America;

- the UK bank levy charge, which increased to US$1.1bn in 2014 from US$904m in 2013, mainly due to an increase in the rate of the levy. Both years also included adjustments relating to the previous year s bank levy charge (2014: US$45m favourable adjustment; 2013: US$12m adverse adjustment); and

- the Financial Services Compensation Scheme levy in the UK, as a result of the timing of the recognition.

During 2014, we generated further sustainable savings of US$1.3bn, primarily driven by re-engineering our back office processes, which in part offset the investments and inflation noted above.

The average number of FTEs was broadly unchanged as reductions through sustainable savings programmes were broadly offset by the initiatives related to Regulatory Programmes and Compliance and business growth.

Reported cost efficiency ratios[25]

	2014	2013	2012
	%	%	%
HSBC	**67.3**	59.6	62.8
Geographical regions			
Europe	**93.7**	84.0	108.4
Asia[8]	**44.0**	40.7	39.4
Middle East and North Africa	**47.7**	51.5	48.0
North America	**78.9**	72.9	60.8
Latin America	**71.7**	56.1	58.7
Global businesses			
Retail Banking and Wealth Management	**71.2**	64.5	58.4
Commercial Banking	**45.9**	43.1	45.9
Global Banking and Markets	**67.7**	51.9	54.2
Global Private Banking	**74.8**	91.4	67.6

For footnotes, see page 109.

Share of profit in associates and joint ventures

	2014 US$m	2013 US$m	2012 US$m
Associates			
Bank of Communications Co., Limited	**1,974**	1,878	1,670
Ping An Insurance (Group) Company of China, Ltd			763
Industrial Bank Co., Limited			670
The Saudi British Bank	**455**	403	346
Other	**64**	5	72
Share of profit in associates	**2,493**	2,286	3,521
Share of profit in joint ventures	**39**	39	36
Year ended 31 December	**2,532**	2,325	3,557

HSBC s reported share of profit in associates and joint ventures was US$2.5bn, an increase of US$207m or 9%, in part due to the non-recurrence of an impairment charge of US$106m on our banking associate in Vietnam in 2013. Excluding this, our share of profit in associates and joint ventures increased, driven by higher contributions from BoCom and The Saudi British Bank.

Our share of profit from BoCom rose as a result of balance sheet growth and increased trading income, partly offset by higher operating expenses and a rise in loan impairment charges.

At 31 December 2014, we performed an impairment review of our investment in BoCom and concluded that it was not impaired, based on our value in use calculation

(see Note 20 on the Financial Statements for further details).

In future periods, the value in use may increase or decrease depending on the effect of changes to model inputs. It is expected that the carrying amount will increase in 2015 due to retained profits earned by BoCom. At the point where the carrying amount exceeds the value in use, HSBC would continue to recognise its share of BoCom s profit or loss, but the carrying amount would be reduced to equal the value in use, with a corresponding reduction in income, unless the market value has increased to a level above the carrying amount.

Profits from The Saudi British Bank rose, reflecting strong balance sheet growth.

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Tax expense

	2014 US$m	2013 US$m	2012 US$m
Profit before tax	**18,680**	22,565	20,649
Tax expense	**(3,975)**	(4,765)	(5,315)
Profit after tax for the year ended 31 December	**14,705**	17,800	15,334
Effective tax rate	**21.3%**	21.1%	25.7%

The effective tax rate for 2014 of 21.3% was lower than the blended UK corporation tax rate for the year of 21.5%.

The effective tax rate in the year reflected the following recurring benefits: tax exempt income from government bonds and equities held by a number of Group entities and recognition of the Group s share of post-tax profits of associates and joint ventures within our pre-tax income. In addition, the effective tax rate reflected a current tax credit for prior periods. This was partly offset by non-tax deductible settlements and provisions in connection with foreign exchange investigations.

The tax expense decreased by US$0.8bn to US$4.0bn for 2014, primarily due to a reduction in accounting profits and the benefit of the current tax credit for previous years.

In 2014, the tax borne and paid by the Group to the relevant tax authorities, including tax on profits, bank levy and employer-related taxes, was US$7.9bn (2013: US$8.6bn). The amount differs from the tax charge reported in the income statement due to indirect taxes such as VAT and the bank levy which are included in pre-tax profit, and the timing of payments.

We also play a major role as tax collector for governments in the jurisdictions in which we operate. Such taxes include employee-related taxes and taxes withheld from payments to deposit holders. In 2014, we collected US$9.1bn (2013: US$8.8bn).

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2013 compared with 2012

2013 compared with 2012 commentaries have not been updated to reflect our change from underlying performance to adjusted performance. For comparison, adjusted PBT would have been US$23.0bn and US$20.5bn for 2013 and 2012 respectively as compared with underlying PBT of US$21.6bn and US$15.3bn for 2013 and 2012 respectively. Constant currency, underlying and adjusted are reconciled on pages 105(b) to 105(au).

Consolidated income statement

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 (LICs) 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.

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.

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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 FTEs 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.

Group performance by income and expense item

Net interest income

The commentary in the following sections is on a constant currency basis unless stated otherwise.

Reported net interest income of US$35.5bn decreased by 6% compared with 2012 and on a constant currency basis, net interest income fell by US$1.5bn. Both net interest spread and margin also fell, reflecting lower yields on customer lending following the disposal in 2012 of the CRS business in the US, which was higher yielding relative to the average yield of our portfolio, and lower yields on our surplus liquidity. These factors were partially offset by a lower cost of funds, principally on customer accounts and debt issued by the Group.

On an underlying basis, which excludes the net interest income earned by the businesses sold during 2013 (see page 50) from both years (2013: US$273m; 2012: US$2.0bn) and currency translation movements of US$682m, net interest income increased by 1%. This reflected balance sheet growth in Hong Kong and Europe, partly offset by lower net interest income earned in North America as a result of the run-off and disposal of

CML portfolios in the US and the consumer finance business in Canada.

Interest income

On a constant currency basis, interest income fell. This was driven by lower interest income from customer lending, including loans classified within Assets held for sale , as a consequence of the disposal of the CRS business in the US in 2012 and the CML non-real estate loan portfolio and select tranches of CML first lien mortgages in the US in 2013. In addition, average yields on customer lending in Latin America fell, notably in Brazil, following lower average interest rates; re-pricing in line with local competition; a change in the composition of the lending portfolios as we focused on growing secured, lower yielding, lending balances for corporate and Premier customers. Interest income earned in Panama, where we disposed of the business, also fell. By contrast interest income on customer lending in Asia rose, driven by growth in residential mortgage balances in RBWM and term and trade-related and commercial real estate and other property-related lending in CMB. This increase in interest income was partially offset by compressed yields on trade lending and lower yields as interest rates declined in a number of countries across the region.

Interest income in Balance Sheet Management also decreased. Yields on financial investments and cash placed with banks and central banks declined as the proceeds from maturities and sales of available-for-sale debt securities were invested at prevailing rates, which were lower. This was partly offset by growth in customer deposits leading to an overall increase in the size of the Balance Sheet Management portfolio.

Interest expense

Interest expense fell in the year, though to a lesser extent than interest income, driven by a lower cost of funds relating to customer accounts. The reduction in interest rates paid to customers in Europe and Asia more than offset the effect of the growth in the average balances of customer accounts. There was also a decline in the interest expense on customer accounts in Latin America, principally in Brazil, reflecting the managed reduction in term deposits as we continued to change the funding base, substituting wholesale customer deposits for medium-term loan notes, together with a lower average base interest rate. The disposal of the business in Panama also reduced interest expense.

Interest expense on debt issued by the Group decreased too. In North America, as a result of the business disposals and the run-off of the CML portfolio, our funding requirements declined and led to a fall in average outstanding balances. In Europe, average outstanding balances fell as a result of net redemptions. Additionally, the effective rate of interest declined as new issuances were at lower prevailing rates.

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Repos and reverse repos

During the final quarter, GB&M changed the way it manages reverse repurchase (reverse repo) and repurchase (repo) activities. For full details, see page 68. This had the effect of reducing the net interest margin as average interest earning assets and interest bearing liabilities increased significantly. These reverse repo and repo agreements have a lower gross yield and cost of funds, respectively, when compared with the remainder of our portfolio.

Net interest income includes the expense of internally funded trading assets, while related revenue is reported in Net trading income . The internal cost of funding these assets declined, reflecting a decrease in the average trading asset balances in most regions and reductions in our average cost of funds in these regions. In reporting our global business results, this cost is included within Net trading income .

Net fee income

Net fee income was broadly unchanged on a reported basis and increased by US$207m on a constant currency basis.

Fees from unit trusts grew, primarily in Hong Kong, as we captured improved market sentiment and strong customer demand. Fees from funds under management increased, primarily in Europe and Hong Kong, reflecting improved market conditions. Fee income from credit facilities rose, mainly in Europe in CMB.

Underwriting fees rose, notably in Europe and Hong Kong, as client demand for equity and debt capital financing increased and the collaboration between CMB and GB&M strengthened.

These factors were partly offset by the sale of the CRS business in North America, which led to a reduction in cards and insurance fee income and fee expenses. Fee income related to the sale fell following the expiry of the majority of the transition service agreements entered into during 2012. This is reported in other fee income while associated costs are reported in Operating expenses .

Net trading income

Reported net trading income of US$8.7bn was US$1.6bn higher than in 2012. On a constant currency basis, income increased by US$1.8bn, notably in Europe. Net income from trading activities primarily arose from our Markets business within GB&M, which recorded a resilient performance during 2013.

The rise in net income from trading activities was due in part to lower adverse foreign exchange movements on assets held as economic hedges of foreign currency debt designated at fair value. These adverse movements offset favourable foreign exchange movements on the foreign currency debt which are reported in Net expense from financial instruments designated at fair value . In addition, we made foreign exchange gains of US$442m on sterling debt issued by HSBC Holdings. We also recorded a favourable debit valuation adjustment (DVA) of US$105m on derivative contracts, compared with a net reported charge of US$385m in 2012, as a result of a change in estimation methodology in respect of credit valuation adjustments (CVA s) of US$903m and a DVA of US$518m, to reflect evolving market practices.

Net income from trading activities in Markets also rose. Trading revenue in Credit grew driven by revaluation gains from price appreciation on assets in the legacy portfolio together with increased customer activity. Foreign Exchange revenue rose as a result of increased client demand for hedging solutions, in part from increased collaboration, although this was partly offset by margin compression and reduced market volatility in the second half of 2013. Equities revenue also grew, from higher client flows and increased revaluation gains in Europe, together with minimal fair value movements on own credit spreads on structured liabilities, compared with adverse fair value movements in 2012.

Rates trading income in 2012 included a charge following a change in the CVA methodology, as noted above. In 2013, we won new client mandates and reported smaller adverse fair value movements on our credit spreads on structured liabilities. These factors were broadly offset by reduced revenue as in 2012 we benefited from a significant tightening of spreads on eurozone bonds following the ECB s liquidity intervention. Revenue in 2013 was also affected by uncertainty regarding the tapering of quantitative easing in the US.

During 2013, we reported adverse fair value movements of US$682m compared with US$553m in 2012 on the contingent forward sale contract relating to Ping An in Asia.

Net interest income from trading activities also declined. This was driven by lower yields on debt securities in part reflecting the downward movement in interest rates.

In addition, net trading income was adversely affected by losses of US$194m relating to the termination of qualifying accounting hedges, mainly in HSBC Finance Corporation (HSBC Finance) of US$199m, as a result of anticipated changes in funding.

In 2013, there were favourable movements on non-qualifying hedges compared with adverse movements in 2012. In North America, we reported favourable fair value movements on non-qualifying hedges as US long-term interest rates increased, compared with adverse fair value movements in 2012. There were also favourable fair value movements on non-qualifying hedges in Europe, compared with adverse movements in 2012

Net income from financial instruments designated at fair value

The accounting policies for the designation of financial instruments at fair value and the treatment of the associated income and expenses are described in Notes 2 and 25 on the Financial Statements, respectively.

The majority of the financial liabilities designated at fair value are fixed-rate long-term debt issues, the interest rate profile of which has been changed to floating through swaps as part of a documented interest rate management strategy. The movement in fair value of these long-term debt issues and the related hedges

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includes the effect of our credit spread changes and any ineffectiveness in the economic relationship between the related swaps and own debt. As credit spreads widen or narrow, accounting profits or losses, respectively, are booked. The size and direction of the changes in the credit spread on our debt and ineffectiveness, which are recognised in the income statement, can be volatile from year to year, but do not alter the cash flows expected as part of the documented interest rate management strategy. As a consequence, fair value movements arising from changes in our own credit spread on long-term debt and other fair value movements on the debt and related derivatives are not regarded internally as part of managed performance and are therefore not allocated to global businesses, but are reported in Other . Credit spread movements on own debt designated at fair value are excluded from underlying results, and related fair value movements are not included in the calculation of regulatory capital.

We reported net income from financial instruments designated at fair value of US$768m in 2013 compared with a net expense of US$2.2bn in 2012. This included credit spread-related movements in the fair value of our own long-term debt, on which we experienced adverse fair value movements of US$1.2bn in 2013 compared with US$5.2bn in 2012. Adverse fair value movements were less extensive in 2013 than in 2012 as HSBC spreads tightened significantly in Europe and North America, having widened during 2011.

Net income arising from financial assets held to meet liabilities under insurance and investment contracts increased reflecting higher net investment returns in 2013 than in 2012. These returns reflected favourable equity market movements in the UK and France, partly offset by weaker equity market performance and falling bond prices in Hong Kong and lower net income on the bond portfolio in Brazil.

Investment gains or losses arising from equity markets result in a corresponding movement in liabilities to customers, reflecting the extent to which unit-linked policyholders, in particular, participate in the investment performance of the associated asset portfolio. Where these relate to assets held to back investment contracts, the corresponding movement in liabilities to customers is also recorded under Net income/(expense) from financial instruments designated at fair value . This is in contrast to gains or losses related to assets held to back insurance contracts or investment contracts with discretionary participation features (DPF), where the corresponding movement in liabilities to customers is recorded under Net insurance claims incurred and movement in liabilities to policyholders .

Other changes in fair value reflected lower favourable foreign exchange movements in 2013 than in 2012 on foreign currency debt designated at fair value and issued as part of our overall funding strategy (offset from assets held as economic hedges in Net trading income), and higher adverse movements due to hedging ineffectiveness in 2013.

Gains less losses from financial investments

Gains less losses from financial investments rose by US$823m on a reported basis and by US$840m on a constant currency basis.

This was driven by a significant increase in net gains from the disposal of available-for-sale equity securities in Asia following the completion of the sale of our remaining shareholding in Ping An and an increase in disposal gains in Principal Investments. These increases were partly offset by the non-recurrence of gains in from the sale of our shares in four Indian banks in 2012.

The year on year decline in impairments on available-for-sale equity securities also contributed to the rise in gains less losses from financial investments. This was driven by a reduction in write downs in our Principal Investments business.

Net gains on the disposal of debt securities fell as 2012 included significant gains on the sale of available-for-sale government debt securities, notably in Europe, arising from structural interest rate risk management of the balance sheet.

Net insurance premium income

Net earned insurance premiums decreased by US$1.1bn on a reported basis, and by US$1.0bn on constant currency basis.

The reduction was primarily due to lower net earned premiums in Europe, Latin America and North America, partly offset by an increase in Hong Kong.

In Europe, net earned premiums decreased, mainly as a result of lower sales of investment contracts with DPF in France. In addition, 2012 benefited from a number of large sales through independent financial adviser channels which are now in run off.

In Latin America, net earned premiums decreased in Brazil due to lower sales of unit-linked pension products, primarily as a result of changes to the distribution channel. In addition, the sale of the non-life business in Argentina in 2012 contributed to the decrease.

The reduction in net earned premiums in North America was due to the sale of our insurance manufacturing business in the first half of 2013.

In Hong Kong, premium income increased as a result of higher renewal premiums for insurance contracts with DPF and unit-linked insurance contracts, partly offset by lower sales of new business in 2013 and the disposal of the non-life business during 2012.

Gains on disposal of US branch network, US cards business and Ping An

In 2012, we made significant progress in exiting non-strategic markets and disposing of businesses and investments not aligned with the Group s long-term strategy. These included three major disposals:

In May 2012, HSBC USA Inc., HSBC Finance and HSBC Technology and Services (USA) Inc. sold their

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US Card and Retail Services business, realising a gain on sale of US$3.1bn.

In May 2012, HSBC Bank USA, N.A. (HSBC Bank USA) sold 138 out of 195 branches, primarily in upstate New York, realising a gain of US$661m. In August 2012, it sold the remaining 57 branches to the same purchaser, realising a gain of US$203m.

In December 2012, HSBC Insurance Holdings Limited and The Hongkong and Shanghai Banking Corporation agreed to sell their entire shareholdings in Ping An, representing 15.57% of the issued share capital of Ping An, in two tranches. The first tranche was completed on 7 December 2012, at which point we ceased to account for Ping An as an associate and recognised a gain on disposal of US$3.0bn. The remaining shareholding in respect of the second tranche was recognised as a financial investment.

The fixing of the sale price in respect of the second tranche gave rise to a contingent forward sale contract, for which there was an adverse fair value movement of US$553m recorded in Net trading income in 2012. The disposal of our investment in Ping An was completed in 2013. We realised a gain of US$1.2bn, which was recorded in Gains less losses from financial investments . This was partly offset by the adverse fair value movement of US$682m on the contingent forward sale contract recorded in Net trading income , leading to a net gain in the year of US$553m.

Other operating income

Other operating income of US$2.6bn increased by US$532m in 2013 on a reported basis and by US$727m on a constant currency basis.

Reported other operating income included net gains on the disposals and the reclassifications listed on page 49 of US$2.2bn in 2013, principally relating to an accounting gain arising from the reclassification of Industrial Bank as a financial investment following its issue of additional share capital to third parties and a gain on the disposal of our operations in Panama, compared with net gains of US$736m in 2012.

On an underlying basis, which excludes the net gains above, the results of disposed of operations and the effects of foreign currency translation, other operating income decreased. This was driven by losses totalling US$424m on the sales of our CML non-real estate personal loan portfolio and several tranches of real estate secured loans, and a loss of US$279m following the write-off of goodwill relating to our GPB business in Monaco. In addition, we recognised a loss of US$146m on the sale of the HFC Bank UK secured loan portfolio in RBWM in Europe. These factors were partly offset by higher disposal and revaluation gains on investment properties in Hong Kong.

There were lower favourable movements on the present value of the in-force (PVIF) long-term insurance business asset compared with 2012. This was largely due to lower values of new business in Europe and Asia, reflecting lower sales. Additionally, expected returns increased due to the growth of the opening PVIF asset year on year, particularly in Hong Kong and Brazil.

These factors were partly offset by higher favourable assumption changes in Hong Kong, which exceeded the adverse experience and assumption changes in Latin America. The lower other PVIF movements in 2013 compared with 2012 were driven by Latin America, notably the favourable effect of the recognition of a PVIF asset in Brazil in 2012 which did not recur.

Net insurance claims and benefits paid and movement in liabilities to policyholders

Net insurance claims incurred and movement in liabilities to policyholders decreased by 4% on a reported basis, and by 3% on a constant currency basis.

The reduction largely reflected the decrease in premiums, notably in Latin America, North America and France, and included the effect of business disposals described under Net earned insurance premiums .

This reduction was partly offset by increases in reserves attributable to increased renewal premiums in Hong Kong and higher investment returns on the assets held to support policyholder contracts where the policyholder bears investment risk. These returns reflected favourable equity market movements in the UK and France, partly offset by weaker equity market performance and falling bond prices in Hong Kong and lower net income on the bond portfolio in Brazil.

The gains or losses recognised on the financial assets designated at fair value held to support these insurance and investment contract liabilities are reported in Net income from financial instruments designated at fair value .

Loan impairment charges and other credit risk provisions

On a reported basis, loan impairment charges and other credit risk provisions (LICs) were US$2.5bn lower than in 2012, decreasing in the majority of regions, most notably in North America, Europe and the Middle East and North Africa. Underlying LICs declined by US$1.9bn to US$5.8bn.

The percentage of impairment charges to average gross loans and advances reduced to 0.7% at 31 December 2013 from 0.9% at 31 December 2012.

On a constant currency basis, LICs fell by US$2.3bn, a reduction of 28%. Collectively assessed charges decreased by US$2.1bn while individually assessed impairment charges increased by US$198m. Credit risk provisions on available-for-sale debt securities reflected net releases of US$211m in 2013 compared with charges in 2012.

The fall in collectively assessed charges largely arose in North America, in part due to improvements in housing market conditions. In addition, the decrease reflected lower lending balances, reduced new impaired loans and

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lower delinquency levels in the CML portfolio. This was partially offset by increases in Latin America, principally in Mexico due to higher collective impairments in RBWM. In Brazil, improvements in credit quality were broadly offset by higher charges from model changes and assumption revisions for restructured loan portfolios in RBWM and Business Banking in CMB.

The increase in individually assessed loan impairment charges reflected higher levels of impairment in Latin America, particularly on exposures to homebuilders in Mexico and across a number of corporate exposures in Brazil. These were partly offset by releases in the Middle East and North Africa, mainly in GB&M for a small number of customers as a result of an overall improvement in the loan portfolio compared with charges in 2012. In Europe, higher provisions in GB&M were broadly offset by decreases in CMB, mainly in the UK and Greece.

The movement in credit risk provisions on available-for-sale debt securities was largely in GB&M as a result of net releases in Europe compared with charges in 2012, and a credit risk provision on an available-for-sale debt security in 2012 in Asia.

In *North America*, LICs decreased by US$2.3bn to US$1.2bn, mainly in the US, in part due to improvements in housing market conditions. In addition, the decrease reflected lower lending balances from continued run-off and loan sales, and lower levels of new impaired loans and delinquency in the CML portfolio. US$322m of the decline in loan impairment charges was due to the sale of the CRS business in 2012. These factors were partly offset by an increase of US$130m relating to a rise in the estimated average period of time from a loss event occurring to writing off real estate loans to twelve months (previously a period of ten months was used). In CMB, loan impairment charges increased by US$77m, reflecting higher collectively assessed charges in the US as a result of increased lending balances in key growth markets and higher individually assessed impairments on a small number of exposures mainly in Canada.

In *Europe*, LICs decreased by 20% to US$1.5bn. In the UK, GB&M reported net releases of credit risk provisions on available-for-sale asset backed securities (ABS s), compared with impairment charges in 2012, offset in part by higher individually assessed provisions. In addition, there were lower loan impairment charges in CMB due to lower collectively and individually assessed provisions, and in RBWM due to lower collectively assessed provisions reflecting recoveries from debt sales. In other countries in Europe, lower individually assessed impairment provisions in Greece were partly offset by increases in Turkey, where there was growth in unsecured lending in RBWM and a rise in Spain, where the challenging economic conditions continued to affect the market.

In the *Middle East and North Africa*, LICs reflected a net release of US$42m compared with a charge of US$282m in 2012. We recorded provision releases, mainly in GB&M, for a small number of UAE-related exposures, reflecting an overall improvement in the loan portfolio

compared with charges in 2012. In addition, loan impairment charges declined, due to lower individually assessed loan impairments in the UAE in CMB, and lower provisions in RBWM on residential mortgages following a repositioning of the book towards higher quality lending and improved property prices.

In *Latin America*, LICs increased by US$693m, primarily in Mexico due to specific impairments in CMB relating to homebuilders from a change in the public housing policy, and higher collective impairments in RBWM as a result of increased volumes and higher delinquency in our unsecured lending portfolio. In Brazil, LICs increased due to changes to the impairment model and assumption revisions for restructured loan account portfolios in RBWM and CMB, following a realignment of local practices to Group standard policy. LICs were also adversely affected by higher specific impairments in CMB across a number of corporate exposures. These factors were partly offset by improvements in credit quality in Brazil following the modification of credit strategies in previous years to mitigate rising delinquency rates.

LICs in *Asia* were in line with 2012 as higher charges in Hong Kong due to a revision to the assumptions used in our collective assessment models in RBWM and a rise in individual impairment charges in CMB, were broadly offset by the non-recurrence of a large individually assessed impairment of a corporate exposure in Australia and a credit risk provision on an available-for-sale debt security in GB&M.

Operating expenses

Reported operating expenses of US$38.6bn were US$4.4bn or 10% lower than 2012. On an underlying basis, costs fell by 6%.

On a constant currency basis, operating expenses in 2013 were US$3.7bn or 9% lower than in 2012, primarily due to the non-recurrence of a charge for US AML, BSA, and OFAC investigations of US$1.9bn, and a reduction in restructuring and other related costs of US$369m. UK customer redress programmes were also lower than in 2012. These included:

- a charge for additional estimated redress for possible mis-selling in previous years of payment protection insurance (PPI) policies of US$756m (US$1.7bn in 2012);
- US$261m in respect of interest rate protection products (US$586m in 2012);
- US$149m in respect of wealth management products; and
- The provision for the UK customer redress programmes at 31 December 2013 is US$2.1bn.

The business disposals, primarily the disposal of the CRS business and the non-strategic branches in the US in 2012, resulted in a lower cost base in 2013.

Excluding the above, expenses were US$808m higher than in 2012. The UK bank levy charge of US$904m in 2013 increased compared with US$571m in 2012, mainly due to an increase in its rate. In addition,

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operating expenses in both years included adjustments relating to the prior year charge for the UK bank levy (2013: US$12m adverse adjustment; 2012: US$99m favourable adjustment).

Litigation-related expenses increased primarily due to a provision in respect of regulatory investigations in GPB, Madoff-related litigation costs in GB&M, and a customer remediation provision connected with our former CRS business.

During 2013:

- we increased our investment in digital and wealth management capabilities in RBWM;
- in CMB we continued our ongoing expansion into the large corporate market in the US; and
- increased investment spend on regulatory requirements particularly through the Global Standards programme.

In addition, other costs rose due to higher operational expenses in part driven by general inflationary pressures including wage inflation across the Group and rental costs in Asia. Cost growth in the Middle East and North Africa resulted from a customer redress programme in RBWM relating to fees charged on overseas credit card transactions, the acquisition of the Lloyds business in the UAE in 2012 and the merger with Oman International Bank S.A.O.G. (OIB). Operating expenses also increased in Hong Kong and North America as a result of changes to the recognition of pension costs.

These cost increases were in part offset by further sustainable cost savings of US$1.5bn from our ongoing organisational effectiveness programmes. In addition, we recorded an accounting gain of US$430m from changes in delivering ill-health benefits to certain employees in the UK (see Note 6 on the Financial Statements).

The number of employees expressed in full-time equivalent numbers (FTE s) at the end of 2013 was 3% lower than at the end of 2012 due to sustainable cost savings initiatives and business disposals. Average staff numbers fell by 6% compared with 2012

Share of profit in associates and joint ventures

The share of profit in associates and joint ventures was US$2.3bn, a decrease of 35% compared with 2012 on both a reported and constant currency basis. This was driven by the disposal of Ping An in 2012 and the reclassification in 2013 of Industrial Bank as a financial investment.

The recognition of profits ceased from Ping An following the agreement to sell our shareholding in December 2012, and from Industrial Bank following the issuance of additional share capital to third parties in January 2013, which resulted in our diluted shareholding being classified as a financial investment. In addition, in 2013, we recorded an impairment charge of US$106m on our banking associate in Vietnam.

Our share of profit from BoCom rose as a result of balance sheet growth and increased fee income, partly

offset by higher operating expenses and a rise in loan impairment charges.

At 31 December 2013, we performed an impairment review of our investment in BoCom and concluded that it was not impaired at the year end, based on our value in use calculation (see Note 21 on the Financial Statements for further details). In future years, the value in use will remain relatively stable if the current calculation assumptions remain broadly the same. However, it is expected that the carrying amount will increase in 2014 due to retained profits earned by BoCom. At the point where the carrying amount exceeds the value in use, the carrying amount would be reduced to equal value in use, with a corresponding reduction in income, unless the market value has increased to a level above the carrying amount.

Profits from The Saudi British Bank rose, reflecting strong lending growth and effective cost management.

Tax expense

The effective tax rate for 2013 of 21.1% was lower than the UK corporation tax rate of 23.25%.

The lower effective tax rate reflected the geographical distribution of our profit, the non-taxable gain on profits resulting from the reclassification of our holding in Industrial Bank as a financial investment and the disposal of our operations in Panama and our investment in Ping An.

The tax expense decreased by US$0.6bn to US$4.8bn despite a US$2.0bn increase in accounting profit before tax, due to the combination of benefits noted above and because the 2012 tax expense included the non-tax deductible effect of fines and penalties paid as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanction laws.

In 2013, the tax borne and paid by the Group to the relevant tax authorities, including tax on profits, bank levy and employer-related taxes, was US$8.6bn (2012: US$9.3bn). The amount differs from the tax charge reported in the income statement due to indirect taxes such as VAT and the bank levy included in pre-tax profit, and the timing of payments.

We also play a major role as tax collector for governments in the jurisdictions in which we operate. Such taxes include employee-related taxes and taxes withheld from payments to deposit holders. In 2013, we collected US$8.8bn (2012: US$8.5bn).

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Consolidated balance sheet

Five-year summary consolidated balance sheet

	2014	2013	2012	2011	2010
	US$m	US$m	US$m	US$m	US$m
ASSETS					
Cash and balances at central banks	**129,957**	166,599	141,532	129,902	57,383
Trading assets[26]	**304,193**	303,192	408,811	330,451	385,052
Financial assets designated at fair value	**29,037**	38,430	33,582	30,856	37,011
Derivatives	**345,008**	282,265	357,450	346,379	260,757
Loans and advances to banks[27]	**112,149**	120,046	117,085	139,078	141,869
Loans and advances to customers[27,28]	**974,660**	992,089	962,972	899,010	897,847
Reverse repurchase agreements non-trading[26,27]	**161,713**	179,690	70,112	83,328	126,921
Financial investments	**415,467**	425,925	421,101	400,044	400,755
Other assets	**161,955**	163,082	179,893	196,531	147,094
Total assets at 31 December	**2,634,139**	2,671,318	2,692,538	2,555,579	2,454,689
LIABILITIES AND EQUITY					
Liabilities					
Deposits by banks[27]	**77,426**	86,507	95,480	95,205	87,221
Customer accounts[27]	**1,350,642**	1,361,297	1,311,396	1,223,140	1,190,763
Repurchase agreements non-trading[26,27]	**107,432**	164,220	40,567	48,402	60,325
Trading liabilities[26]	**190,572**	207,025	304,563	265,192	300,703
Financial liabilities designated at fair value	**76,153**	89,084	87,720	85,724	88,133
Derivatives	**340,669**	274,284	358,886	345,380	258,665
Debt securities in issue	**95,947**	104,080	119,461	131,013	145,401
Liabilities under insurance contracts	**73,861**	74,181	68,195	61,259	58,609
Other liabilities	**121,459**	120,181	123,141	134,171	109,954
Total liabilities at 31 December	**2,434,161**	2,480,859	2,509,409	2,389,486	2,299,774
Equity					
Total shareholders equity	**190,447**	181,871	175,242	158,725	147,667

Non-controlling interests	**9,531**	8,588	7,887	7,368	7,248
Total equity at 31 December	**199,978**	190,459	183,129	166,093	154,915
Total liabilities and equity at 31 December	**2,634,139**	2,671,318	2,692,538	2,555,579	2,454,689

Five-year selected financial information

	2014 **US$m**	2013 US$m	2012 US$m	2011 US$m	2010 US$m
Called up share capital	**9,609**	9,415	9,238	8,934	8,843
Capital resources[29,30]	**190,730**	194,009	180,806	170,334	167,555
Undated subordinated loan capital	**2,773**	2,777	2,778	2,779	2,781
Preferred securities and dated subordinated loan capital[31]	**47,208**	48,114	48,260	49,438	54,421
Risk-weighted assets[29]	**1,219,765**	1,092,653	1,123,943	1,209,514	1,103,113
Financial statistics					
Loans and advances to customers as a percentage of customer accounts[27]	**72.2**	72.9	73.4	73.5	75.4
Average total shareholders equity to average total assets	**7.01**	6.55	6.16	5.64	5.53
Net asset value per ordinary share at year-end[32] (US$)	**9.28**	9.27	9.09	8.48	7.94
Number of US$0.50 ordinary shares in issue (millions)	**19,218**	18,830	18,476	17,868	17,686
Closing foreign exchange translation rates to US$:					
US$1: £	**0.642**	0.605	0.619	0.646	0.644
US$1:	**0.823**	0.726	0.758	0.773	0.748

For footnotes, see page 109.

A more detailed consolidated balance sheet is contained in the Financial Statements on page 337.

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Movement in 2014

Total reported assets were US$2.6 trillion, 1% lower than at 31 December 2013. On a constant currency basis, total assets were US$85bn or 3% higher.

Our balance sheet remains strong with a ratio of customer advances to customer accounts of 72%. Although customer loans and customer accounts have fallen on a reported basis, both have increased on a constant currency basis, notably rising in Asia.

The following commentary is on a reported basis unless otherwise stated.

Assets

Cash and balances at central banks decreased by US$37bn, notably in Europe, in part reflecting net reductions in repurchase and reverse repurchase agreements.

Trading assets were broadly unchanged. Excluding adverse foreign exchange movements of US$18bn, trading assets grew, primarily from the holdings of debt securities in Asia to support GB&M s Rates business. In Europe, trading assets were broadly unchanged as increased holdings of equity securities were broadly offset by reductions in several other asset classes.

Financial assets designated at fair value decreased by US$9bn, notably in Europe, largely from the transfer to Assets held for sale of balances relating to the UK Pension business of HSBC Life (UK) Limited.

Derivative assets increased by 22%, notably in Europe relating to interest rate and foreign exchange derivative contracts reflecting market movements, including changes in yield curves and foreign exchange rates.

Loans and advances to customers marginally decreased by US$17bn or 2% including adverse foreign exchange movements of US$45bn. Excluding these movements, customer lending grew by US$28bn, or 3%, largely from growth in Asia of US$32bn and, to a lesser extent, in North America and Latin America. By contrast, balances decreased in Europe by US$15bn, as term lending growth in CMB and GB&M was more than offset by a fall in corporate overdraft balances relating to a small number of customers, as explained further below.

In Asia, term lending to CMB and GB&M customers grew, which included growth in commercial real estate and other property-related lending. Mortgage balances also increased, mainly in Hong Kong. In North America, the growth in balances was driven by increased term lending to corporate and commercial customers in CMB and GB&M, partly offset by a decline in RBWM from the continued reduction in the US run-off portfolio and the transfer to Assets held for sale of US first lien mortgage balances. Balances also rose in Latin America, mainly in CMB in Brazil and GB&M in Mexico.

The fall in lending in Europe of US$15bn was driven by a reduction in corporate overdraft balances. In the UK, a small number of clients benefit from the use of net interest arrangements across their overdraft and deposit positions.

During the year, as we aligned our approach in our Payments and Cash Management business to be more globally consistent, many of these clients increased the frequency with which they settled these balances, reducing their overdraft and deposit balances which fell by US$28bn. Other customer loans and advances increased by US$13bn, mainly in CMB and GB&M, driven by an increase in term lending to corporate and commercial customers, notably in the second half of the year.

Reverse repurchase agreements decreased by US$18bn, driven by a managed reduction in Europe as we reassessed the overall returns of these activities in light of new regulatory requirements. This decrease was partly offset by increases in Asia and North America.

Liabilities

Repurchase agreements decreased by US$57bn or 35%, driven by a decrease in Europe, notably in the UK and France, reflecting the managed reduction in reverse repurchase agreements in Europe as noted above.

Customer accounts decreased marginally by US$11bn, and included adverse foreign exchange movements of US$58bn. Excluding these movements, balances increased by US$47bn or 4%, with growth in all regions, notably Asia, of US$36bn. The increase in Asia reflected growth in our Payments and Cash Management business in CMB and GB&M, an increase in balances in Securities Services in GB&M and a rise in RBWM, in part reflecting successful deposit campaigns. In Europe, balances increased marginally despite a US$28bn fall in corporate current accounts, mainly in GB&M, in line with the fall in corporate overdraft balances, and a reduction in client deposits in GPB. These factors were more than offset by growth in CMB and, to a lesser extent, in GB&M as deposits from our Payments and Cash Management business increased together with a rise in RBWM balances reflecting customers continued preference for holding balances in current and savings accounts.

Trading liabilities fell by US$16bn including adverse foreign exchange movements of US$12bn. Excluding these, balances fell reflecting changes in client demand.

Financial liabilities designated at fair value reduced by US$13bn, mainly in Europe reflecting the transfer to Liabilities held for sale of balances relating to the UK Pension business of HSBC Life (UK) Limited.

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

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Equity

Total shareholders equity rose by 5%, driven by profits generated in the year, which were partially offset by dividends paid. In addition, shareholders equity increased as we issued new contingent convertible securities of US$5.7bn during 2014. For further details

of these securities, see Note 35 on the Financial Statements. These movements were partly offset by a reduction of US$9bn in our foreign exchange reserve reflecting the notable appreciation in the US dollar against sterling and the euro, particularly in the second half of the year.

Reconciliation of consolidated reported and constant currency assets and liabilities

	31 December 2014 compared with 31 December 2013					
	31 Dec 13 as reported US$m	Currency translation adjustment[33] US$m	31 Dec 13 at 31 Dec 14 exchange rates US$m	31 Dec 14 as reported US$m	Reported change %	Constant currency change %
Cash and balances at central banks	166,599	(9,384)	157,215	129,957	(22)	(17)
Trading assets	303,192	(18,176)	285,016	304,193		7
Financial assets designated at fair value	38,430	(2,467)	35,963	29,037	(24)	(19)
Derivative assets	282,265	(16,582)	265,683	345,008	22	30
Loans and advances to banks[27]	120,046	(4,923)	115,123	112,149	(7)	(3)
Loans and advances to customers[27]	992,089	(45,494)	946,595	974,660	(2)	3
Reverse repurchase agreements non-trading[26,27]	179,690	(9,961)	169,729	161,713	(10)	(5)
Financial investments	425,925	(15,285)	410,640	415,467	(2)	1
Other assets	163,082	(385)	162,697	161,955	(1)	
Total assets	2,671,318	(122,657)	2,548,661	2,634,139	(1)	3

Deposits by banks[27]	**86,507**	**(3,317)**	**83,190**	**77,426**	**(10)**	**(7)**
Customer accounts[27]	**1,361,297**	**(57,673)**	**1,303,624**	**1,350,642**	**(1)**	**4**
Repurchase agreements non-trading[26, 27]	**164,220**	**(7,730)**	**156,490**	**107,432**	**(35)**	**(31)**
Trading liabilities	**207,025**	**(12,208)**	**194,817**	**190,572**	**(8)**	**(2)**
Financial liabilities designated at fair value	**89,084**	**(3,930)**	**85,154**	**76,153**	**(15)**	**(11)**
Derivative liabilities	**274,284**	**(16,214)**	**258,070**	**340,669**	**24**	**32**
Debt securities in issue	**104,080**	**(5,089)**	**98,991**	**95,947**	**(8)**	**(3)**
Liabilities under insurance contracts	**74,181**	**(4,447)**	**69,734**	**73,861**		**6**
Other liabilities	**120,181**	**(4,221)**	**115,960**	**121,459**	**1**	**5**
Total liabilities	**2,480,859**	**(114,829)**	**2,366,030**	**2,434,161**	**(2)**	**3**
Total shareholders equity	**181,871**	**(7,720)**	**174,151**	**190,447**	**5**	**9**
Non-controlling interests	**8,588**	**(108)**	**8,480**	**9,531**	**11**	**12**
Total equity	**190,459**	**(7,828)**	**182,631**	**199,978**	**5**	**9**
Total liabilities and equity	**2,671,318**	**(122,657)**	**2,548,661**	**2,634,139**	**(1)**	**3**

For footnotes, see page 109.

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Combined view of lending and deposits[26,27]

	2014 US$m	2013 US$m	Change %
Customers amortised cost			
Loans and advances to customers	**974,660**	992,089	(2)
Loans and advances to customers reported in Assets held for sale[34]	**577**	1,703	(66)
Reverse repurchase agreements non-trading	**66,310**	88,215	(25)
Combined customer lending	**1,041,547**	1,082,007	(4)
Customer accounts	**1,350,642**	1,361,297	(1)
Customer accounts reported in Liabilities of disposal groups held for sale	**145**	2,187	(93)
Repurchase agreements non-trading	**79,556**	121,515	(35)
Combined customer deposits	**1,430,343**	1,484,999	(4)
Banks amortised cost			
Loans and advances to banks	**112,149**	120,046	(7)
Reverse repurchase agreements non-trading	**95,403**	91,475	4
Combined bank lending	**207,552**	211,521	(2)
Deposits by banks	**77,426**	86,507	(10)
Repurchase agreements non-trading	**27,876**	42,705	(35)
Combined bank deposits	**105,302**	129,212	(19)
Customers and banks fair value			
Trading assets reverse repos	**1,297**	10,120	(87)
loans and advances to customers	**908**	7,180	(87)
loans and advances to banks	**389**	2,940	(87)
Trading liabilities repos	**3,798**	17,421	(78)
customer accounts	**898**	9,611	(91)
deposits by banks	**2,900**	7,810	(63)

For footnotes, see page 109.

Financial investments

	2014	2013

	Equity securities US$bn	**Debt securities US$bn**	**Total US$bn**	Equity securities US$bn	Debt securities US$bn	Total US$bn
Balance Sheet Management		**306.8**	**306.8**		314.4	314.4
Insurance entities		**48.5**	**48.5**		46.4	46.4
Structured entities	**0.1**	**14.9**	**15.0**	0.1	22.6	22.7
Principal Investments	**2.0**		**2.0**	2.7		2.7
Other	**8.6**	**34.6**	**43.2**	6.3	33.4	39.7
At 31 December	**10.7**	**404.8**	**415.5**	9.1	416.8	425.9

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Average balance sheet

Average balance sheet and net interest income

Average balances and related interest are shown for the domestic operations of our principal commercial banks by geographical region. Other operations comprise the operations of our principal commercial banking and consumer finance entities outside their domestic markets and all other banking operations, including investment banking balances and transactions.

Average balances are based on daily averages for the principal areas of our banking activities with monthly or less frequent averages used elsewhere. Balances and transactions with fellow subsidiaries are reported gross in the principal commercial banking and consumer finance entities and the elimination entries are included within Other operations .

Net interest margin numbers are calculated by dividing net interest income as reported in the income statement by the average interest-earning assets from which interest income is reported within the Net interest income line of the income statement. Total interest-earning assets include loans where the carrying amount has been adjusted as a result of impairment allowances. In accordance with IFRSs, we recognise interest income on assets after the carrying amount has been adjusted as a result of impairment. Fee income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate and recorded in Interest income .

Assets

	2014			2013			2012		
	Average balance US$m	**Interest income US$m**	**Yield %**	Average balance US$m	Interest income US$m	Yield %	Average balance US$m	Interest income US$m	Yield %
Summary									
Interest-earning assets measured at amortised cost (itemised below)	**1,786,536**	**50,955**	**2.85**	1,669,368	51,192	3.07	1,625,068	56,702	3.49
	238,958	**5,596**	**2.34**	354,817	5,763	1.62	368,406	6,931	1.88

Trading assets and financial assets designated at fair value[61,62]										
Impairment provisions		**(14,015)**			(15,954)			(17,421)		
Non-interest-earning assets		**668,564**			683,785			730,901		
Total assets and interest income		**2,680,043**	**56,551**	**2.11**	2,692,016	56,955	2.12	2,706,954	63,633	2.35
Average yield on all interest-earning assets				**2.79**			2.81			3.19
Short-term funds and loans and advances to banks[27]										
Europe	HSBC Bank	**96,638**	**997**	**1.03**	89,921	880	0.98	82,206	1,000	1.22
	HSBC Private Banking Holdings (Suisse)	**9,704**	**10**	**0.10**	15,400	10	0.06	2,072	9	0.43
	HSBC France	**7,055**	**66**	**0.94**	10,603	93	0.88	13,204	115	0.87
Asia[63]	Hang Seng Bank	**15,374**	**279**	**1.81**	16,496	251	1.52	16,396	283	1.73
	The Hongkong and Shanghai Banking Corporation	**57,141**	**822**	**1.44**	53,372	809	1.52	54,148	837	1.55
	HSBC Bank Malaysia	**5,060**	**158**	**3.12**	5,487	162	2.95	4,243	123	2.90
MENA	HSBC Bank Middle East	**4,678**	**29**	**0.62**	5,018	27	0.54	5,530	32	0.58
North America	HSBC Bank USA	**28,148**	**105**	**0.37**	24,907	84	0.34	23,707	104	0.44
	HSBC Bank Canada	**606**	**4**	**0.66**	425	3	0.71	389	4	1.03
Latin America	HSBC Mexico	**2,675**	**86**	**3.21**	2,846	109	3.83	3,053	119	3.90
	Brazilian operations	**5,416**	**498**	**9.19**	5,579	388	6.95	9,008	735	8.16
	HSBC Bank Argentina	**1,083**	**12**	**1.11**	1,199	18	1.50	82	18	21.95
Other operations		**3,570**	**2**	**0.06**	5,124	17	0.33	21,793	126	0.58
		237,148	**3,068**	**1.29**	236,377	2,851	1.21	235,831	3,505	1.49

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		2014 Average balance US$m	2014 Interest income US$m	2014 Yield %	2013 Average balance US$m	2013 Interest income US$m	2013 Yield %	2012 Average balance US$m	2012 Interest income US$m	2012 Yield %
Loans and advances to customers[27]										
Europe	HSBC Bank	**302,817**	**10,423**	**3.44**	292,200	10,631	3.64	281,255	10,565	3.76
	HSBC Private Banking Holdings (Suisse)	**13,026**	**159**	**1.22**	15,235	194	1.27	12,591	199	1.58
	HSBC France	**43,736**	**1,626**	**3.72**	47,404	1,656	3.49	45,030	1,649	3.66
	HSBC Finance				173	10	5.78	886	42	4.74
Asia[63]	Hang Seng Bank	**79,586**	**2,410**	**3.03**	72,537	2,179	3.00	64,907	1,895	2.92
	The Hongkong and Shanghai Banking Corporation	**263,732**	**8,517**	**3.23**	237,915	8,022	3.37	208,961	7,627	3.65
	HSBC Bank Malaysia	**13,548**	**672**	**4.96**	13,928	683	4.90	13,456	707	5.25
MENA	HSBC Bank Middle East	**26,618**	**1,133**	**4.26**	25,537	1,124	4.40	24,012	1,214	5.06
North America	HSBC Bank USA	**63,770**	**1,791**	**2.81**	56,538	1,776	3.14	53,555	1,715	3.20
	HSBC Finance	**26,446**	**2,171**	**8.21**	34,146	3,064	8.97	43,565	3,903	8.96
	HSBC Bank Canada	**37,472**	**1,371**	**3.66**	39,199	1,431	3.65	41,151	1,551	3.77
Latin America	HSBC Mexico	**15,770**	**1,542**	**9.78**	15,335	1,658	10.81	14,411	1,613	11.19
	Brazilian operations	**27,275**	**4,579**	**16.79**	25,688	4,604	17.92	27,621	5,468	19.80
	HSBC Bank Argentina	**3,078**	**798**	**25.93**	3,615	799	22.10	3,644	718	19.70

Other operations		**14,437**	**237**	**1.64**	17,872	698	3.91	56,654	2,004	3.54
		931,311	**37,429**	**4.02**	897,322	38,529	4.29	891,699	40,870	4.58
Reverse repurchase agreements	**non-trading[27]**									
Europe	HSBC Bank	**66,360**	**450**	**0.68**	28,131	113	0.40	12,621	71	0.56
	HSBC France	**29,703**	**62**	**0.21**	45,929	48	0.10	43,986	125	0.28
Asia[63]	The Hongkong and Shanghai Banking Corporation	**23,562**	**333**	**1.41**	11,722	272	2.32	7,585	206	2.72
	HSBC Bank Malaysia	**991**	**31**	**3.13**	378	11	2.91	1,132	34	3.00
MENA	HSBC Bank Middle East	**18**	**2**	**11.11**	620	7	1.13	392	9	2.30
North America	HSBC Bank USA	**1,196**	**10**	**0.84**	1,837	13	0.71	6,312	29	0.46
	HSBC Finance							322	1	0.31
	HSBC Bank Canada	**7,169**	**84**	**1.17**	9,196	93	1.01	4,810	50	1.04
Latin America	HSBC Mexico	**90**	**3**	**3.33**	133	5	3.76			
	Brazilian operations	**7,241**	**753**	**10.40**	5,541	404	7.29	5,602	420	7.50
	HSBC Bank Argentina	**88**	**10**	**11.36**	138	13	9.42	314	27	8.60
Other operations		**61,855**	**62**	**0.10**	10,699	16	0.15	29	3	10.34
		198,273	**1,800**	**0.91**	114,324	995	0.87	83,105	975	1.17
Financial investments										
Europe	HSBC Bank	**100,609**	**867**	**0.86**	88,406	1,223	1.38	80,475	1,275	1.58
	HSBC Private Banking Holdings (Suisse)	**10,890**	**114**	**1.05**	13,509	183	1.35	5,722	107	1.87
	HSBC France	**12,685**	**113**	**0.89**	13,733	94	0.68	11,208	130	1.16
Asia[63]	Hang Seng Bank	**33,246**	**655**	**1.97**	31,502	601	1.91	29,319	590	2.01
	The Hongkong and Shanghai Banking Corporation	**118,096**	**2,109**	**1.79**	104,740	1,781	1.70	94,790	1,821	1.92
		2,749	**94**	**3.42**	2,197	72	3.28	1,798	59	3.28

	HSBC Bank Malaysia									
MENA	HSBC Bank Middle East	**10,515**	**104**	**0.99**	11,838	113	0.95	10,266	113	1.10
North America	HSBC Bank USA	**47,963**	**774**	**1.61**	56,302	884	1.57	61,510	1,092	1.78
	HSBC Finance							941	67	7.12
	HSBC Bank Canada	**17,970**	**246**	**1.37**	20,364	279	1.37	21,179	297	1.40
Latin America	HSBC Mexico	**9,914**	**409**	**4.13**	7,782	351	4.51	8,021	379	4.73
	Brazilian operations	**8,350**	**1,003**	**12.01**	7,404	740	9.99	9,527	1,019	10.70
	HSBC Bank Argentina	**518**	**130**	**25.10**	451	71	15.74	701	96	13.69
Other operations		**26,311**	**1,705**	**6.48**	35,081	1,610	4.59	51,872	2,033	3.92
		399,816	**8,323**	**2.08**	393,309	8,002	2.03	387,329	9,078	2.34

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Assets (continued)

		2014 Average balance US$m	2014 Interest income US$m	2014 Yield %	2013 Average balance US$m	2013 Interest income US$m	2013 Yield %	2012 Average balance US$m	2012 Interest income US$m	2012 Yield %
Other interest-earning assets										
Europe	HSBC Bank	**85,604**	**25**	**0.03**	73,607	64	0.09	119,175	153	0.13
	HSBC Private Banking Holdings (Suisse)	**5,220**	**32**	**0.61**	7,441	69	0.93	14,461	189	1.31
	HSBC France	**6,016**	**97**	**1.61**	14,294	111	0.78	13,107	121	0.92
Asia[63]	Hang Seng Bank	**2,504**	**14**	**0.56**	2,088	14	0.67	1,003	9	0.90
	The Hongkong and Shanghai Banking Corporation	**86,361**	**583**	**0.68**	62,369	498	0.80	59,191	481	0.81
	HSBC Bank Malaysia	**152**			456	2	0.44	553	4	0.72
MENA	HSBC Bank Middle East	**2,221**	**32**	**1.44**	1,888	87	4.61	1,914	72	3.76
North America	HSBC Bank USA	**6,936**	**123**	**1.77**	6,386	103	1.61	12,324	872	7.08
	HSBC Finance	**6,081**	**5**	**0.08**	6,821	19	0.28	7,723	656	8.49
	HSBC Bank Canada	**292**	**5**	**1.71**	1,691	42	2.48	2,340	69	2.95
Latin America	HSBC Mexico	**324**			265	6	2.26	614	39	6.35
	Brazilian operations	**1,215**	**136**	**11.19**	2,394	107	4.47	1,338	100	7.47

	HSBC Bank Argentina	**61**			93			106	4	4
Other operations		**(182,999)**	**(717)**		(151,757)	(307)		(206,745)	(495)	
		19,988	**335**	**1.68**	28,036	815	2.91	27,104	2,274	8.39
Total interest-earning assets										
Europe	HSBC Bank	**652,028**	**12,762**	**1.96**	572,265	12,911	2.26	575,732	13,064	2.27
	HSBC Private Banking Holdings (Suisse)	**38,840**	**315**	**0.81**	51,585	456	0.88	34,846	504	1.45
	HSBC France	**99,195**	**1,964**	**1.98**	131,963	2,002	1.52	126,535	2,140	1.69
Asia[63]	Hang Seng Bank	**130,710**	**3,358**	**2.57**	122,623	3,045	2.48	111,625	2,777	2.49
	The Hongkong and Shanghai Banking Corporation	**548,892**	**12,364**	**2.25**	470,118	11,382	2.42	424,675	10,972	2.58
	HSBC Bank Malaysia	**22,500**	**955**	**4.24**	22,446	930	4.14	21,182	927	4.38
MENA	HSBC Bank Middle East	**44,050**	**1,300**	**2.95**	44,901	1,358	3.02	42,114	1,440	3.42
North America	HSBC Bank USA	**148,013**	**2,803**	**1.89**	145,970	2,860	1.96	157,408	3,812	2.42
	HSBC Finance	**32,527**	**2,176**	**6.69**	40,967	3,083	7.53	54,342	4,627	8.51
	HSBC Bank Canada	**63,509**	**1,710**	**2.69**	70,875	1,848	2.61	69,869	1,971	2.82
Latin America	HSBC Mexico	**28,773**	**2,040**	**7.09**	26,361	2,129	8.08	26,099	2,150	8.24
	Brazilian operations	**49,497**	**6,969**	**14.08**	46,606	6,243	13.40	53,096	7,742	14.58
	HSBC Bank Argentina	**4,828**	**950**	**19.68**	5,496	901	16.39	4,847	863	17.80
Other operations		**(76,826)**	**1,289**		(82,808)	2,044		(77,302)	3,713	
		1,786,536	**50,955**	**2.85**	1,669,368	51,192	3.07	1,625,068	56,702	3.49

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Equity and liabilities

		2014 Average balance US$m	2014 Interest expense US$m	2014 Cost %	2013 Average balance US$m	2013 Interest expense US$m	2013 Cost %	2012 Average balance US$m	2012 Interest expense US$m	2012 Cost %
Summary										
Interest-bearing liabilities measured at amortised cost (itemised below)		**1,546,633**	**16,250**	**1.05**	1,426,180	15,653	1.10	1,401,254	19,030	1.36
Trading liabilities and financial liabilities designated at fair value (excluding own debt issued)		**178,518**	**2,856**	**1.60**	301,353	3,027	1.00	318,883	3,445	1.08
Non-interest bearing current accounts		**185,990**			184,370			177,085		
Total equity and other non-interest bearing liabilities		**768,902**			780,113			809,732		
Total equity and liabilities		**2,680,043**	**19,106**	**0.71**	2,692,016	18,680	0.69	2,706,954	22,475	0.83
Average cost on all interest-bearing liabilities				**1.11**			1.08			1.31
Deposits by banks[27,64]										
Europe	HSBC Bank	**20,508**	**139**	**0.68**	21,230	165	0.78	26,708	402	1.51
	HSBC Private Banking Holdings (Suisse)	**354**	**1**	**0.28**	351	1	0.28	657	2	0.30
	HSBC France	**6,191**	**53**	**0.86**	7,747	69	0.89	14,833	142	0.96
Asia[63]	Hang Seng Bank	**960**	**9**	**0.94**	1,095	15	1.37	1,305	15	1.15
	The Hongkong and Shanghai Banking	**19,589**	**79**	**0.40**	15,663	90	0.57	17,154	122	0.71

	Corporation									
	HSBC Bank Malaysia	**1,095**	**26**	**2.37**	864	20	2.31	961	20	2.08
MENA	HSBC Bank Middle East	**982**	**3**	**0.31**	1,471	3	0.20	1,586	6	0.38
North America	HSBC Bank USA	**6,436**	**12**	**0.19**	8,131	16	0.20	7,552	19	0.25
	HSBC Bank Canada	**371**	**1**	**0.27**	607	2	0.33	648	3	0.46
Latin America	HSBC Mexico	**2,078**	**73**	**3.51**	1,018	46	4.52	1,103	52	4.71
	Brazilian operations	**2,309**	**84**	**3.64**	3,356	94	2.80	3,931	154	3.92
	HSBC Bank Argentina	**10**	**1**	**10.00**	20	2	10.00	44	3	6.82
Other operations		**334**			63	32	50.79	1,541	61	3.96
		61,217	**481**	**0.79**	61,616	555	0.90	78,023	1,001	1.28
Financial liabilities designated at fair value own debt issued[65]										
Europe	HSBC Holdings	**18,745**	**234**	**1.25**	19,719	366	1.86	23,864	446	1.87
	HSBC Bank	**27,762**	**421**	**1.52**	28,969	443	1.53	28,046	556	1.98
	HSBC France	**8,232**	**66**	**0.80**	9,173	67	0.73	7,147	118	1.65
North America	HSBC Bank USA	**2,032**	**33**	**1.62**	1,933	35	1.81	1,853	38	2.05
	HSBC Finance	**7,195**	**58**	**0.81**	8,878	80	0.90	12,147	184	1.51
Other operations		**2,408**	**25**	**1.04**	3,661	(24)	(0.66)	1,959	(17)	(0.87)
		66,374	**837**	**1.26**	72,333	967	1.34	75,016	1,325	1.77

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Equity and liabilities (continued)

		2014 Average balance US$m	2014 Interest expense US$m	2014 Cost %	2013 Average balance US$m	2013 Interest expense US$m	2013 Cost	2012 Average balance US$m	2012 Interest expense US$m	2012 Cost %
Customer accounts[27,66]										
Europe	HSBC Bank	**372,151**	**2,268**	**0.61**	329,867	2,229	0.68	303,178	2,421	0.80
	HSBC Private Banking Holdings (Suisse)	**8,165**	**31**	**0.38**	16,414	70	0.43	15,912	84	0.53
	HSBC France	**20,988**	**189**	**0.90**	24,519	237	0.97	23,912	320	1.34
Asia[63]	Hang Seng Bank	**98,794**	**472**	**0.48**	91,778	360	0.39	85,425	365	0.43
	The Hongkong and Shanghai Banking Corporation	**377,748**	**2,743**	**0.73**	344,968	2,548	0.74	320,028	2,628	0.82
	HSBC Bank Malaysia	**13,457**	**291**	**2.16**	13,673	295	2.16	13,567	310	2.28
MENA	HSBC Bank Middle East	**16,533**	**75**	**0.45**	18,387	106	0.58	17,477	163	0.93
North America	HSBC Bank USA	**57,015**	**78**	**0.14**	56,411	104	0.18	63,581	223	0.35
	HSBC Bank Canada	**40,682**	**319**	**0.78**	41,905	330	0.79	41,842	328	0.78
Latin America	HSBC Mexico	**15,050**	**300**	**1.99**	15,316	383	2.50	16,718	489	2.92
	Brazilian operations	**18,542**	**1,828**	**9.86**	20,602	1,467	7.12	29,569	2,351	7.95
	HSBC Bank Argentina	**2,758**	**373**	**13.52**	3,318	343	10.34	3,594	268	7.46

Other operations		**46,610**	**164**	**0.35**	58,342	322	0.55	77,253	700	0.91
		1,088,493	**9,131**	**0.84**	1,035,500	8,794	0.85	1,012,056	10,650	1.05
Repurchase agreements non-trading[27]										
Europe	HSBC Bank	**72,481**	**213**	**0.29**	29,019	111	0.38	7,660	57	0.74
	HSBC Private Banking Holdings (Suisse)	**74**			67		0.14	14		0.00
	HSBC France	**29,539**	**59**	**0.20**	37,554	34	0.09	35,255	112	0.32
Asia[63]	Hang Seng Bank	**11**			6		4.24			
	The Hongkong and Shanghai Banking Corporation	**1,760**	**56**	**3.18**	779	32	4.11	1,207	52	4.31
	HSBC Bank Malaysia	**35**	**1**	**2.86**	65	1	1.54	57	1	1.75
MENA	HSBC Bank Middle East	**2**			17	1	5.88	2		0.00
North America	HSBC Bank USA	**11,485**	**20**	**0.17**	9,269	12	0.13	4,588	1	0.02
	HSBC Bank Canada	**2,167**	**25**	**1.15**	2,996	30	1.00	4,239	22	0.52
Latin America	HSBC Mexico	**4,748**	**152**	**3.20**	1,842	90	4.89	1,017	39	3.83
	Brazilian operations	**910**	**96**	**10.55**	1,104	87	7.88	1,175	100	8.51
	HSBC Bank Argentina	**3**								
Other operations		**67,490**	**30**	**0.04**	11,692	7	0.06	322	3	0.93
		190,705	**652**	**0.34**	94,410	405	0.43	55,536	387	0.70
Debt securities in issue										
Europe	HSBC Holdings	**16,781**	**945**	**5.63**	13,405	807	6.02	12,719	797	6.27
	HSBC Bank	**56,949**	**589**	**1.03**	64,528	768	1.19	69,294	989	1.43
	HSBC France	**10,846**	**52**	**0.48**	13,365	54	0.40	14,801	118	0.80
Asia[63]	Hang Seng Bank	**1,155**	**8**	**0.69**	1,393	12	0.86	1,606	15	0.93
	The Hongkong	**6,365**	**176**	**2.77**	7,586	186	2.45	7,732	241	3.12

	and Shanghai Banking Corporation									
	HSBC Bank Malaysia	**461**	**19**	**4.12**	967	26	2.69	1,016	25	2.46
MENA	HSBC Bank Middle East	**2,262**	**45**	**1.99**	3,057	64	2.09	3,769	83	2.20
North America	HSBC Bank USA	**15,935**	**414**	**2.60**	14,012	415	2.96	12,738	390	3.06
	HSBC Finance	**13,045**	**483**	**3.70**	19,888	739	3.72	29,198	1,059	3.63
	HSBC Bank Canada	**10,232**	**257**	**2.51**	13,158	342	2.60	12,675	390	3.08
Latin America	HSBC Mexico	**1,061**	**57**	**5.37**	813	41	5.04	897	51	5.69
	Brazilian operations	**12,707**	**1,565**	**12.32**	10,963	863	7.87	9,114	732	8.03
	HSBC Bank Argentina	**1**			52	10	19.23	121	20	16.53
Other operations		**(18,076)**	**(56)**		(12,211)	(145)		(14,332)	(155)	
		129,724	**4,554**	**3.51**	150,976	4,182	2.77	161,348	4,755	2.95

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		2014 Average balance US$m	2014 Interest expense US$m	2014 Cost %	2013 Average balance US$m	2013 Interest expense US$m	2013 Cost %	2012 Average balance US$m	2012 Interest expense US$m	2012 Cost %
Other interest-bearing liabilities										
Europe	HSBC Bank	**103,819**	**646**	**0.62**	96,464	659	0.68	126,279	671	0.53
	HSBC Private Banking Holdings (Suisse)	**7,903**	**23**	**0.29**	7,869	13	0.17	4,195	4	0.10
	HSBC France	**12,838**	**34**	**0.26**	26,159	77	0.29	20,853	28	0.13
	HSBC Finance				23			303	2	0.66
Asia[63]	Hang Seng Bank	**1,918**	**45**	**2.35**	2,021	48	2.38	1,715	39	2.27
	The Hongkong and Shanghai Banking Corporation	**91,468**	**635**	**0.69**	60,056	490	0.82	52,040	477	0.92
	HSBC Bank Malaysia	**1,342**	**14**	**1.04**	1,339	8	0.60	1,069	16	1.50
MENA	HSBC Bank Middle East	**2,617**	**57**	**2.18**	2,557	58	2.27	1,681	76	4.52
North America	HSBC Bank USA	**17,632**	**11**	**0.06**	17,793	176	0.99	26,255	408	1.55
	HSBC Finance	**5,817**	**258**	**4.44**	5,265	220	4.18	3,196	162	5.07
	HSBC Bank Canada	**599**	**4**	**0.67**	3,007	25	0.83	772	4	0.52
Latin America	HSBC Mexico	**1,031**	**13**	**1.26**	1,658	19	1.15	1,305	19	1.46
	Brazilian operations	**3,927**	**357**	**9.09**	3,497	189	5.40	4,705	362	7.69
		40	**7**	**17.50**	29	3	10.34	26	3	11.54

	HSBC Bank Argentina									
Other operations		**(240,831)**	**(1,509)**		(216,392)	(1,235)		(225,119)	(1,359)	
		10,120	**595**	**5.88**	11,345	750	6.61	19,275	912	4.73
Total interest-bearing liabilities										
Europe	HSBC Holdings	**35,526**	**1,179**	**3.32**	33,125	1,173	3.54	36,583	1,243	3.40
	HSBC Bank	**653,670**	**4,276**	**0.65**	570,077	4,375	0.77	561,165	5,096	0.91
	HSBC Private Banking Holdings (Suisse)	**16,496**	**55**	**0.33**	24,701	84	0.34	20,778	90	0.43
	HSBC France	**88,634**	**453**	**0.51**	118,517	538	0.45	116,801	838	0.72
	HSBC Finance				23			303	2	0.66
Asia[63]	Hang Seng Bank	**102,927**	**535**	**0.52**	96,293	435	0.45	90,051	434	0.48
	The Hongkong and Shanghai Banking Corporation	**496,930**	**3,689**	**0.74**	428,959	3,346	0.78	398,161	3,520	0.88
	HSBC Bank Malaysia	**16,390**	**351**	**2.14**	16,908	350	2.07	16,670	372	2.23
MENA	HSBC Bank Middle East	**22,994**	**190**	**0.83**	25,489	232	0.91	24,515	328	1.34
North America	HSBC Bank USA	**110,535**	**568**	**0.51**	107,549	758	0.70	116,567	1,079	0.93
	HSBC Finance	**26,057**	**799**	**3.07**	34,031	1,039	3.05	44,541	1,405	3.15
	HSBC Bank Canada	**54,051**	**606**	**1.12**	61,673	729	1.18	60,176	747	1.24
Latin America	HSBC Mexico	**23,968**	**595**	**2.48**	20,647	579	2.80	21,040	650	3.09
	Brazilian operations	**38,395**	**3,930**	**10.24**	39,522	2,700	6.83	48,494	3,699	7.63
	HSBC Bank Argentina	**2,812**	**381**	**13.55**	3,419	358	10.47	3,785	294	7.77
Other operations		**(142,752)**	**(1,357)**		(154,753)	(1,043)		(158,376)	(767)	
		1,546,633	**16,250**	**1.05**	1,426,180	15,653	1.10	1,401,254	19,030	1.36

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Net interest margin[67]

		2014 %	2013 %	2012 %
Total				
		1.94	2.13	2.32
Europe	HSBC Bank	**1.30**	1.49	1.38
	HSBC Private Banking Holdings (Suisse)	**0.67**	0.72	1.19
	HSBC France	**1.52**	1.11	1.03
	HSBC Finance		5.78	4.50
Asia[63]	Hang Seng Bank	**2.16**	2.13	2.10
	The Hongkong and Shanghai Banking Corporation	**1.58**	1.70	1.75
	HSBC Bank Malaysia	**2.68**	2.58	2.62
MENA	HSBC Bank Middle East	**2.52**	2.51	2.64
North America	HSBC Bank USA	**1.51**	1.44	1.74
	HSBC Finance	**4.23**	4.99	5.93
	HSBC Bank Canada	**1.74**	1.58	1.75
Latin America	HSBC Mexico	**5.02**	5.88	5.75
	Brazilian operations	**6.14**	7.60	7.61
	HSBC Bank Argentina	**11.79**	9.88	11.74

Distribution of average total assets

		2014 %	2013 %	2012 %
Europe	HSBC Bank	**39.2**	40.1	44.8
	HSBC Private Banking Holdings (Suisse)	**1.5**	2.0	1.7
	HSBC France	**9.0**	11.4	11.5
Asia[63]	Hang Seng Bank	**5.7**	5.3	4.8
	The Hongkong and Shanghai Banking Corporation	**26.3**	25.0	23.3
	HSBC Bank Malaysia	**0.9**	1.0	1.0
MENA	HSBC Bank Middle East	**1.9**	2.0	1.8
North America	HSBC Bank USA	**8.5**	8.7	10.2
	HSBC Finance	**1.3**	1.7	2.1
	HSBC Bank Canada	**3.0**	3.2	3.2
Latin America	HSBC Mexico	**1.5**	1.5	1.5
	Brazilian operations	**2.4**	2.3	2.7
	HSBC Bank Argentina			0.2

Other operations (including consolidation adjustments)	**(1.2)**	(4.2)	(8.8)
	100.0	100.0	100.0

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Analysis of changes in net interest income and net interest expense

The following tables allocate changes in net interest income and net interest expense between volume and rate for 2014 compared with 2013, and for 2013 compared with 2012. We isolate volume variances and allocate any change arising from both volume and rate to rate.

Interest income

			Increase/(decrease) in 2014 compared with 2013			Increase/(decrease) in 2013 compared with 2012		
		2014	**Volume**	**Rate**	2013	Volume	Rate	2012
		US$m	**US$m**	**US$m**	US$m	US$m	US$m	US$m
Short-term funds and loans and advances to banks[27]								
Europe	HSBC Bank	**997**	**66**	**51**	880	94	(214)	1,000
	HSBC Private Banking Holdings (Suisse)	**10**	**(4)**	**4**	10	57	(56)	9
	HSBC France	**66**	**(31)**	**4**	93	(23)	1	115
Asia[63]	Hang Seng Bank	**279**	**(17)**	**45**	251	2	(34)	283
	The Hongkong and Shanghai Banking Corporation	**822**	**57**	**(44)**	809	(12)	(16)	837
	HSBC Bank Malaysia	**158**	**(13)**	**9**	162	36	3	123
MENA	HSBC Bank Middle East	**29**	**(2)**	**4**	27	(3)	(2)	32
North America	HSBC Bank USA	**105**	**11**	**10**	84	5	(25)	104
	HSBC Bank Canada	**4**	**1**		3		(1)	4
Latin America	HSBC Mexico	**86**	**(7)**	**(16)**	109	(8)	(2)	119
	Brazilian operations	**498**	**(11)**	**121**	388	(280)	(67)	735
	HSBC Bank Argentina	**12**	**(2)**	**(4)**	18	245	(245)	18
Other operations		**2**	**(5)**	**(10)**	17	(97)	(12)	126
		3,068	**9**	**208**	2,851	8	(662)	3,505
Loans and advances to customers[27]								
Europe	HSBC Bank	**10,423**	**386**	**(594)**	10,631	412	(346)	10,565

	HSBC Private Banking Holdings (Suisse)	**159**	**(28)**	**(7)**	194	42	(47)	199
	HSBC France	**1,626**	**(128)**	**98**	1,656	87	(80)	1,649
	HSBC Finance		**(10)**		10	(34)	2	42
Asia[63]	Hang Seng Bank	**2,410**	**211**	**20**	2,179	223	61	1,895
	The Hongkong and Shanghai Banking Corporation	**8,517**	**870**	**(375)**	8,022	1,057	(662)	7,627
	HSBC Bank Malaysia	**672**	**(19)**	**8**	683	25	(49)	707
MENA	HSBC Bank Middle East	**1,133**	**48**	**(39)**	1,124	77	(167)	1,214
North America	HSBC Bank USA	**1,791**	**227**	**(212)**	1,776	95	(34)	1,715
	HSBC Finance	**2,171**	**(691)**	**(202)**	3,064	(844)	5	3,903
	HSBC Bank Canada	**1,371**	**(63)**	**3**	1,431	(74)	(46)	1,551
Latin America	HSBC Mexico	**1,542**	**47**	**(163)**	1,658	103	(58)	1,613
	Brazilian operations	**4,579**	**284**	**(309)**	4,604	(383)	(481)	5,468
	HSBC Bank Argentina	**798**	**(119)**	**118**	799	(6)	87	718
Other operations		**237**	**(134)**	**(327)**	698	(1,373)	67	2,004
		37,429	**1,458**	**(2,558)**	38,529	258	(2,599)	40,870

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Interest income (continued)

			Increase/(decrease) in 2014 compared with 2013			Increase/(decrease) in 2013 compared with 2012		
		2014	**Volume**	**Rate**	2013	Volume	Rate	2012
		US$m	**US$m**	**US$m**	US$m	US$m	US$m	US$m
Reverse repurchase agreements non-trading[27]								
Europe	HSBC Bank	**450**	**153**	**184**	113	87	(45)	71
	HSBC France	**62**	**(16)**	**30**	48	5	(82)	125
Asia[63]	The Hongkong and Shanghai Banking Corporation	**333**	**275**	**(214)**	272	113	(47)	206
	HSBC Bank Malaysia	**31**	**18**	**2**	11	(23)		34
MENA	HSBC Bank Middle East	**2**	**(7)**	**2**	7	5	(7)	9
North America	HSBC Bank USA	**10**	**(5)**	**2**	13	(21)	5	29
	HSBC Finance					(1)		1
	HSBC Bank Canada	**84**	**(20)**	**11**	93	46	(3)	50
Latin America	HSBC Mexico	**3**	**(2)**		5		5	
	Brazilian operations	**753**	**124**	**225**	404	(5)	(11)	420
	HSBC Bank Argentina	**10**	**(5)**	**2**	13	(15)	1	27
Other operations		**62**	**77**	**(31)**	16	1,103	(1,090)	3
		1,800	**730**	**75**	995	365	(345)	975
Financial investments								
Europe	HSBC Bank	**867**	**168**	**(524)**	1,223	125	(177)	1,275
	HSBC Private Banking Holdings (Suisse)	**114**	**(35)**	**(34)**	183	146	(70)	107
	HSBC France	**113**	**(7)**	**26**	94	29	(65)	130
Asia[63]	Hang Seng Bank	**655**	**33**	**21**	601	44	(33)	590
	The Hongkong and Shanghai Banking Corporation	**2,109**	**227**	**101**	1,781	126	(166)	1,821
	HSBC Bank Malaysia	**94**	**18**	**4**	72	13		59
MENA	HSBC Bank Middle East	**104**	**(13)**	**4**	113	17	(17)	113
North America	HSBC Bank USA	**774**	**(131)**	**21**	884	(93)	(115)	1,092
	HSBC Finance					(67)		67
	HSBC Bank Canada	**246**	**(33)**		279	(11)	(7)	297

Latin America	HSBC Mexico	**409**	**96**	**(38)**	351	(11)	(17)	379
	Brazilian operations	**1,003**	**94**	**169**	740	(227)	(52)	1,019
	HSBC Bank Argentina	**130**	**11**	**48**	71	(34)	9	96
Other operations		**1,705**	**(403)**	**498**	1,610	(658)	235	2,033
		8,323	**132**	**189**	8,002	140	(1,216)	9,078

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Interest expense

			Increase/(decrease) in 2014 compared with 2013			Increase/(decrease) in 2013 compared with 2012		
		2014	**Volume**	**Rate**	2013	Volume	Rate	2012
		US$m	**US$m**	**US$m**	US$m	US$m	US$m	US$m
Deposits by banks[27]								
Europe	HSBC Bank	**139**	**(6)**	**(20)**	165	(83)	(154)	402
	HSBC Private Banking Holdings (Suisse)	**1**			1	(1)		2
	HSBC France	**53**	**(14)**	**(2)**	69	(68)	(5)	142
Asia[63]	Hang Seng Bank	**9**	**(2)**	**(4)**	15	(2)	2	15
	The Hongkong and Shanghai Banking Corporation	**79**	**22**	**(33)**	90	(11)	(21)	122
	HSBC Bank Malaysia	**26**	**5**	**1**	20	(2)	2	20
MENA	HSBC Bank Middle East	**3**	**(1)**	**1**	3		(3)	6
North America	HSBC Bank USA	**12**	**(3)**	**(1)**	16	1	(4)	19
	HSBC Bank Canada	**1**	**(1)**		2		(1)	3
Latin America	HSBC Mexico	**73**	**48**	**(21)**	46	(4)	(2)	52
	Brazilian operations	**84**	**(29)**	**19**	94	(23)	(37)	154
	HSBC Bank Argentina	**1**	**(1)**		2	(2)	1	3
Other operations			**138**	**(170)**	32	(59)	30	61
		481	**(4)**	**(70)**	555	(210)	(236)	1,001
Customer accounts[27]								
Europe	HSBC Bank	**2,268**	**288**	**(249)**	2,229	214	(406)	2,421
	HSBC Private Banking Holdings (Suisse)	**31**	**(35)**	**(4)**	70	3	(17)	84
	HSBC France	**189**	**(34)**	**(14)**	237	8	(91)	320
Asia[63]	Hang Seng Bank	**472**	**27**	**85**	360	27	(32)	365
	The Hongkong and Shanghai Banking Corporation	**2,743**	**243**	**(48)**	2,548	205	(285)	2,628
	HSBC Bank Malaysia	**291**	**(5)**	**1**	295	2	(17)	310
MENA	HSBC Bank Middle East	**75**	**(11)**	**(20)**	106	8	(65)	163
North America	HSBC Bank USA	**78**	**1**	**(27)**	104	(25)	(94)	223
	HSBC Bank Canada	**319**	**(10)**	**(1)**	330		2	328
Latin America	HSBC Mexico	**300**	**(7)**	**(76)**	383	(41)	(65)	489

Brazilian operations	**1,828**	**(147)**	**508**	1,467	(713)	(171)	2,351
HSBC Bank Argentina	**373**	**(58)**	**88**	343	(21)	96	268
Other operations	**164**	**(65)**	**(93)**	322	(172)	(206)	700
	9,131	**450**	**(113)**	8,794	246	(2,102)	10,650

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			Increase/(decrease) in 2014 compared with 2013			Increase/(decrease) in 2013 compared with 2012		
		2014	**Volume**	**Rate**	2013	Volume	Rate	2012
		US$m	**US$m**	**US$m**	US$m	US$m	US$m	US$m
Repurchase agreements non-trading[27]								
Europe	HSBC Bank	**213**	**165**	**(63)**	111	158	(104)	57
	HSBC France	**59**	**(7)**	**32**	34	7	(85)	112
Asia[63]	The Hongkong and Shanghai Banking Corporation	**56**	**40**	**(16)**	32	(18)	(2)	52
	HSBC Bank Malaysia	**1**	**(1)**	**1**	1			1
MENA	HSBC Bank Middle East		**(1)**		1		1	
North America	HSBC Bank USA	**20**	**3**	**5**	12	1	10	1
	HSBC Bank Canada	**25**	**(8)**	**3**	30	(6)	14	22
Latin America	HSBC Mexico	**152**	**141**	**(79)**	90	32	19	39
	Brazilian operations	**96**	**(15)**	**24**	87	(6)	(7)	100
	HSBC Bank Argentina							
Other operations		**30**	**33**	**(10)**	7	106	(102)	3
		652	**414**	**(167)**	405	272	(254)	387
Financial liabilities designated at fair value own debt issued								
Debt securities in issue								
Europe	HSBC Holdings	**945**	**203**	**(65)**	807	43	(33)	797
	HSBC Bank	**589**	**(90)**	**(89)**	768	(68)	(153)	989
	HSBC France	**52**	**(10)**	**8**	54	(11)	(53)	118
Asia[63]	Hang Seng Bank	**8**	**(2)**	**(2)**	12	(2)	(1)	15
	The Hongkong and Shanghai Banking Corporation	**176**	**(28)**	**18**	186	(7)	(48)	241
	HSBC Bank Malaysia	**19**	**(14)**	**7**	26	(1)	2	25
MENA	HSBC Bank Middle East	**45**	**(17)**	**(2)**	64	(16)	(3)	83
North America	HSBC Bank USA	**414**	**57**	**(58)**	415	39	(14)	390
	HSBC Finance	**483**	**(255)**	**(1)**	739	(338)	18	1,059
	HSBC Bank Canada	**257**	**(76)**	**(9)**	342	15	(63)	390
Latin America	HSBC Mexico	**57**	**12**	**4**	41	(5)	(5)	51
	Brazilian operations	**1,565**	**137**	**565**	863	148	(17)	732
	HSBC Bank Argentina		**(10)**		10	(11)	1	20
Other operations		**(56)**		**89**	(145)		10	(155)

	4,554	**(589)**	**961**	4,182	(306)	(267)	4,755

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Short-term borrowings

Short-term borrowings in the form of repurchase agreements are shown separately on the face of the balance sheet. Other forms of short-term borrowings are included within customer accounts, deposits by banks, debt securities in issue and trading liabilities. Short-term borrowings are defined by the US Securities and Exchange Commission as Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings.

Our only significant short-term borrowings are securities sold under agreements to repurchase and certain debt securities in issue. For securities sold under agreements to repurchase, we run matched repo and reverse repo trading books. We generally observe lower year-end demand in our reverse repo lending business which results in lower repo balances at the balance sheet date. Additional information on these is provided in the table below.

Repos and short-term bonds

	2014 US$m	2013 US$m	2012 US$m
Securities sold under agreements to repurchase			
Outstanding at 31 December	**111,230**	181,641	170,790
Average amount outstanding during the year	**195,482**	218,580	206,352
Maximum quarter-end balance outstanding during the year	**227,637**	210,452	176,162
Weighted average interest rate during the year	**0.3%**	0.3%	0.4%
Weighted average interest rate at the year-end	**0.6%**	0.5%	0.5%
Short-term bonds			
Outstanding at 31 December	**38,868**	40,667	44,240
Average amount outstanding during the year	**39,547**	46,455	40,349
Maximum quarter-end balance outstanding during the year	**41,117**	54,933	44,240
Weighted average interest rate during the year	**1.7%**	1.4%	1.4%
Weighted average interest rate at the year-end	**1.6%**	0.7%	1.3%

Contractual obligations

The table below provides details of our material contractual obligations as at 31 December 2014.

Payments due by period				
Total	Less than	1 3 years	3 5 years	

		1 year			More than 5 years
	US$m	US$m	US$m	US$m	US$m
Long-term debt obligations	**198,051**	**56,704**	**46,735**	**27,135**	**67,477**
Term deposits and certificates of deposit	**128,790**	**121,865**	**3,825**	**2,528**	**572**
Capital (finance) lease obligations	**87**	**32**	**29**	**5**	**21**
Operating lease obligations	**5,372**	**1,022**	**1,555**	**1,000**	**1,795**
Purchase obligations	**656**	**540**	**40**	**53**	**23**
Short positions in debt securities and equity shares	**64,917**	**44,466**	**6,913**	**2,729**	**10,809**
Current tax liability	**1,213**	**1,213**			
Pension/healthcare obligation	**17,466**	**1,536**	**3,198**	**3,398**	**9,334**
	416,552	**227,378**	**62,295**	**36,848**	**90,031**

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Loan maturity and interest sensitivity analysis

At 31 December 2014, the geographical analysis of loan maturity and interest sensitivity by loan type on a contractual repayment basis was as follows:

	Europe US$m	Asia US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Maturity of 1 year or less						
Loans and advances to banks	16,736	58,142	10,013	6,957	9,025	100,873
Commercial loans to customers						
Manufacturing and international trade and services	76,974	88,223	9,441	11,333	14,894	200,865
Real estate and other property related	10,708	23,722	1,395	3,634	1,511	40,970
Non-bank financial institutions	14,887	10,458	1,876	4,978	958	33,157
Governments	1,104	250	1,072	10	398	2,834
Other commercial	31,419	19,586	2,047	2,780	3,468	59,300
	135,092	142,239	15,831	22,735	21,229	337,126
Maturity after 1 year but within 5 years						
Loans and advances to banks	4,667	3,497	483	370	335	9,352
Commercial loans to customers						
Manufacturing and international trade and services	29,570	21,185	1,969	15,257	4,984	72,965
Real estate and other property related	17,122	36,462	664	8,082	618	62,948
Non-bank financial institutions	7,115	3,436	1,336	3,868	403	16,158
Governments	235	359	481	33	172	1,280
Other commercial	18,377	14,714	1,563	7,829	2,477	44,960
	72,419	76,156	6,013	35,069	8,654	198,311
Interest rate sensitivity of loans and advances to banks and commercial loans to customers						
Fixed interest rate	14,799	2,182	1,277	3,988	3,150	25,396
Variable interest rate	62,289	77,471	5,219	31,451	5,839	182,269
	77,088	79,653	6,496	35,439	8,989	207,665
Maturity after 5 years						
Loans and advances to banks	523	1,321		80		1,924

Commercial loans to customers						
Manufacturing and international trade and services	**9,742**	**1,175**	**677**	**2,193**	**361**	**14,148**
Real estate and other property related	**7,482**	**9,873**	**185**	**3,774**	**442**	**21,756**
Non-bank financial institutions	**941**	**103**	**78**	**187**	**31**	**1,340**
Governments	**923**	**585**		**121**	**400**	**2,029**
Other commercial	**9,064**	**4,666**	**1,092**	**2,946**	**998**	**18,766**
	28,152	**16,402**	**2,032**	**9,221**	**2,232**	**58,039**
Interest rate sensitivity of loans and advances to banks and commercial loans to customers						
Fixed interest rate	**7,698**	**1,220**	**695**	**724**	**351**	**10,688**
Variable interest rate	**20,977**	**16,503**	**1,337**	**8,577**	**1,881**	**49,275**
	28,675	**17,723**	**2,032**	**9,301**	**2,232**	**59,963**

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Deposits

The following tables summarise the average amount of bank deposits, customer deposits and certificates of deposit (CD s) and other money market instruments (which are included within Debt securities in issue in

the balance sheet), together with the average interest rates paid thereon for each of the past three years. The geographical analysis of average deposits is based on the location of the office in which the deposits are recorded and excludes balances with HSBC companies.

Deposits by banks[27]

	2014		2013		2012	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**36,427**		42,687		52,274	
Demand and other non-interest bearing	**8,819**		13,198		9,377	
Demand interest bearing	**5,778**	**0.4**	5,154	0.5	8,988	0.4
Time	**14,191**	**1.0**	17,465	1.1	24,698	1.5
Other	**7,639**	**0.4**	6,870	0.7	9,211	2.0
Asia[63]	**26,524**		26,928		26,676	
Demand and other non-interest bearing	**5,189**		9,606		7,222	
Demand interest bearing	**13,828**	**0.5**	12,181	0.6	11,832	0.6
Time	**3,581**	**0.7**	4,282	0.8	5,891	1.2
Other	**3,926**	**0.3**	859	1.6	1,731	0.9
Middle East and North Africa	**1,546**		2,529		1,890	
Demand and other non-interest bearing	**563**		1,058		301	
Demand interest bearing	**3**		12		8	6.5
Time	**938**	**0.2**	1,422	0.2	1,543	0.4
Other	**42**		37		38	1.4
North America	**10,497**		12,237		12,696	
Demand and other non-interest bearing	**3,686**		3,488		4,470	
Demand interest bearing	**2,557**	**0.1**	2,787	0.1	2,996	0.1
Time	**3,308**	**0.3**	5,110	0.3	4,756	0.4
Other	**946**	**0.1**	852		474	0.2

Latin America	**4,642**		4,703		6,070	
Demand and other non-interest bearing	**162**		118		212	
Demand interest bearing	**837**	**3.8**	333	4.5	333	3.9
Time	**2,244**	**3.0**	2,783	3.1	3,665	3.7
Other	**1,399**	**4.4**	1,469	4.4	1,860	5.1
Total	**79,636**		89,084		99,606	
Demand and other non-interest bearing	**18,419**		27,467		21,582	
Demand interest bearing	**23,003**	**0.6**	20,468	0.5	24,157	0.5
Time	**24,262**	**1.0**	31,062	1.1	40,553	1.4
Other	**13,952**	**0.7**	10,087	1.2	13,314	2.2

For footnotes, see page 109.

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Customer accounts[27]

	2014 Average balance US$m	**2014** Average rate %	2013 Average balance US$m	2013 Average rate %	2012 Average balance US$m	2012 Average rate %
Europe	**490,511**		462,669		436,756	
Demand and other non-interest bearing	**73,088**		75,480		71,342	
Demand interest bearing	**314,374**	**0.4**	272,973	0.4	242,769	0.4
Savings	**57,464**	**1.4**	63,585	1.4	62,626	1.8
Time	**43,760**	**1.0**	50,010	1.1	59,034	1.3
Other	**1,825**	**2.6**	621	8.2	985	4.0
Asia[63]	**566,595**		533,002		505,395	
Demand and other non-interest bearing	**62,988**		59,023		55,628	
Demand interest bearing	**374,026**	**0.2**	347,526	0.2	314,762	0.3
Savings	**108,074**	**2.3**	104,099	2.2	107,176	2.1
Time	**21,381**	**0.9**	20,978	0.7	26,633	1.0
Other	**126**	**2.4**	1,376	0.4	1,196	0.8
Middle East and North Africa	**39,076**		40,451		37,604	
Demand and other non-interest bearing	**18,410**		16,801		14,564	
Demand interest bearing	**11,587**	**0.4**	13,248	0.4	10,967	0.6
Savings	**7,974**	**2.1**	9,981	2.6	11,555	3.0
Time	**1,074**	**1.2**	357	1.4	452	2.2
Other	**31**		64		66	1.5
North America	**135,692**		137,181		145,230	
Demand and other non-interest bearing	**27,361**		27,992		28,403	
Demand interest bearing	**38,843**	**0.3**	37,837	0.3	38,419	0.3
Savings	**60,075**	**0.5**	63,565	0.6	68,039	0.7
Time	**9,290**	**0.2**	7,673	0.3	9,587	0.4
Other	**123**	**0.8**	114	1.8	782	0.4
Latin America	**50,918**		54,585		71,212	
Demand and other non-interest bearing	**12,452**		13,092		14,203	
Demand interest bearing	**7,412**	**1.2**	7,237	1.8	8,258	2.2
Savings	**22,062**	**10.0**	24,652	7.4	35,294	7.5
Time	**8,850**	**2.8**	9,459	4.4	13,095	4.0
Other	**142**	**5.6**	145	9.7	362	4.1
Total	**1,282,792**		1,227,888		1,196,197	

Demand and other non-interest bearing	**194,299**		192,388		184,140	
Demand interest bearing	**746,242**	**0.3**	678,821	0.3	615,175	0.4
Savings	**255,649**	**2.3**	265,882	2.1	284,690	2.4
Time	**84,355**	**1.1**	88,477	1.3	108,801	1.5
Other	**2,247**	**2.6**	2,320	3.1	3,391	2.0

For footnotes, see page 109.

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Report of the Directors: Financial Review (continued)

Customer accounts by country

	2014	2013
	US$m	US$m
Europe	**545,959**	581,933
UK	**439,313**	462,796
France[35]	**40,750**	45,149
Germany	**15,757**	16,615
Switzerland	**11,058**	16,796
Turkey	**7,856**	7,795
Other	**31,225**	32,782
Asia[8]	**577,491**	548,483
Hong Kong	**389,094**	365,905
Australia	**19,312**	19,812
India	**11,678**	11,549
Indonesia	**5,788**	5,865
Mainland China	**46,588**	40,579
Malaysia	**16,292**	17,093
Singapore	**43,731**	43,988
Taiwan	**14,901**	12,758
Other	**30,107**	30,934
Middle East and North Africa (excluding Saudi Arabia)	**39,720**	38,683
Egypt	**7,663**	7,401
UAE	**19,771**	18,433
Other	**12,286**	12,849
North America	**138,884**	140,809
US	**84,894**	80,037
Canada	**43,871**	47,872
Other	**10,119**	12,900
Latin America	**48,588**	51,389
Argentina	**4,384**	4,468
Brazil	**23,204**	23,999
Mexico	**18,360**	21,529
Other	**2,640**	1,393
At 31 December	1,350,642	1,361,297

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Certificates of deposit and other money market instruments

	2014		2013		2012	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**20,970**	**0.4**	28,680	0.5	32,602	0.4
Asia	**2,441**	**1.6**	3,199	2.0	5,321	2.4
North America	**5,406**	**0.3**	5,583	0.6	9,339	0.6
Latin America	**12,035**	**12.1**	9,335	8.3	7,344	8.5
	40,852	**3.9**	46,797	2.3	54,606	1.8

Certificates of deposit and other time deposits

The maturity analysis of certificates of deposit (CD s) and other wholesale time deposits is expressed by remaining maturity. The majority of CDs and time deposits are in amounts of US$100,000 and over or the equivalent in other currencies.

	At 31 December 2014				
	3 months or less US$m	**After 3 months but within 6 months US$m**	**After 6 months but within 12 months US$m**	**After 12 months US$m**	**Total US$m**
Europe	**48,787**	**11,442**	**5,078**	**4,515**	**69,822**
Certificates of deposit	**8,315**	**6,115**	**1,005**		**15,435**
Time deposits:					
banks	**10,446**	**1,160**	**321**	**2,166**	**14,093**
customers	**30,026**	**4,167**	**3,752**	**2,349**	**40,294**
Asia	**23,299**	**1,177**	**1,039**	**1,023**	**26,538**
Certificates of deposit	**641**	**221**	**44**	**717**	**1,623**
Time deposits:					
banks	**2,080**	**34**	**4**	**21**	**2,139**
customers	**20,578**	**922**	**991**	**285**	**22,776**
Middle East and North Africa	**913**	**150**	**721**	**215**	**1,999**

Time deposits:					
banks	**541**	**134**	**13**		**688**
customers	**372**	**16**	**708**	**215**	**1,311**
North America	**13,336**	**3,028**	**713**	**526**	**17,603**
Time deposits:					
banks	**3,369**	**2**		**87**	**3,458**
customers	**9,967**	**3,026**	**713**	**439**	**14,145**
Latin America	**10,189**	**1,131**	**864**	**646**	**12,830**
Certificates of deposit	**983**	**697**	**31**	**496**	**2,207**
Time deposits:					
banks	**1,900**	**135**	**725**	**123**	**2,883**
customers	**7,306**	**299**	**108**	**27**	**7,740**
Total	**96,524**	**16,928**	**8,415**	**6,925**	**128,792**
Certificates of deposit	**9,939**	**7,033**	**1,080**	**1,213**	**19,265**
Time deposits:					
banks	**18,336**	**1,465**	**1,063**	**2,397**	**23,261**
customers	**68,249**	**8,430**	**6,272**	**3,315**	**86,266**

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Ratio of earnings to fixed charges[69]

	2014	2013	2012	2011	2010
Ratio of earnings to fixed charges					
excluding interest on deposits	**3.39**	3.84	3.03	2.82	2.71
including interest on deposits	**1.86**	2.09	1.76	1.68	1.73
Ratio of earnings to combined fixed charges and preference share dividends					
excluding interest on deposits	**3.07**	3.50	2.79	2.64	2.56
including interest on deposits	**1.79**	2.01	1.71	1.64	1.69

For footnote, see page 109.

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Report of the Directors: Financial Review (continued)

Reconciliation of RoRWA measures

Performance Management

During 2014, we targeted a return on average ordinary shareholders equity of 12% 15%. For internal management purposes we monitored global businesses and geographical regions by pre-tax return on RWAs, a metric which combines return on equity and regulatory capital efficiency objectives. We targeted a return on average risk-weighted assets of 2.2%-2.6% in 2014.

In addition to the return on average risk-weighted assets (RoRWA) we measure our performance internally using the non-GAAP measure of adjusted RoRWA, which is adjusted profit before tax as a percentage of average risk-weighted assets adjusted for the effects of foreign

currency translation differences and the effects of significant items. Excluded from adjusted RoRWA are certain items which distort year-on-year performance as explained on page 40.

We also present the non-GAAP measure of adjusted RoRWA which is further adjusted for the effect of operations that are not regarded as contributing to the long-term performance of the Group. These include the run-off portfolios and the CRS business which was sold in 2012.

The CRS average RWAs in the table below represent the average of the associated operational risk RWAs that were not immediately released on disposal and have not already been adjusted as part of the adjusted RoRWA calculation. At the end of 2014, the residual CRS operational risk RWAs relating to the CRS portfolio were fully amortised.

Reconciliation of adjusted RoRWA (excluding run-off portfolios and Card and Retail Services)

	2014			2013		
	Pre-tax return US$m	**Average RWAs[36] US$bn**	**RoRWA[36] %**	Pre-tax return US$m	Average RWAs[36] US$bn	RoRWA[36] %
Reported	**18,680**	**1,209**	**1.5**	22,565	1,104	2.0
	22,829	**1,207**	**1.9**	22,981	1,071	2.1

Adjusted[37]						
Run-off portfolios	**870**	**115**	**0.8**	443	121	0.4
Legacy credit in GB&M	**172**	**48**	**0.4**	186	33	0.6
US CML and other[38]	**698**	**67**	**1.0**	257	88	0.3
Card and Retail Services					4	
Adjusted (excluding run-off portfolios and CRS)	**21,959**	**1,092**	**2.0**	22,538	946	2.4

Reconciliation of reported and adjusted average risk-weighted assets

	Year ended 31 December		
	2014 **US$bn**	2013 US$bn	Change %
Average reported RWAs[36]	**1,209**	1,104	9.5
Currency translation adjustment[33]		(8)	
Acquisitions, disposals and dilutions	**(2)**	(21)	
Other significant items		(4)	
Average adjusted RWAs[36]	**1,207**	1,071	12.6

For footnotes, see page 109.

Critical accounting

estimates and judgements

The results of HSBC reflect the choice of accounting policies, assumptions and estimates that underlie the preparation of HSBC s consolidated financial statements. The significant accounting policies, including the policies which include critical accounting estimates and judgements, are described in Note 1 and in the individual Notes on the Financial Statements. The accounting policies listed below are highlighted as they involve a high degree of judgement and estimation uncertainty and have a material impact on the financial statements:

Impairment of loans and advances: Note 1(k) on page 349;
Deferred tax assets: Note 8 on page 365;

Valuation of financial instruments: Note 13 on page 378;

- Impairment of interests in associates: Note 20 on page 403;
- Goodwill impairment: Note 21 on page 407; and
- Provisions: Note 29 on page 420.

In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of the items above, it is possible that the outcomes in the next financial year could differ from those on which management s estimates are based, resulting in the recognition and measurement of materially different amounts from those estimated by management in the 2014 Financial Statements.

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Report of the Directors: Financial Review (continued)

Global businesses

Summary

HSBC reviews operating activity on a number of bases, including by geographical region and by global business.

The commentaries below present global businesses followed by geographical regions (page 78). Performance is discussed in this order because certain strategic themes, business initiatives and trends affect more than one geographical region. All commentaries are on an

adjusted basis (page 40) unless stated otherwise, while tables are on a reported basis unless stated otherwise.

Basis of preparation

The results of global businesses are presented in accordance with the accounting policies used in the preparation of HSBC s consolidated financial statements. Our operations are closely integrated and, accordingly, the presentation of global business data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and global functions, to the extent that these can be meaningfully attributed to operational business lines. While such allocations have been made on a systematic and consistent basis, they necessarily involve some subjectivity.

Where relevant, income and expense amounts presented include the results of inter-segment funding along with inter-company and inter-business line transactions. All such transactions are undertaken on arm s length terms.

The expense of the UK bank levy is included in the Europe geographical region as HSBC regards the levy as a cost of being headquartered in the UK. For the purposes of the presentation by global business, the cost of the levy is included in Other .

Profit/(loss) before tax

	2014		2013		2012	
	US$m	**%**	US$m	%	US$m	%
Retail Banking and Wealth Management	**5,651**	**30.3**	6,649	29.5	9,575	46.4
Commercial Banking	**8,744**	**46.8**	8,441	37.4	8,535	41.3
Global Banking and Markets	**5,889**	**31.5**	9,441	41.8	8,520	41.3
Global Private Banking	**626**	**3.4**	193	0.9	1,009	4.9
Other[39]	**(2,230)**	**(12.0)**	(2,159)	(9.6)	(6,990)	(33.9)
Year ended 31 December	**18,680**	**100.0**	22,565	100.0	20,649	100.0

Total assets[40]

	2014		2013	
	US$m	**%**	US$m	%
Retail Banking and Wealth Management	**499,083**	**18.9**	517,085	19.4
Commercial Banking	**372,739**	**14.2**	360,623	13.5
Global Banking and Markets	**1,839,644**	**69.8**	1,975,509	74.0
Global Private Banking	**88,342**	**3.4**	97,655	3.7
Other	**164,537**	**6.2**	171,812	6.4
Intra-HSBC items	**(330,206)**	**(12.5)**	(451,366)	(17.0)

At 31 December	**2,634,139**	**100.0**	2,671,318	100.0

For footnotes, see page 109.

Risk-weighted assets

	2014		2013	
	US$bn	**%**	US$bn	%
Retail Banking and Wealth Management	**205.1**	**16.8**	233.5	21.4
Commercial Banking	**432.4**	**35.4**	391.7	35.8
Global Banking and Markets	**516.1**	**42.3**	422.3	38.6
Global Private Banking	**20.8**	**1.8**	21.7	2.0
Other	**45.4**	**3.7**	23.5	2.2
At 31 December	**1,219.8**	**100.0**	1,092.7	100.0

Principal Retail Banking and Wealth Management business

RBWM comprises the Principal RBWM business, the US run-off portfolio and the disposed-of US CRS business. We believe that looking at the Principal RBWM business allows management to more clearly discuss the cause of material changes from year-to-year in the ongoing

business and to assess the factors and trends in the business which are expected to have a material effect in future years. The reconciliation of RBWM to Principal RBWM is on page 64. Tables which reconcile reported to adjusted financial measures are available on www.hsbc.com.

Retail Banking and Wealth Management

RBWM provides banking and wealth management services for our personal customers to help them secure their future prosperity and realise their ambitions.

	Total RBWM US$m	US CRS US$m	US run-off portfolio US$m	Principal RBWM US$m
2014				
Net interest income	**16,782**		**1,390**	**15,392**
Net fee income	**6,668**		**(4)**	**6,672**
Other income/(expense)[42]	**1,144**		**(49)**	**1,193**
Net operating income[4]	**24,594**		**1,337**	**23,257**
LICs[43]	**(1,819)**		**(30)**	**(1,789)**
Net operating income	**22,775**		**1,307**	**21,468**
Total operating expenses	**(17,522)**		**(738)**	**(16,784)**
Operating profit	**5,253**		**569**	**4,684**
Income from associates[44]	**398**			**398**
Profit before tax	**5,651**		**569**	**5,082**
RoRWA[36]	**2.6%**		**0.8%**	**3.3%**
2013				
Net interest income	18,339		2,061	16,278
Net fee income	7,021		11	7,010
Other income/(expense)[42]	1,380		(400)	1,780
Net operating income[4]	26,740		1,672	25,068
LICs[43]	(3,227)		(705)	(2,522)
Net operating income	23,513		967	22,546
Total operating expenses	(17,248)		(1,166)	(16,082)
Operating profit/(loss)	6,265		(199)	6,464
Income/(expense) from associates[44]	384		(1)	385
Profit/(loss) before tax	6,649		(200)	6,849
RoRWA[36]	2.6%		(0.2%)	4.4%
2012				
Net interest income	20,298	1,267	2,563	16,468

Net fee income	7,205	395	33	6,777
Other income/(expense)[42]	6,358	3,155	(200)	3,403
Net operating income[4]	33,861	4,817	2,396	26,648
LICs[43]	(5,515)	(322)	(2,569)	(2,624)
Net operating income/ (expense)	28,346	4,495	(173)	24,024
Total operating expenses	(19,769)	(729)	(1,103)	(17,937)
Operating profit/(loss)	8,577	3,766	(1,276)	6,087
Income from associates[44]	998		2	996
Profit/(loss) before tax	9,575	3,766	(1,274)	7,083
RoRWA[36]	3.1%	14.7%	(1.1%)	4.2%

For footnotes, see page 109.

Principal RBWM RoRWA

3.3%

Global mobile application

downloads surpass

6 million

Best Mobile Banking Application 2014

(Global Finance Magazine)

Strategic direction

RBWM provides retail banking and wealth management services for personal customers in markets where we have, or can build, the scale in our target customer segments to do so cost effectively.

We focus on three strategic imperatives:

- building a consistent, high standard, customer needs-driven wealth management service for retail customers drawing on our Insurance and Asset Management businesses;

- using our global expertise to improve customer service and productivity to provide a high standard of banking solutions and service to our customers efficiently; and simplifying and re-shaping the RBWM portfolio of businesses to focus our capital and resources on key markets.

Our three growth priorities are customer growth in target segments, deepening customer relationships through wealth management and relationship-led lending, and enhancing distribution capabilities, including digital.

Implementing Global Standards, enhancing risk management control models and simplifying processes also remain top priorities for RBWM.

Review of reported performance

On a reported basis, RBWM profit before tax reduced by US$1.0bn to US$5.7bn, while Principal RBWM profit before tax fell by US$1.8bn to US$5.1bn. The reduction in RBWM partly reflected the effects of significant items (see page 42) including provisions of US$568m arising from the ongoing review of compliance with the CCA in the UK, adverse movements in non-qualifying hedges of US$493m in 2014 compared with favourable movements of US$262m in 2013, UK customer redress provisions of US$992m compared with US$953m in 2013, and disposals.

In the US run-off portfolio, a profit before tax was recorded compared with a loss in 2013. A reduction in revenue was more than offset by lower LICs reflecting decreased lending balances, reduced new impaired loans and lower delinquency levels. Operating expenses also fell, mainly from the non-recurrence of a customer remediation provision relating to our former CRS business and lower divestiture costs.

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Review of adjusted performance[45]

The commentary that follows reflects performance in our Principal RBWM[46] business (see page 63).

Profit before tax (US$m)

Profit before tax fell by US$0.7bn to US$6.9bn. Revenue was broadly unchanged, while lower LICs were more than offset by higher operating expenses.

Revenue (US$m)

Revenue was broadly unchanged despite the effect of de-risking initiatives and against a backdrop of continued low interest rates and muted growth in certain key markets. Higher income from current accounts, savings and deposits was broadly offset by lower revenues from personal lending and wealth management products.

Principal RBWM: management view of adjusted revenue

	2014 US$m	2013 US$m
Current accounts, savings and deposits	**5,839**	5,606
Wealth management products	**6,201**	6,263
investment distribution[47]	**3,456**	3,568
life insurance manufacturing	**1,603**	1,602
asset management	**1,142**	1,093
Personal lending	**11,300**	11,455
mortgages	**3,169**	3,182
credit cards	**4,339**	4,310
other personal lending[48]	**3,792**	3,963
Other[49]	**645**	873
Net operating income[4]	**23,985**	24,197

For footnotes, see page 109.

Revenue from current accounts, savings and deposits increased by 4%. This reflected an increase in customer account balances, of 4% compared with 2013, mainly in Hong Kong and the UK. In addition, higher revenue reflected increased spreads on savings products in the UK and, to a lesser extent, on deposits in mainland China where market interest rates increased.

Revenue from wealth management products reduced by 1%. Investment distribution income declined, mainly as a result of lower fees in the UK, in part reflecting the Retail Distribution Review undertaken in 2013, and in Brazil reflecting a change in product mix. Life insurance manufacturing income was broadly unchanged. This reflected higher new business sales and investment income in Hong Kong, and a net favourable movement in the PVIF asset in Brazil, offset by a reduction in the PVIF asset in France where a fall in long-term yields increased the cost of guarantees on savings business.

Personal lending revenue was down by 1%. While mortgage and credit card revenues were broadly unchanged, other personal lending income declined by 4%, notably in the UK due to the cessation of certain overdraft fees.

LICs decreased by 22% with reductions across all regions, mainly in Brazil due to impairment model changes and assumption revisions for restructured loans in 2013 which were not repeated in 2014. LICs also reduced in the US and the UK, partly reflecting lower delinquency levels and reduced outstanding credit card and UK loan balances.

Operating expenses (US$m)

Operating expenses increased by 7%, reflecting inflationary pressures, particularly in Latin America, in addition to higher costs associated with Regulatory Programmes and Compliance. The increase also reflected the timing of the recognition of the Financial Services Compensation Scheme levy in the UK and higher marketing costs across the regions. These factors were partly offset by sustainable cost savings of over US$200m.

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Report of the Directors: Financial Review (continued)

Growth priorities

Focus on relationship-led personal lending to drive balance sheet growth

In 2014, we continued to focus on improving the quality of our revenue through the ongoing implementation of de-risking initiatives, although these have weighed on income. They included the introduction of a new discretionary incentive framework for our Retail Banking customer-facing staff similar to the one launched for Wealth Management relationship managers (RM s) in 2013, removing the formulaic link between product sales and variable pay for front line staff. We also continued to simplify our product range, improve our risk governance and align our practices following regulatory changes.

We aim to deepen relationships with our existing customers and use personal lending to generate new business, targeting different segments and offerings in each market. To achieve this we continued to use improved analytics to support product decisions. Based on pricing and customer response measures, we enhanced revenue and grew balances in certain targeted segments, including the re-launch of the Advance segment in 17 markets in 2014. Lending and deposit balances and revenue per customer for Advance increased compared with 2013.

We maintained discipline around growing lending within our risk appetite in our home and priority growth markets. Home loan average balances increased by 3% in 2014, reflecting growth in our priority markets, notably with double-digit growth in approximately half of these countries as we re-balanced the product mix towards secured loans, although this mix change translated into lower spreads. In our home markets, we continued to target growth in unsecured lending, with average balances marginally higher including an increase in average card balances in Hong Kong, partly offset by a reduction in the UK. Despite overall balance growth, LICs remained lower than in 2013.

Customer recommendation levels improved in several markets during 2014, with the total volume of complaints related to products and services decreasing by more than 20% in the second half of the year, compared with the equivalent period in 2013. Further work is required and is ongoing to better meet our customer needs as they continue to evolve.

Continue to develop wealth management with a focus on growing customer balances

We remain committed to capturing opportunities from wealth creation, primarily through our Premier offering with its customers generating nearly four times the average revenue of non-Premier clients.

Although revenue from wealth management products remained lower than expected we continued to grow wealth balances, which comprise investment and insurance balances. These balances increased compared with 2013 across insurance, mutual funds and equities trading.

In 2014, Global Asset Management continued its strategy of strengthening collaboration across the global businesses to serve their customers. This helped to attract US$29bn of net new money principally in fixed income and liquidity products, in particular with GB&M clients. The investment performance in over 74% of Global Asset Management s eligible funds by value were above the market median.

In 2014, we improved our RMs productivity through new training programmes and tools. Client contact and coverage rates increased from 2013 with higher numbers of client appointments, financial reviews and needs fulfilled per RM.

Develop digital capabilities to support customers and reduce cost

We continue to develop our digital channels and streamline processes to improve the customer experience and to deliver cost savings through our distribution network.

In 2014, downloads of our global mobile application, now with enriched functionality, were over 3m with the total number of downloads surpassing 6m. *Global Finance* magazine presented HSBC with the award for Best Mobile Banking App at its 2014 World s Best Internet Bank event based on the application s global reach and functionality.

In addition, we launched our first straight-through on-line mortgage application service in the UK and, by the end of 2014, 14% of our annual approvals were produced online. We also deployed new Premier platforms, digital capabilities and tablet-based tools to enhance the end-to-end delivery process and customer experience. Across our priority growth markets, the revenue derived from digital channels increased by 18% compared with 2013.

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Report of the Directors: Financial Review (continued)

Commercial Banking

CMB offers a full range of commercial financial services and tailored solutions to more than 2.5 million customers ranging from small and medium-sized enterprises to publicly quoted companies in almost 60 countries.

	2014 US$m	2013 US$m	2012 US$m
Net interest income	**10,506**	10,200	10,361
Net fee income	**4,738**	4,717	4,470
Other income[42]	**1,059**	1,448	1,720
Net operating income[4]	**16,303**	16,365	16,551
LICs[43]	**(1,675)**	(2,384)	(2,099)
Net operating income	**14,628**	13,981	14,452
Total operating expenses	**(7,489)**	(7,049)	(7,598)
Operating profit	**7,139**	6,932	6,854
Income from associates[44]	**1,605**	1,509	1,681
Profit before tax	**8,744**	8,441	8,535
RoRWA[36]	**2.1%**	2.2%	2.2%

Record reported profit before tax of

US$8.7bn

10%

Growth in customer lending balances

(excluding the effect of currency translation)

Best Global Cash Management Bank for

Corporates and Financial Institutions

for the third consecutive year

(Euromoney 2014)

Strategic direction

CMB aims to be the banking partner of choice for our customers building on our rich heritage, international capabilities and relationships to enable global connectivity.

We have four growth priorities:

- providing consistency and efficiency for our customers through a business model organised around global customer segments and products;
- utilising our distinctive geographical network to support and facilitate global trade and capital flows;
- delivering excellence in our core flow products specifically in Trade and in Payments and Cash Management; and
- enhancing collaboration with other global businesses.

Implementing Global Standards, enhancing risk management controls and simplifying processes also remain top priorities for CMB.

For footnotes, see page 109.

Review of reported performance

In 2014, CMB reported a record profit before tax of US$8.7bn, 4% higher than in 2013. Reported profit before tax included the effect of a number of significant items (see page 42), notably the gain on sale of our operations in Panama of US$479m in 2013. The increase in reported profit before tax was also driven by a reduction in LICs, although this was partly offset by higher operating expenses.

Review of adjusted performance[45]

Profit before tax (US$m)

Profit before tax grew by 13% to US$8.9bn. This was driven by increased revenue and a reduction in LICs, partly offset by a rise in operating expenses.

Revenue (US$m)

Revenue grew by 5%, driven by Credit and Lending and Payments and Cash Management, notably in our home markets of Hong Kong and the UK. This was due to higher net interest income from growth in average lending and deposit balances in Hong Kong and rising average deposit balances and wider lending spreads in the UK. Higher net fee income was driven by an increase in term lending fees in the UK.

Despite lending spread compression compared with 2013, spreads in 2014 stabilised and showed signs of recovery in certain markets. In addition, we saw notable growth in our UK lending balances in the second half of 2014.

Report of the Directors: Financial Review (continued)

Management view of adjusted revenue

	2014	2013
	US$m	US$m
Global Trade and Receivables Finance	**2,680**	2,625
Credit and Lending	**6,316**	5,938
Payments and Cash Management, current accounts and savings deposits	**5,018**	4,709
Markets products, Insurance and Investments and Other[51]	**2,298**	2,207
Net operating income[4]	**16,312**	15,479

For footnotes, see page 109.

The table above has been restated to reclassify Foreign Exchange revenue. In 2014, Markets products, Insurance and Investments and Other included Foreign Exchange revenue of US$207m previously included within Global Trade and Receivables Finance (2013: US$213m) and US$516m previously included within Payments and Cash Management (2013: US$462m).

Global Trade and Receivables Finance revenue increased by 2% compared with 2013. Average balances rose, with growth in Asia, Europe and Latin America. The effect was partly offset by spread compression in Latin America, reflecting a change in portfolio mix in Brazil. In 2014, spread compression stabilised and showed signs of recovery in certain markets.

Credit and Lending revenue increased by 6% compared with 2013, reflecting higher average balances in Hong Kong and the US and, to a lesser extent, in Brazil. Revenue also increased in the UK due to wider lending spreads and increased fee income from term lending due to higher new business volumes. These factors were partly offset by spread compression in Latin America, primarily in Brazil as discussed above and in Mexico due to the repositioning of the business, and in mainland China.

Payments and Cash Management revenue increased by 7% compared with 2013. This reflected strong deposit growth, notably in the UK and Hong Kong, along with an increase in high value payment transaction volumes. This was partly offset by spread compression, notably in Europe.

Markets products, Insurance and Investments and Other revenue was 4% higher, primarily in North America. In Canada, this reflected the non-recurrence of a write-down of an investment property held for sale in 2013 and a gain on sale of an investment portfolio in 2014. In the US, higher revenue was driven by a gain on sale of a real estate portfolio.

LICs decreased by US$663m, mainly in Europe and Latin America. Lower LICs in Europe reflected a reduction in individually assessed loan impairment charges in the UK. The reduction in Latin America was driven by lower individually assessed charges in Mexico, in particular relating to homebuilders, and lower collectively assessed impairments in Brazil due to impairment model changes and assumption revisions for restructured loans in the Business Banking portfolios in 2013 not repeated in 2014. These factors were partly offset by higher individually assessed charges in Asia, notably in mainland China and Hong Kong.

Operating expenses (US$m)

Operating expenses increased by 8%, principally in Europe, Latin America and Asia. In Europe and Asia, higher costs reflected increased investment in staff to support business growth and inflationary pressures, while in Latin America costs rose due to inflation which was largely attributable to union-agreed salary increases in Brazil and Argentina. In addition, operating expenses increased due to higher Regulatory Programmes and Compliance costs.

Income from associates increased by 4% due to the improved performance of BoCom and The Saudi British Bank.

Growth priorities

Providing consistency through a globally led business model

Our business strategy is built on the foundation of global scale and consistency, focusing on customer segments and customer behaviour to ensure we provide tailored products to suit their needs. We continue to invest in providing global product coverage for our business segments. This enables us to manage risk more efficiently.

The creation of new senior management positions and a more defined global strategy within our customer segments enabled us to improve client coverage. In 2014, we appointed a new Global Head of International Subsidiary Banking to drive investment in supporting our international customers across our network. We also established dedicated RM teams for international subsidiary banking in key markets to focus on meeting the needs of these subsidiaries and growing the associated revenue streams.

We appointed a new Global Head of Lending and Transaction Management with a remit to support all segments. This globally-aligned product group is designed to optimise capital allocation and improve revenue mix within our risk appetite.

In 2014, we redefined our Large Corporate segment to focus on a smaller number of higher-value clients. The Large Corporate segment experienced strong

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Report of the Directors: Financial Review (continued)

growth in most markets fuelled by multi-country flow mandates and increased event-driven capital markets activity. The increased focus on global wallet and connectivity led to increased awareness amongst our customers of our franchise and capabilities, resulting in stronger global strategic partnerships.

In addition, we increased our market presence in six of our key MME markets (Hong Kong, the UK, Canada, the US, Mexico and Brazil). We made further progress by appointing regional and country heads of MME and by enhancing our client management system.

In Business Banking, we invested in additional RMs in key markets, increased training worldwide and continued to deploy a globally consistent customer management system within our relationship-managed portfolios. Six major campaigns were launched in 2014 to help SME customers achieve their growth ambitions and expand overseas, including offering funds in the UK, France, the US, Canada, Australia and Turkey totalling US$18bn.

Utilising our geographical network to support our customers international growth ambitions

HSBC s network across the major global trade corridors continued to assist us to provide value-added solutions for our clients. For example, we helped one of the largest retailers in the US to improve its supply chain management by providing holistic financing and liquidity solutions including working capital, trade and supply chain finance.

In Payments and Cash Management, CMB remained well positioned to benefit from global trends such as the increase in cross-border payment flows as we are strategically located where more than 85% of the world s payment activity originates. For example, new customer mandates increased by 23% on 2013. In addition, we improved our digital offering, migrating over 80,000 customers to date from legacy platforms to core electronic banking channels, and continued to develop innovative products. These included the enhancement of our Global Liquidity Solutions, which enables customers in mainland China to connect their operating cash with their liquidity structures globally.

Delivering excellence in our core products

HSBC is one of the largest trade finance banks in the world with access to more than 85% of the world s trade and capital flows. We continued to enhance our open account financing capabilities through investment in Receivables Finance and Supply Chain, specifically the launch of a new Supply Chain Solutions platform and the consolidation of the existing Receivables platform into regional hubs. This offers customers broader access to expertise and liquidity and gives us the ability to deploy our capabilities rapidly in new markets, providing better risk management and lower operating costs.

Against the backdrop of declining commodity prices, we achieved double-digit asset balance growth in Commodity and Structured Trade Finance compared with 2013.

Enhancing collaboration with other global businesses

We maintained our focus on strengthening CMB s collaboration with GB&M and GPB by increasing product coverage across the Group to our customers. In 2014, CMB customers generated over 80% of HSBC s total collaboration revenues. Revenue from collaboration remained broadly unchanged compared with 2013. This was driven by lower sales of Markets products to CMB customers, notably in the Foreign Exchange business, offset by growth in the sale of Capital Financing products with regard to mergers and acquisitions and debt capital markets.

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Report of the Directors: Financial Review (continued)

Global Banking and Markets

GB&M provides tailored financial solutions to major government, corporate and institutional clients worldwide.

	2014 US$m	2013 US$m	2012 US$m
Net interest income	**7,022**	6,766	6,960
Net fee income	**3,560**	3,482	3,329
Net trading income[50]	**5,861**	6,780	5,690
Other income[42]	**1,335**	2,148	2,294
Net operating income[4]	**17,778**	19,176	18,273
LICs[43]	**(365)**	(207)	(670)
Net operating income	**17,413**	18,969	17,603
Total operating expenses	**(12,028)**	(9,960)	(9,907)
Operating profit	**5,385**	9,009	7,696
Income from associates[44]	**504**	432	824
Profit before tax	**5,889**	9,441	8,520
RoRWA[36]	**1.2%**	2.3%	2.1%

Client flows up in Equities,

although subdued in Foreign Exchange

Sustained growth in revenues in

Payments and Cash Management

Bond and Derivatives

House of the year

(International Finance Review 2014)

Strategic direction

GB&M s business model and strategy is well established with the objective of being a top 5 bank to our priority clients and in our chosen products and geographies.

We focus on the following growth priorities:

- connecting clients to international growth opportunities;
- continuing to be well positioned in products that will benefit from global trends; and
- leveraging our distinctive international expertise and geographical network which connects developed and faster-growing regions.

Enhancing risk management controls, implementing Global Standards and collaborating with other global businesses also remain top priorities for GB&M.

For footnotes, see page 109.

Review of reported performance

GB&M s reported profit before tax of US$5.9bn was down by US$3.6bn, primarily in Europe and North America, from higher operating expenses and lower revenue. The increase in operating expenses and decrease in revenue reflected a number of significant items (see page 42). Operating expenses included settlements and provisions of US$1.2bn in connection with foreign exchange investigations, of which US$809m was recorded in the fourth quarter of 2014, and a charge of US$533m in the US relating to a settlement agreement with the Federal Housing Finance Agency, which are included in significant items.

Review of adjusted performance[45]

Profit before tax (US$m)

Profit before tax of US$8.1bn was US$1.1bn lower than in 2013, driven by higher operating expenses and a fall in revenue, which included the introduction of the FFVA on certain derivative contracts that resulted in a charge of

US$263m.

Revenue (US$m)

Revenue was lower principally due to the effect of the FFVA and a reduction in our Foreign Exchange business which was partly offset by an increase in Capital Financing.

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Report of the Directors: Financial Review (continued)

Management view of adjusted revenue

	2014 US$m	2013 US$m
Markets[52]	**6,262**	6,933
Credit	**567**	801
Rates	**1,563**	1,678
Foreign Exchange	**2,916**	3,140
Equities	**1,216**	1,314
Capital Financing	**4,066**	3,981
Payments and Cash Management	**1,794**	1,743
Securities Services	**1,698**	1,653
Global Trade and Receivables Finance	**767**	723
Balance Sheet Management	**3,020**	3,046
Principal Investments	**531**	450
Other[53]	**(32)**	3
Total operating income[4]	**18,106**	18,532

For footnotes, see page 109.

The table below outlines the effect on businesses and total adjusted operating income of the FFVA:

Effect of FFVA on total operating income

	2014 US$m	2013 US$m
Total operating income	**18,106**	18,532
FFVA in Rates	**(164)**	
FFVA in Credit	**(97)**	
FFVA in other businesses	**(2)**	
Total operating income excluding FFVA	**18,369**	18,532
of which Rates excluding FFVA	**1,727**	1,678
of which Credit excluding FFVA	**664**	801

Excluding the above, revenue in the majority of our Markets businesses was lower. This was predominantly driven by a decline in our Foreign Exchange business, which was affected by lower volatility, notably in the first half of 2014, and reduced client flows. Credit revenue also decreased due to adverse movements in credit spreads and a reduction in Legacy Credit. Equities revenue fell too, as 2013 benefited from higher revaluation gains which more than offset a rise in revenue from increased client flows and higher derivatives income in 2014. By contrast, Rates revenue rose due to favourable market movements, notably in Asia, along with minimal fair value movements on our own credit spread on structured liabilities compared with adverse movements in 2013. These factors were partly offset by a fall in Rates revenue in Europe.

In Capital Financing, revenue grew by US$85m, as the effects of increased volumes and market share gains across our advisory, equity capital markets and lending products were partly offset by spread and fee compression.

Payments and Cash Management revenue was marginally higher, due to both increased deposit balances, notably in Asia, and a rise in high value transaction volumes, partly offset by spread compression. We also experienced growth in Securities Services revenue, in part from new business in Europe, and Global Trade and Receivables Finance from growth in lending balances.

LICs were higher due to a revision to certain estimates used in our corporate collective loan impairment calculation and increased individually assessed provisions, including a provision against a guarantee in Brazil recorded as a credit risk provision. These were partially offset by higher net releases on available-for-sale ABSs in our legacy portfolio than in 2013.

Operating expenses (US$m)

Operating expenses increased by 6%, primarily due to higher Regulatory Programmes and Compliance related costs and from increased staff costs. These factors were partially offset by sustainable savings of over US$80m.

Growth priorities

Connecting clients to international growth opportunities

Following the re-shaping of GB&M in 2013, as part of which we brought together all our financing businesses into Capital Financing, including lending, debt capital markets and equity capital markets, we continued to focus on better aligning our resources with clients needs. We segmented our client base and created a Client Strategy Group to ensure that GB&M s product, sector and coverage expertise supports clients in the growth of their business activities. Strong collaboration between these teams was recently demonstrated by our appointment as the joint global coordinator and joint book runner on the largest European corporate equity rights issue since 2011. This was our fifth transaction with this client in the last 12 months.

We are utilising our global network to provide solutions for our clients in both established markets and faster-growing regions. Our ability to connect clients to opportunities was highlighted by the first Sukuk bond issued outside the Islamic world on which we acted as sole structuring advisor, joint lead manager and joint book runner.

We continued to strengthen our Foreign Exchange franchise by enhancing our risk management capabilities and further developing our distribution platforms and electronic pricing capabilities. This will improve our systems and governance whilst enabling us to better serve clients with a robust and efficient offering.

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Report of the Directors: Financial Review (continued)

Continuing to be well positioned in products that will benefit from global trends

Capturing new opportunities arising from the internationalisation of the renminbi continues to be one of our key growth priorities. Recently, we acted as joint lead manager, book runner and financial advisor on a pioneering Formosa bond issue, which simultaneously listed on three exchanges worldwide. We were also voted Best Overall for Products and Services by *Asiamoney* Offshore RMB Services Survey 2014 for the third consecutive year, demonstrating our continued leading position in the overseas renminbi market.

In November 2014 we launched the Stock Connect programme, a mechanism linking trading and clearing between the Shanghai and Hong Kong securities markets. This will give our clients direct access to the Chinese A-share market and the ability to fund equity purchases in renminbi.

Geographical expansion of large corporates and rising world trade are expected to increase the demand for cross-border payments and related services. Our strength in Payments and Cash Management was recognised by *Euromoney*, who named HSBC the Best Global Cash Manager for Non-financial Institutions and Best Global Cash Manager for Corporate and Financial Institutions , for the second and third consecutive years, respectively. We were also able to win a mandate for renminbi cash management and additional foreign exchange and deposit business from a global automotive group which is seeking to expand into mainland China.

Leveraging our distinctive international expertise and geographical network which connects developed and faster-growing regions

Our distinctive geographical network and global expertise allows us to provide a truly international service to our clients. We recently demonstrated the value of our global capital markets capabilities and leading position in faster-growing markets to a European automotive group. We advised and acted as joint sub-underwriter on a domestic securitisation in mainland China which was structured to attract both international and domestic investors. We were the first foreign bank to advise on the structuring of an internationally rated ABS transaction in mainland China.

GB&M continues to focus on collaborating with other global businesses and supporting clients in accessing a range of products across our Markets and Capital Financing businesses. In 2014, collaboration revenue between GB&M and CMB was broadly unchanged, driven by a reduction in Foreign Exchange which was offset by growth in Capital Financing, notably in advisory.

Global Private Banking

GPB serves high net worth individuals and families with complex and international needs within the Group s priority markets.

	2014 US$m	2013 US$m	2012 US$m
Net interest income	**994**	1,146	1,294
Net fee income	**1,056**	1,150	1,232
Other income[42]	**327**	143	646
Net operating income[4]	**2,377**	2,439	3,172
LICs[43]	**8**	(31)	(27)
Net operating income	**2,385**	2,408	3,145
Total operating expenses	**(1,778)**	(2,229)	(2,143)
Operating profit	**607**	179	1,002
Income from associates[44]	**19**	14	7
Profit before tax	**626**	193	1,009
RoRWA[36]	**2.9%**	0.9%	4.6%

Positive net new money of

US$14bn

in areas targeted for growth

since December 2013

Performance continued to be affected by

actions taken to reposition the customer

base

Best Family Office Offering

(Private Banker International Global Wealth Awards)

Strategic direction

GPB aims to build on HSBC s commercial banking heritage to be the leading private bank for high net worth business owners by:

capturing growth opportunities in home and priority growth markets, particularly from intra-Group collaboration by accessing owners and principals of CMB and GB&M clients; and

repositioning the business to concentrate on onshore markets and a smaller number of target offshore markets, aligned with Group priorities.

Implementing Global Standards, enhancing risk management controls, tax transparency and simplifying processes also remain top priorities for GPB.

For footnotes, see page 109.

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Report of the Directors: Financial Review (continued)

Review of reported performance

Reported profit before tax of US$626m was US$433m higher than in 2013. This was due to a small number of significant items (see page 42), most notably in 2013 from the loss on write-off of allocated goodwill relating to our Monaco business of US$279m and regulatory provisions of US$352m.

We expect our GPB results in 2015 to be affected by the reduction in our client assets as we continue to reposition our business model, including reducing the number of clients in non-priority markets.

Review of adjusted performance[45]

Profit before tax (US$m)

Profit before tax fell by US$162m to US$738m, mainly due to reduced revenue as we continued to reposition the business, partly offset by lower operating expenses and LICs.

Revenue (US$m)

Revenue decreased by 11% compared with 2013, due to lower trading income and net fee income reflecting a managed reduction in client assets and lower market volatility. Net interest income also declined, mainly in Europe and Asia, driven by a reduction in deposit balances and lower treasury income, respectively, both reflecting actions to reposition the business. In addition, lending spreads narrowed compared with 2013.

Net loan impairment releases in 2014 compared with charges of US$33m in 2013, largely due to releases of collective impairment allowances in the UK and in the US.

Operating expenses (US$m)

Operating expenses decreased by 5%, primarily due to the release of a UK customer redress provision recognised in 2012, the non-recurrence of the UK provision relating to a bilateral Rubik tax agreement between the UK and Swiss governments, and the managed reduction in staff numbers.

Reported client assets[54]

	2014 US$bn	2013 US$bn
At 1 January	**382**	398
Net new money	**(3)**	(26)
Of which: areas targeted for growth	**14**	(7)
Value change	**8**	12
Disposals	**(11)**	(3)
Exchange and other	**(11)**	1
At 31 December	**365**	382

Reported client assets by geography

	2014 US$bn	2013 US$bn
Europe	**179**	197
Asia	**112**	108
North America	**63**	65
Latin America	**11**	12
At 31 December	**365**	382

For footnote, see page 109.

On a reported basis, client assets, which include funds under management and cash deposits, decreased, mainly in Europe, due to the effect of the sale of a portfolio of clients in Switzerland, the disposal of our HSBC Trinkaus & Burkhardt AG business in Luxembourg and negative net new money. In addition there were unfavourable foreign exchange movements, mainly in Europe. This was partly offset by favourable market movements. Negative net new money of US$3bn was mainly driven by the continued repositioning of our business, though we attracted positive net new money of US$14bn in areas that we have targeted for growth, including our home and priority growth markets and the high net worth client segment.

Report of the Directors: Financial Review (continued)

On a reported basis, our return on assets, defined as the percentage of revenue to average client assets, was 63bps in 2014, broadly unchanged compared with 2013. On an adjusted basis, our return on assets was 6bps lower in 2014, reflecting the effect of the repositioning and reduced market volatility. Our client return on assets, which excludes treasury and capital revenue, also decreased by 4bps.

In January 2015, the Swiss National Bank removed its currency cap with the euro which resulted in the appreciation of the Swiss franc. We monitor the impact of foreign exchange rate fluctuations on a continuing basis and do not expect any significant effect on the reported results of our GPB business.

Strategic direction

Capture growth in our home and priority growth markets and focus on collaboration revenues

In 2014, new referrals from other global businesses generated net new money of over US$10bn, which was US$5.5bn higher than in 2013. In total, 74% of our net new money from areas targeted for growth in 2014 came from Group-referred clients, helped by adopting a more coordinated and systematic approach to identifying client needs in conjunction with the other global businesses.

We integrated our collaboration efforts with GB&M and CMB into one team, the Corporate Client Group (CCG). This was established to improve client introductions to and from GPB by standardising best practices and developing tailored offerings to meet client needs more effectively. The CCG is also responsible for enhancing coverage of existing personal and corporate relationships through a coordinated approach. In addition, the Global Solutions Group was established to deliver bespoke solutions to ultra-high net worth and global priority clients. This involves working closely with GB&M and CMB to enhance the service we offer to these sophisticated clients.

We also established the Wealth Client Group with responsibility for ensuring greater alignment and increased collaboration with RBWM, including utilising RBWM s transactional banking capabilities.

To support client growth, we expanded our product offering with investment opportunities in three new Alternatives products, comprising one private equity fund and two real estate funds. We strengthened our investment group by ensuring that the majority of clients with assets greater than US$5m now have access to a dedicated investment counsellor. We partnered with the GB&M Global Research team to improve the advisory services for our clients supported by easy client access to a wider range of investment research reports. We plan to deploy this globally by the end of 2015. We also worked closely with HSBC Securities Services to provide our ultra-high net worth and family office clients with access to our institutional global custody platform in Europe and the Middle East and North Africa, providing clients with access to trade capture, clearing and settlement, safekeeping and investment administration services.

Repositioning the business

We continued to reposition the GPB business model and client base in 2014 by reviewing our portfolio and seeking to ensure that all clients comply with our Global Standards, including financial crime compliance and tax transparency standards.

We remain focused on clients with wider Group connectivity within our home and priority growth markets. Following the announcement of the sale of a portfolio of clients in Switzerland to LGT Bank (Switzerland) Ltd earlier this year, we completed the migration of US$8bn of client assets in the second half of 2014. We also continued to reduce the number of clients in non-priority markets.

In 2014, we continued to streamline and rationalise the business, closing a number of non-strategic representative offices, and we announced the consolidation of our trust business in Europe into a regional hub in Jersey. We also commenced development of a new global IT banking platform. This is expected to deliver improved efficiency, enhanced services and a consistent client offering by consolidating GPB s multiple systems onto a single banking platform. We remain on track to deliver the first phase of the implementation in 2015.

We enhanced our digital capabilities with the deployment of a new mobile application in Switzerland, Monaco, Luxembourg and Guernsey, enabling clients to view their investment holdings and transactions while on the move. We introduced a secure tablet application for front office staff in Switzerland delivering digital document browsing during client visits, and also deployed video meeting capabilities in the US. Wider deployment of these and other applications is scheduled for 2015.

Report of the Directors: Financial Review (continued)

Other[39]

Other contains the results of HSBC s holding company and financing operations, central support and functional costs with associated recoveries, unallocated investment activities, centrally held investment companies, certain property transactions and movements in fair value of own debt.

	2014 US$m	2013 US$m	2012 US$m
Net interest expense	**(501)**	(737)	(730)
Net fee income/(expense)	**(65)**	64	194
Net trading income/(expense)[50]	**(92)**	6	(537)
Changes in fair value of long-term debt issued and related derivatives	**508**	(1,228)	(4,327)
Changes in other financial instruments designated at fair value	**(9)**	(576)	(1,136)
Net income/(expense) from financial instruments designated at fair value	**499**	(1,804)	(5,463)
Other income	**6,524**	8,122	8,868
Net operating income[4]	**6,365**	5,651	2,332
LICs[43]			
Net operating income	**6,365**	5,651	2,332
Total operating expenses	**(8,601)**	(7,796)	(9,369)
Operating loss	**(2,236)**	(2,145)	(7,037)
Income/(expense) from associates[44]	**6**	(14)	47
Loss before tax	**(2,230)**	(2,159)	(6,990)

For footnotes, see page 109.

Review of reported performance

Reported loss before tax of US$2.2bn was 3% higher than in 2013. This was driven by increased operating costs partly offset by higher revenue.

The increase in loss before tax of US$71m included favourable movements in the fair value of own debt of US$417m in 2014 compared with adverse movements of US$1.2bn in 2013. These results also included the following items in 2013:

gain on derecognition of Industrial Bank as an associate (US$1.1bn);

net gain on disposal of Ping An Insurance (Group) Company of China, Ltd (Ping An) (US$553m); and

foreign exchange gains relating to sterling debt issued by HSBC Holdings (US$442m);
and the following items in 2014:

gain on sale of our shareholding in Bank of Shanghai in 2014 (US$428m); and

an impairment on our investment in Industrial Bank (US$271m).

For further details of all significant items, see page 42.

Review of adjusted performance[45]

Loss before tax (US$m)

The **loss before tax** decreased, reflecting increased revenue partly offset by higher operating costs.

Revenue (US$m)

Revenue rose by US$1.3bn, primarily due to favourable movements in 2014 of US$96m on interest and exchange rate ineffectiveness in the hedging of long-term debt designated at fair value issued principally by HSBC Holdings and its European subsidiaries, compared with adverse movements of US$551m in 2013. In addition, recoveries of certain expenses from global businesses increased, reflecting higher operating expenses, and we recorded a gain arising from the external hedging of an intra-Group financing transaction in Europe. There was also a release of accrued interest on uncertain tax reserves in the US. These factors were partly offset by the expiry of the TSAs relating to the sale of the CRS business in the US and lower income from investment properties in Asia.

Operating expenses (US$m)

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Report of the Directors: Financial Review (continued)

Operating expenses increased by US$946m due to higher costs associated with Regulatory Programmes and Compliance, an increase in Global Resourcing costs in India and mainland China and the 2013 release of a litigation provision in Asia. In addition, the UK bank levy charge of US$1.1bn in 2014 was higher than the charge of US$916m in 2013, primarily due to an increase in the rate of the levy. This was partly offset by a reduction in North America by the expiry of the TSAs relating to the sale of the CRS business.

Analysis by global business

HSBC profit/(loss) before tax and balance sheet data

	2014						
	Retail Banking and Wealth Management US$m	**Commercial Banking US$m**	**Global Banking and Markets US$m**	**Global Private Banking US$m**	**Other[39] US$m**	**Inter-segment elimination[55] US$m**	**Total US$m**
Profit/(loss) before tax							
Net interest income/(expense)	16,782	10,506	7,022	994	(501)	(98)	34,705
Net fee income/(expense)	6,668	4,738	3,560	1,056	(65)		15,957
Trading income/(expense) excluding net interest income	(28)	620	4,063	298	(100)		4,853
Net interest income/(expense) on trading activities	9	(2)	1,798	(4)	8	98	1,907
Net trading income/(expense)[50]	(19)	618	5,861	294	(92)	98	6,760
Changes in fair					508		508

value of long- term debt issued and related derivatives							
Net income/(expense) from other financial instruments designated at fair value	**1,675**	**288**	**12**	**(1)**	**(9)**		**1,965**
Net income/(expense) from financial instruments designated at fair value	**1,675**	**288**	**12**	**(1)**	**499**		**2,473**
Gains less losses from financial investments	**14**	**31**	**1,117**	**9**	**164**		**1,335**
Dividend income	**24**	**18**	**80**	**5**	**184**		**311**
Net insurance premium income	**10,570**	**1,296**	**5**	**50**			**11,921**
Other operating income	**719**	**248**	**124**	**33**	**6,176**	**(6,169)**	**1,131**
Total operating income	**36,433**	**17,743**	**17,781**	**2,440**	**6,365**	**(6,169)**	**74,593**
Net insurance claims[56]	**(11,839)**	**(1,440)**	**(3)**	**(63)**			**(13,345)**
Net operating income[4]	**24,594**	**16,303**	**17,778**	**2,377**	**6,365**	**(6,169)**	**61,248**
Loan impairment (charges)/recoveries and other credit risk provisions	**(1,819)**	**(1,675)**	**(365)**	**8**			**(3,851)**
Net operating income	**22,775**	**14,628**	**17,413**	**2,385**	**6,365**	**(6,169)**	**57,397**
Employee expenses[57]	**(5,038)**	**(2,439)**	**(3,655)**	**(732)**	**(8,502)**		**(20,366)**
Other operating expenses	**(12,484)**	**(5,050)**	**(8,373)**	**(1,046)**	**(99)**	**6,169**	**(20,883)**
Total operating expenses	**(17,522)**	**(7,489)**	**(12,028)**	**(1,778)**	**(8,601)**	**6,169**	**(41,249)**
Operating profit/(loss)	**5,253**	**7,139**	**5,385**	**607**	**(2,236)**		**16,148**
Share of profit in associates and joint ventures	**398**	**1,605**	**504**	**19**	**6**		**2,532**
Profit/(loss) before tax	**5,651**	**8,744**	**5,889**	**626**	**(2,230)**		**18,680**

	%	%	%	%	%		%
Share of HSBC s profit before tax	**30.3**	**46.8**	**31.5**	**3.4**	**(12.0)**		**100.0**
Cost efficiency ratio	**71.2**	**45.9**	**67.7**	**74.8**	**135.1**		**67.3**

Balance sheet data[40]

	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)[27]	**359,744**	**313,999**	**254,463**	**44,102**	**2,352**		**974,660**
Total assets	**499,083**	**372,739**	**1,839,644**	**88,342**	**164,537**	**(330,206)**	**2,634,139**
Customer accounts[27]	**581,421**	**363,654**	**319,121**	**85,465**	**981**		**1,350,642**

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Report of the Directors: Financial Review (continued)

	2013						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other[39] US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income/(expense)	18,339	10,200	6,766	1,146	(737)	(175)	35,539
Net fee income	7,021	4,717	3,482	1,150	64		16,434
Trading income/(expense) excluding net interest income	689	649	4,953	390	(38)		6,643
Net interest income/(expense) on trading activities	(3)		1,827	4	44	175	2,047
Net trading income[50]	686	649	6,780	394	6	175	8,690
Changes in fair value of long-term debt issued and related derivatives					(1,228)		(1,228)
Net income/(expense) from other financial instruments designated at fair value	1,638	332	599	4	(576)	(1)	1,996
Net income/(expense) from financial instruments designated at fair value	1,638	332	599	4	(1,804)	(1)	768

Gains less losses from financial investments	55	1	747	(3)	1,212		2,012
Dividend income	21	15	129	8	149		322
Net insurance premium income	10,543	1,375	6	16			11,940
Other operating income/(expense)	544	621	670	(239)	6,761	(5,725)	2,632
Total operating income	38,847	17,910	19,179	2,476	5,651	(5,726)	78,337
Net insurance claims[56]	(12,107)	(1,545)	(3)	(37)			(13,692)
Net operating income[4]	26,740	16,365	19,176	2,439	5,651	(5,726)	64,645
Loan impairment charges and other credit risk provisions	(3,227)	(2,384)	(207)	(31)			(5,849)
Net operating income	23,513	13,981	18,969	2,408	5,651	(5,726)	58,796
Employee expenses[57]	(5,219)	(2,327)	(3,549)	(776)	(7,325)		(19,196)
Other operating expenses	(12,029)	(4,722)	(6,411)	(1,453)	(471)	5,726	(19,360)
Total operating expenses	(17,248)	(7,049)	(9,960)	(2,229)	(7,796)	5,726	(38,556)
Operating profit/(loss)	6,265	6,932	9,009	179	(2,145)		20,240
Share of profit/(loss) in associates and joint ventures	384	1,509	432	14	(14)		2,325
Profit/(loss) before tax	6,649	8,441	9,441	193	(2,159)		22,565
	%	%	%	%	%		%
Share of HSBC s profit before tax	29.5	37.4	41.8	0.9	(9.6)		100.0
Cost efficiency ratio	64.5	43.1	51.9	91.4	138.0		59.6
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	375,086	297,852	272,473	44,224	2,454		992,089

Total assets	517,085	360,623	1,975,509	97,655	171,812	(451,366)	2,671,318
Customer accounts[27]	579,994	354,298	328,800	96,770	1,435		1,361,297

For footnotes, see page 109.

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Profit/(loss) before tax and balance sheet data (continued)

	2012						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other[38] US$m	Inter segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income/(expense)	20,298	10,361	6,960	1,294	(730)	(511)	37,672
Net fee income	7,205	4,470	3,329	1,232	194		16,430
Trading income/(expense) excluding net interest income	276	617	3,588	476	(549)		4,408
Net interest income on trading activities	28	16	2,102	14	12	511	2,683
Net trading income/(expense)[49]	304	633	5,690	490	(537)	511	7,091
Changes in fair value of long-term debt issued and related derivatives					(4,327)		(4,327)
Net income/(expense) from other financial instruments designated at fair value	1,893	250	1,094		(1,136)		2,101
Net income/(expense)	1,893	250	1,094		(5,463)		(2,226)

from financial instruments designated at fair value							
Gains less losses from financial investments	96	22	730	(3)	344		1,189
Dividend income	24	18	148	6	25		221
Net insurance premium income	11,191	1,786	25	42			13,044
Gains on disposal of US branch network, US cards business and Ping An	3,735	277			3,012		7,024
Other operating income	1,472	536	313	151	5,487	(5,859)	2,100
Total operating income	46,218	18,353	18,289	3,212	2,332	(5,859)	82,545
Net insurance claims[56]	(12,357)	(1,802)	(16)	(40)			(14,215)
Net operating income[1]	33,861	16,551	18,273	3,172	2,332	(5,859)	68,330
Loan impairment charges and other credit risk provisions	(5,515)	(2,099)	(670)	(27)			(8,311)
Net operating income	28,346	14,452	17,603	3,145	2,332	(5,859)	60,019
Employee expenses[57]	(5,532)	(2,247)	(3,764)	(915)	(8,033)		(20,491)
Other operating expenses	(14,237)	(5,351)	(6,143)	(1,228)	(1,336)	5,859	(22,436)
Total operating expenses	(19,769)	(7,598)	(9,907)	(2,143)	(9,369)	5,859	(42,927)
Operating profit/(loss)	8,577	6,854	7,696	1,002	(7,037)		17,092
Share of profit in associates and joint ventures	998	1,681	824	7	47		3,557
Profit/(loss) before tax	9,575	8,535	8,520	1,009	(6,990)		20,649
	%	%	%	%	%		%
Share of HSBC s profit before tax	46.4	41.3	41.3	4.9	(33.9)		100.0
Cost efficiency ratio	58.4	45.9	54.2	67.6			62.8

Balance sheet data[40]

	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	378,022	288,033	249,209	45,213	2,495		962,972
Total assets	536,244	363,659	1,942,470	118,440	201,741	(470,016)	2,692,538
Customer accounts[27]	562,151	338,405	303,561	105,708	1,571		1,311,396

For footnotes, see page 109.

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Geographical regions

Summary

Additional information on results in 2014 may be found in the Financial Summary on pages 40 to 62.

In the analysis of profit and loss by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US$2,972m (2013: US$2,628m; 2012: US$2,684m).

From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific . This aligns with changes made in the financial information used internally to manage the business. Comparative data have been represented accordingly.

All commentaries are on an adjusted basis (page 40) unless otherwise stated, while tables are on a reported basis unless otherwise stated.

Profit/(loss) before tax

	2014		2013		2012	
	US$m	**%**	US$m	%	US$m	%
Europe	**596**	**3.2**	1,825	8.1	(3,414)	(16.5)
Asia[8]	**14,625**	**78.3**	15,853	70.3	18,030	87.3
Middle East and North Africa	**1,826**	**9.8**	1,694	7.5	1,350	6.5
North America	**1,417**	**7.6**	1,221	5.4	2,299	11.1
Latin America	**216**	**1.1**	1,972	8.7	2,384	11.6
Year ended 31 December	**18,680**	**100.0**	22,565	100.0	20,649	100.0

Total assets[40]

	2014 US$m	2014 %	2013 US$m	2013 %
Europe	**1,290,926**	**49.0**	1,392,959	52.1
Asia[8]	**878,723**	**33.4**	831,791	31.1
Middle East and North Africa	**62,417**	**2.4**	60,810	2.3
North America	**436,859**	**16.6**	432,035	16.2
Latin America	**115,354**	**4.4**	113,999	4.3
Intra-HSBC items	**(150,140)**	**(5.8)**	(160,276)	(6.0)
At 31 December	**2,634,139**	**100.0**	2,671,318	100.0

Risk-weighted assets[58]

	2014 US$bn	2014 %	2013 US$bn	2013 %
At 31 December	**1,219.8**	**100.0**	1,092.7	100.0
Europe	**375.4**	**30.1**	300.1	27.1
Asia[8]	**499.8**	**40.0**	430.7	38.9
Middle East and North Africa	**63.0**	**5.0**	62.5	5.7
North America	**221.4**	**17.8**	223.8	20.2
Latin America	**88.8**	**7.1**	89.5	8.1

For footnotes, see page 109.

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Europe

Our principal banking operations in Europe are HSBC Bank plc in the UK, HSBC France, HSBC Bank A.S. in Turkey, HSBC Private Bank (Suisse) SA and HSBC Trinkaus & Burkhardt AG. Through these subsidiaries we provide a wide range of banking, treasury and financial services to personal, commercial and corporate customers across Europe.

	2014 US$m	2013 US$m	2012 US$m
Net interest income	**10,611**	10,693	10,394
Net fee income	**6,042**	6,032	6,169
Net trading income	**2,534**	4,423	2,707
Other income/(expense)	**2,384**	(181)	(1,662)
Net operating income[4]	**21,571**	20,967	17,608
LICs[43]	**(764)**	(1,530)	(1,921)
Net operating income	**20,807**	19,437	15,687
Total operating expenses	**(20,217)**	(17,613)	(19,095)
Operating profit/(loss)	**590**	1,824	(3,408)
Income/(expense) from associates[44]	**6**	1	(6)
Profit/(loss) before tax	**596**	1,825	(3,414)
Cost efficiency ratio	**93.7%**	84.0%	108.4%
RoRWA[36]	**0.2%**	0.6%	(1.0%)
Year-end staff numbers	**69,363**	68,334	70,061

Best Debt House in Western Europe

for the second consecutive year

(Euromoney Awards)

UK No1 Trade Bank

(Global Finance Magazine)

US$3.1bn

of regulatory fines, provisions,

penalties and UK customer redress

For footnotes, see page 109.

Economic background

The **UK** recovery continued through the second half of 2014, though the pace of expansion moderated towards the end of the year. Preliminary estimates indicate that the annual rate of growth of real Gross Domestic Product (GDP) was 2.6%. The unemployment rate fell to 5.7% in the three months to December and wage growth accelerated slightly from a very low level. The annual Consumer Price Index (CPI) measure of inflation reached a 14-year low of 0.5% in December. After a period of rapid activity in 2013 and the early months of 2014, there were signs that both economic activity and price inflation in the housing market were moderating as the year ended. The Bank of England kept the Bank Rate steady at 0.5%.

The recovery in **eurozone** economic activity in 2014 was slow and uneven across member states. Real GDP in the region as a whole grew by 0.9% in the year. The German and Spanish economies grew by 1.6% and 1.5%, respectively, while French GDP grew by a more modest 0.4%. Eurozone inflation fell to minus 0.2% in December, prompting fears that the region could move towards a sustained period of deflation. The likelihood that low growth and inflation could persist for an extended period prompted the European Central Bank (ECB) to cut the main refinancing rate and the deposit rate to 0.05% and minus 0.2%, respectively, in September and embark on a policy of balance sheet expansion starting with purchases of covered bonds and asset-backed securities.

Financial overview

Profit before tax (US$m)

Our European operations reported a profit before tax of US$596m in 2014 compared with US$1.8bn in 2013. The decrease in reported profit before tax was driven by a number of significant items and increased operating expenses, partly offset by reduced LICs. The former included charges relating to UK customer redress of US$1.3bn, settlements and provisions in relation to regulatory investigations into foreign exchange of US$1.2bn, of which US$809m was recorded in the fourth quarter of 2014, and provisions arising from the on-going review of compliance with the CCA in the UK of US$632m. For further details of all significant items, see page 42.

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Profit/(loss) before tax by country within global businesses

	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Total US$m
UK	**589**	**2,193**	**(801)**	**191**	**(2,228)**	**(56)**
France[35]	**(181)**	**240**	**354**		**(199)**	**214**
Germany	**28**	**71**	**162**	**27**	**(10)**	**278**
Switzerland		**5**	**2**	**38**	**(3)**	**42**
Turkey	**(155)**	**5**	**92**		**(6)**	**(64)**
Other	**33**	**34**	**240**	**59**	**(184)**	**182**
Year ended 31 December 2014	**314**	**2,548**	**49**	**315**	**(2,630)**	**596**
UK	1,471	1,684	1,246	252	(3,493)	1,160
France[35]	285	255	351	21	(162)	750
Germany	30	70	183	44	(25)	302
Switzerland		2	2	(291)		(287)
Turkey	(74)	36	108	(1)	1	70
Other	41	41	(89)	(190)	27	(170)
Year ended 31 December 2013	1,753	2,088	1,801	(165)	(3,652)	1,825
UK	343	832	(111)	235	(6,355)	(5,056)
France[35]	135	203	514	(11)	(263)	578
Germany	29	64	283	40	(72)	344
Switzerland		2	1	133		136
Turkey	(32)	71	104		1	144
Other	34	36	195	102	73	440
Year ended 31 December 2012	509	1,208	986	499	(6,616)	(3,414)

For footnote, see page 109.

Adjusted profit before tax decreased by US$396m, primarily reflecting an increase in costs which was partly offset by a reduction in LICs; revenue was broadly in line with 2013.

Country business highlights

In the **UK**, overall CMB lending increased by 7% compared with 2013, with new lending and re-financing before attrition and amortisation increasing by 38% and over 85% of small business loan applications approved. In addition, Business Banking launched a campaign to offer further support and lending to SME customers. As part of this, £5.8bn (US$9.9bn) of future lending was made available to help finance growth across the UK. Lending in Global Trade and Receivables Finance also grew by 3% as we built on our position in the market in Trade Finance and reduced attrition from our existing clients in Receivables Finance.

In RBWM, we approved £11.4bn (US$18.8bn) of new mortgage lending to over 118,000 customers, including £3.5bn (US$5.8bn) to over 27,500 first-time buyers. However, our aggregate amount of mortgage balances drawn down decreased marginally. The loan-to-value (LTV) ratio on new lending was 60% compared with an average of 43.7% for the total mortgage portfolio. In October 2014, we expanded our mortgage distribution channels to include an intermediary in order to reach the growing proportion of the mortgage market in the UK that wishes to source its finance that way.

As part of the re-shaping of the GB&M business in 2013, we brought together all our financing businesses into Capital Financing, including lending, debt capital markets and equity capital markets. We increased our sector expertise and

enhanced our geographical spread by appointing two new co-heads of UK Banking. In 2014, the advisory and equity capital markets businesses within Capital Financing experienced volume growth that outstripped the market.

In **France**, in GB&M, we acted as sole advisor on one of the largest mergers and acquisitions (M&A) transactions in Europe. In CMB, our Payments and Cash Management business implemented the Single Euro Payments Area platform (SEPA) for euro-denominated credit transfer and direct debit payments across our European locations. This allows our clients to make and receive payments in euros from their HSBC accounts in the 34 countries that have implemented SEPA, all governed by a consistent set of standards, rules and conditions. In addition, in CMB, we allocated a further 1.5bn (US$2.0bn) to the SME fund and approved over 2.0bn (US$2.7bn) of lending in 2014. In RBWM, we experienced strong growth in home loans.

In **Germany**, as part of our growth initiative, we opened three branches in Dortmund, Mannheim and Cologne, increased the number of relationship managers by 26% and held a number of roadshows in countries including France, mainland China and the UK to reinforce Germany as a key international hub. In GPB, we disposed of our HSBC Trinkaus & Burkhardt AG business in Luxembourg.

In **Turkey**, the regulator imposed interest rate caps on credit cards and overdrafts which affected revenue. Despite this, in September 2014 CMB launched a TRL2bn (US$914m) international fund in order to provide sustainable support and global connectivity for international business, of which TRL1.1bn (US$519m) was drawn down.

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In **Switzerland**, we continued to reposition the GPB business and focused on growth through the high net worth client segment. Client assets, which include funds under management and cash deposits, decreased due to this repositioning, as well as the sale of a portfolio of client assets.

In November 2014, we sold the Kazakhstan business in line with the Group strategy.

Review of adjusted performance[45]

Revenue increased by US$76m, primarily in the UK, partly offset by reductions elsewhere, including France, Switzerland and Turkey.

Revenue (US$m)

Country view of adjusted revenue

	2014 US$m	2013 US$m
UK	**16,080**	15,365
France	**2,937**	3,097
Germany	**945**	960
Switzerland	**736**	831
Turkey	**791**	827
Other	**790**	1,123
Year ended 31 December	**22,279**	22,203

In the *UK*, revenue increased by US$715m. This was driven by favourable fair value movements of US$222m from interest and exchange rate ineffectiveness in the hedging of long-term debt issued principally by HSBC Holdings in 2014, compared with adverse movements of US$480m in 2013, and a gain arising from external hedging of an intra-Group financing transaction.

Revenue also rose in CMB due to growth in deposit volumes in Payments and Cash Management and net interest income improved due to wider spreads in term lending. In addition, net fee income grew, partly reflecting increased volumes of new business lending in the Large Corporate and Mid-Market segments.

By contrast, GB&M revenue decreased compared with 2013, primarily driven by Markets. This included the introduction of the FFVA on certain derivative contracts which resulted in a charge affecting Rates and Credit. Revenue also fell in Foreign Exchange, reflecting lower volatility and reduced client flows. Furthermore, revenue decreased in Equities, as 2013 benefited from higher revaluation gains, which more than offset the increase

in revenue from increased client flows and higher derivative income.

RBWM revenue reduced marginally due to spread compression, primarily on mortgages. In addition, fee income fell as a result of higher fees payable under partnership agreements and lower fee income from investment products and overdrafts. These factors were partly offset by improved spreads on savings products and higher current account balances.

In *the rest of Europe*, revenue decreased in France, Switzerland and Turkey. Revenue in France fell principally in RBWM in the Insurance business due to adverse movements of US$203m in the PVIF asset, reflecting a fall in long-term yields which increased the cost of guarantees on the savings business, compared with favourable movements of US$48m in 2013. This was coupled with a fall in GB&M in Rates, due to lower volatility and levels of market activity. In Switzerland, the fall in revenue reflected the repositioning of the GPB business and a reduction in client assets. Revenue also decreased in Turkey, principally in RBWM due to interest rate caps on cards and overdrafts imposed by the local regulator, partly offset by an increase in card fees.

LICs reduced, primarily in the UK and, to a lesser extent, in Spain. In the UK in CMB, individually assessed provisions fell, reflecting the quality of the portfolio and improved economic conditions. GB&M also recorded reduced loan impairment charges due to lower individually assessed provisions, and higher net releases of credit risk provisions on available-for-sale ABSs. This was partly offset by an increase due to a revision in certain estimates in our corporate collective loan impairment calculation. Loan impairment charges in RBWM decreased as a result of lower delinquency levels in the improved economic environment and as customers continued to reduce outstanding credit card and loan balances. Loan impairment charges in Spain decreased due to lower individually assessed provisions.

The decreases in the UK and Spain were partly offset by increases in Turkey and France. Loan impairment charges increased in Turkey due to growth in card delinquency rates following regulatory changes. Loan impairment charges in France increased, predominantly in GB&M and CMB due to higher individually assessed provisions.

Operating expenses (US$m)

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Operating expenses rose by US$1.3bn, mainly in the UK, reflecting growth in Regulatory Programmes and Compliance costs in all businesses and increased staff costs. In addition, the UK bank levy charge of US$1.1bn in respect of 2014 was US$0.2bn higher than in 2013, primarily due to an increase in the rate of the levy. Expenses also increased due to the timing of the recognition of the Financial Services Compensation Scheme levy in the UK. These increases were partly offset by sustainable cost savings of over US$330m.

2013 compared with 2012

Economic background

UK Gross Domestic Product (GDP) growth rose to 1.9% in 2013, higher than in previous years, though the level of real GDP remained below the level seen prior to the recession. The recovery was driven in part by stronger household consumption. The Bank of England policy rate remained at 0.5% and the Asset Purchase Scheme came to a halt. The Bank of England announced a forward guidance policy in August in which it indicated Bank Rate would not rise until unemployment had fallen towards 7%. Labour market conditions improved more rapidly than expected and the headline unemployment rate fell to 7.1% in December. The annual rate of Consumer Prices Index (CPI) inflation fell in December to 2.0%, the lowest level of inflation in almost four years.

The **eurozone** emerged from recession in the second quarter of 2013 with the improvement early in the year driven by Germany and France. However, activity failed to gain momentum since quarterly GDP growth averaged just 2.0% in the second half of the year. Domestic demand improved on the back of improving real wage growth and a slower pace of austerity but recovery remained heavily dependent on external demand. Given the weakness of the economy in early 2013, the ECB cut its refinancing rate from 0.75% to 0.5% in May and then in July adopted a forward guidance policy under which it committed to keep rates at present or lower levels for an extended period . Despite the return to growth, CPI inflation dropped to 0.7% in October 2013 prompting the ECB to cut the refinancing rate by a further 0.25% in November. A combination of improving growth and the ECB s Outright Monetary Transactions programme, which enables it to buy eurozone government bonds in time of market stress, helped alleviate the sovereign crisis evident in former years and bond yields in Italy and Spain fell to their lowest levels since 2010.

Review of performance

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. For comparison, adjusted profit before tax would have been US$4.1bn and US$3.5bn for 2013 and 2012 respectively as compared with constant currency profit before tax of US$1.8bn and a loss before tax of US$3.4bn for 2013 and 2012 respectively. Constant currency, underlying and adjusted are reconciled on pages 105(b) to 105(au).

Our European operations reported a profit before tax of US$1.8bn in 2013 compared with a loss of US$3.4bn in 2012 (US$3.3bn on a constant currency basis). On an underlying basis, excluding fair value movements on own debt, the effects of foreign currency translation and acquisitions and disposals, profit before tax increased by US$2.1bn. This was due to significantly lower operating expenses, driven by a decrease in charges relating to UK customer redress programmes, an accounting gain of US$430m relating to changes in delivering ill-health benefits to certain employees in the UK and sustainable cost savings in 2013.

In the UK, we continued to support the housing market during 2013, approving £14.4bn (US$22.5bn) of new mortgage lending to over 135,000 customers. This included £3.8bn (US$6.0bn) to over 30,000 first time buyers. The loan-to-value ratio on new lending was 59.5% compared with an average of 48.3% for the total mortgage portfolio. In addition, we implemented the Global Wealth Incentive Plan to better align customer and business interests.

CMB repositioned its Business Banking segment towards international and internationally aspirant customers while streamlining and re-engineering core processes, which enabled it to obtain efficiencies in a number of areas and supported its continued investment in corporate banking and Global Trade and Receivables Finance. Following the success of the 2012 International SME fund, CMB launched a further fund in 2013, continuing its support for UK businesses that trade or aspire to trade internationally with approved lending of £4.8bn (US$7.5bn), including the renewal of overdraft and other lending facilities. In addition, CMB won awards for Best Service from a Business Bank and Best Online Banking Provider at the *Business Moneyfacts* awards. GB&M s debt capital markets activity in the Credit and Capital Financing businesses was successful in capturing growth in issuance demand, which resulted in leading market positions and increased market share in the sterling markets. We were ranked first by Bloomberg for primary debt capital market issuances in 2013.

In France, CMB launched a similar SME fund to that in the UK, targeted at international trade customers, approving 1.5bn (US$2.0bn) of lending in 2013. GB&M acted as joint book runner of a 6.2bn (US$8.2bn) hybrid bond for a premier French corporate client, demonstrating our ability to deliver large and complex transactions. In RBWM, we increased our market share in the highly competitive home loans market.

In Turkey, unsecured lending grew in RBWM, notably in the credit card business due to new product features and channel capabilities including mobile banking. We launched a similar SME fund to those in the UK and France targeted at international trade customers, approving Turkish lira 1.1bn (US$0.6bn) of lending in 2013.

We continued to support the programme of renminbi internationalisation during the year with flagship client events taking place in the UK, France and Germany.

Report of the Directors: Financial Review (continued)

In Switzerland we continued to address legacy issues and reposition the customer base.

Net interest income increased by 3%, primarily in the UK. In GB&M, Balance Sheet Management net interest income was higher, reflecting both portfolio growth from rising deposit balances and reduced funding costs. In addition, net interest income increased due to higher lending spreads in Capital Financing and a rise in legacy credit. In RBWM net interest income increased, driven by growth in residential mortgage balances and improved lending spreads. RBWM customer account balances also increased as customers held balances in readily accessible current and savings accounts, although the benefit was restricted by deposit spread compression. In CMB, net interest income in the UK rose as a result of growth in term lending revenue from higher spreads on new and renewed business, as well as deposit growth in Payments and Cash Management. The spreads resulted in increased portfolio margins overall.

In France, net interest income increased due to improved spreads and growth in home loan balances.

These factors were partly offset by a decline, mainly in Switzerland in GPB, as higher yielding positions matured and opportunities for reinvestment were limited by lower prevailing yields. Narrower lending and deposit spreads and reduced average deposit balances also contributed to a fall in net interest income in Switzerland.

Net fee income decreased by US$138m, mainly in Switzerland in GPB with lower brokerage fees due to a reduction in client transaction volumes, in part reflecting decreased market volatility and fewer large deals.

In the UK, net fee income decreased in RBWM due to higher fees payable under partnership agreements and lower creditor insurance fees. In GB&M, net fee income fell because of higher fees paid to other regions relating to increased foreign exchange trading activities. This was partly offset by increased issuance demand in debt capital markets and event-driven fee income in equity underwriting from increased deal volumes. In addition, we experienced a rise in lending fees in CMB.

In Turkey, net fee income rose due to the growth in card revenue as the business expanded.

Net trading income increased by US$1.7bn to US$4.4bn. This was primarily in the UK, driven in part by lower adverse foreign exchange movements on assets held as economic hedges of foreign currency debt designated at fair value, with the offset reported in Net income from financial instruments designated at fair value . In addition, there was a foreign exchange gain on sterling debt issued by HSBC Holdings and increased favourable fair value movements on non-qualifying hedges compared with 2012.

In GB&M, net trading income included a favourable DVA of US$65m in 2013. 2012 included a net charge of US$312m as a result of a change in estimation methodology in respect of CVAs of US$615m and DVAs of US$303m, reflecting evolving market practices.

Also in GB&M, Foreign Exchange income rose following increased customer activity, although the rise was offset in part by margin compression and reduced market volatility in the second half of 2013. Net trading income was also higher in the Equities business due to increased deal volumes and revaluation gains. Rates revenue declined due to the benefit in 2012 from tightening spreads following the ECB liquidity intervention, despite new client mandates and increased market participation, particularly in European government bonds. We also experienced lower adverse fair value movements from own credit spreads on structured liabilities.

In France, trading income on non-qualifying hedges increased as long-term interest rates rose.

Net income from financial instruments designated at fair value was US$0.4bn compared with net expense of US$2.2bn in 2012. In the UK, we reported lower adverse movements on the fair value of our own debt of US$1.0bn, compared with adverse movements of US$4.1bn in 2012. Excluding this, net income declined, driven by lower favourable foreign exchange movements on foreign currency debt than in 2012, with the offset reported in Net trading income . In addition, there were higher adverse fair value movements from interest and exchange rate ineffectiveness in the hedging of long-term debt issued principally by HSBC Holdings and its European subsidiaries than in 2012.

By contrast, in the UK and France, we recognised higher net investment gains on the fair value of assets held to meet liabilities under insurance and investment contracts than in 2012, as market conditions improved.

Gains less losses from financial investments increased by US$19m as in the UK we reported gains in RBWM in the Asset Management Group. In GB&M, higher disposal gains and lower impairments on available-for-sale equity securities in Principal Investments were more than offset by lower net gains on the disposal of available-for-sale debt securities in Balance Sheet Management, as part of structural interest rate risk management of the balance sheet.

Net earned insurance premiums decreased by 15%, mainly in RBWM in France reflecting lower sales of investment contracts with DPF and the run-off of business from independent financial adviser channels in 2013.

Other operating income decreased by US$600m due to a loss recognised in GPB following the write-off of goodwill relating to our Monaco business and a loss on sale in RBWM on the disposal of an HFC Bank UK secured loan portfolio.

Net insurance claims incurred and movement in liabilities to policyholders was broadly in line with 2012. Lower reserves established for new business, reflecting the decline in net premium income in France, were partly offset by higher net investment gains on the fair value of assets held to support policyholder contracts in 2013 than in 2012.

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LICs decreased by 20% to US$1.5bn. In the UK, GB&M recorded net releases of credit risk provisions on available-for-sale ABSs compared with impairment charges in 2012, offset in part by higher individually assessed provisions. In addition, loan impairment charges in CMB fell due to lower collectively and individually assessed provisions, and in RBWM due to lower collectively assessed provisions reflecting recoveries from debt sales.

In other countries in Europe, lower individually assessed impairment provisions in Greece were partly offset by increases in Turkey, where there was growth in unsecured lending in RBWM, and a rise in Spain, where the challenging economic conditions continued to affect the market.

Operating expenses decreased by 7%, driven by lower charges relating to UK customer redress programmes, with US$1.2bn reported in 2013 compared with US$2.3bn (US$2.3bn as reported) in 2012. The charges in 2013 included additional estimated redress for possible mis-selling in previous years of US$756m in respect of PPI compared with US$1.7bn in 2012, US$261m in respect of interest rate protection products compared with US$586m in 2012 and US$149m in respect of

Wealth Management products in 2013. Restructuring costs also fell by US$78m from 2012. In addition, 2012 included a charge relating to the US OFAC investigation of US$375m in HSBC Holdings which did not recur.

Excluding these items, operating expenses were broadly unchanged compared with 2012. We benefited from sustainable cost savings of over US$650m as we continued to streamline the business, and a decline in performance-related costs, notably in GB&M. In addition, we reported an accounting gain of US$430m relating to changes in delivering ill-health benefits to certain employees in the UK. These factors were partially offset by the higher UK bank levy charge of US$904m in respect of 2013 compared with a charge of US$571m in 2012, mainly due to an increase in its rate. In addition, operating expenses in both years included adjustments relating to the prior year charge (2013: US$12m adverse adjustment; 2012: US$99m favourable adjustment). In other countries in the region, we experienced higher Madoff-related litigation charges in GB&M in Ireland and a provision in respect of regulatory investigations in GPB in Switzerland.

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Profit/(loss) before tax and balance sheet data Europe

	2014						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
rofit/(loss) before ax							
et interest ncome/(expense)	5,196	3,616	1,956	594	(654)	(97)	10,611
et fee ncome/(expense)	2,456	1,900	1,087	626	(27)		6,042
rading ncome/(expense) xcluding net nterest income	(260)	33	1,943	140	(92)		1,764
et interest ncome/(expense) n trading activities	14	2	660	(4)	1	97	770
et trading ncome/(expense)[50]	(246)	35	2,603	136	(91)	97	2,534
hanges in fair alue of long-term ebt issued and elated derivatives					614		614
et ncome/(expense) rom other financial nstruments esignated at fair alue	616	119	14	(1)	(11)		737
et ncome/(expense) rom financial nstruments esignated at fair	616	119	14	(1)	603		1,351

alue							
Gains less losses from financial investments	12	10	730	9	11		772
Dividend income	3	7	50	2	3		65
Net insurance premium income/(expense)	2,741	217		50			3,008
Other operating income/(expense)	(127)	45	(3)	29	1,249	(186)	1,007
Total operating income	**10,651**	**5,949**	**6,437**	**1,445**	**1,094**	**(186)**	**25,390**
Net insurance claims[56]	(3,450)	(306)		(63)			(3,819)
Net operating income[4]	**7,201**	**5,643**	**6,437**	**1,382**	**1,094**	**(186)**	**21,571**
Loan impairment (charges)/ recoveries and other credit risk provisions	(268)	(502)		4	2		(764)
Net operating income	**6,933**	**5,141**	**6,437**	**1,386**	**1,096**	**(186)**	**20,807**
Total operating expenses	(6,621)	(2,594)	(6,391)	(1,071)	(3,726)	186	(20,217)
Operating profit/(loss)	**312**	**2,547**	**46**	**315**	**(2,630)**		**590**
Share of profit in associates and joint ventures	2	1	3				6
Profit/(loss) before tax	**314**	**2,548**	**49**	**315**	**(2,630)**		**596**
	%	%	%	%	%		%
Share of HSBC s profit before tax	1.7	13.6	0.3	1.7	(14.1)		3.2
Cost efficiency ratio	91.9	46.0	99.3	77.5	340.6		93.7

Balance sheet data[40]

	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	165,112	106,342	113,136	24,766	377		409,733
Total assets	221,679	120,819	948,951	64,676	64,182	(129,381)	1,290,926
Customer accounts[27]	202,413	135,837	166,075	41,380	254		545,959

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Report of the Directors: Financial Review (continued)

	2013						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income/(expense)	5,600	3,353	1,774	722	(694)	(62)	10,693
Net fee income/(expense)	2,545	1,789	957	744	(3)		6,032
Trading income excluding net interest income	206	30	2,181	192	698		3,307
Net interest income on trading activities	2	5	1,013	4	30	62	1,116
Net trading income[50]	208	35	3,194	196	728	62	4,423
Changes in fair value of long-term debt issued and related derivatives					(936)		(936)
Net income/(expense) from other financial instruments designated at fair value	1,059	271	591	4	(570)	(1)	1,354
Net income/(expense) from financial instruments designated at fair value	1,059	271	591	4	(1,506)	(1)	418
Gains less losses from financial	52		344	(17)			379

investments							
Dividend income	4	2	65	4			75
Net insurance premium income/(expense)	2,782	361	(1)	16			3,158
Other operating income/(expense)	(103)	9	110	(253)	766		529
Total operating income/(expense)	12,147	5,820	7,034	1,416	(709)	(1)	25,707
Net insurance claims[56]	(4,136)	(567)		(37)			(4,740)
Net operating income/(expense)[4]	8,011	5,253	7,034	1,379	(709)	(1)	20,967
Loan impairment charges and other credit risk provisions	(329)	(935)	(242)	(24)			(1,530)
Net operating income/(expense)	7,682	4,318	6,792	1,355	(709)	(1)	19,437
Total operating expenses	(5,934)	(2,231)	(4,987)	(1,519)	(2,943)	1	(17,613)
Operating profit/(loss)	1,748	2,087	1,805	(164)	(3,652)		1,824
Share of profit/(loss) in associates and joint ventures	5	1	(4)	(1)			1
Profit/(loss) before tax	1,753	2,088	1,801	(165)	(3,652)		1,825
	%	%	%	%	%		%
Share of HSBC s profit before tax	7.8	9.2	8.0	(0.7)	(16.2)		8.1
Cost efficiency ratio	74.1	42.5	70.9	110.2	(415.1)		84.0
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	177,357	105,498	145,136	27,289	830		456,110
Total assets	238,499	124,242	1,054,506	75,718	72,174	(172,180)	1,392,959
Customer accounts[27]	205,288	134,120	191,715	49,789	1,021		581,933

For footnotes, see page 109.

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Profit/(loss) before tax and balance sheet data Europe (continued)

	2012						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income/(expense)	5,437	3,228	1,409	820	(543)	43	10,394
Net fee income	2,622	1,658	1,032	848	9		6,169
Trading income excluding net interest income	67	26	848	216	25		1,182
Net interest income on trading activities	7	14	1,500	14	33	(43)	1,525
Net trading income[49]	74	40	2,348	230	58	(43)	2,707
Changes in fair value of long-term debt issued and related derivatives					(3,091)		(3,091)
Net income/(expense) from other financial instruments designated at fair value	770	139	1,073		(1,106)		876
Net income/(expense) from financial instruments designated at fair	770	139	1,073		(4,197)		(2,215)

value							
Gains less losses from financial investments	(5)	(1)	375	(3)	(2)		364
Dividend income		1	104	3	3		111
Net insurance premium income	3,150	438		42			3,630
Other operating income	84	58	88	61	796	(9)	1,078
Total operating income/(expense)	12,132	5,561	6,429	2,001	(3,876)	(9)	22,238
Net insurance claims[56]	(4,054)	(536)		(40)			(4,630)
Net operating income/(expense)[1]	8,078	5,025	6,429	1,961	(3,876)	(9)	17,608
Loan impairment charges and other credit risk provisions	(347)	(1,109)	(436)	(29)			(1,921)
Net operating income/(expense)	7,731	3,916	5,993	1,932	(3,876)	(9)	15,687
Total operating expenses	(7,225)	(2,708)	(4,999)	(1,431)	(2,741)	9	(19,095)
Operating profit/(loss)	506	1,208	994	501	(6,617)		(3,408)
Share of profit/(loss) in associates and joint ventures	3		(8)	(2)	1		(6)
Profit/(loss) before tax	509	1,208	986	499	(6,616)		(3,414)
	%	%	%	%	%		%
Share of HSBC s profit before tax	2.5	5.9	4.8	2.4	(32.0)		(16.5)
Cost efficiency ratio	89.4	53.9	77.8	73.0	(70.7)		108.4
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	170,002	105,796	129,499	29,963	881		436,141
Total assets	240,744	132,718	1,044,507	76,145	75,513	(180,387)	1,389,240
Customer accounts[27]	191,024	121,648	164,743	57,061	739		535,215

For footnotes, see page 109.

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Asia[7]

HSBC s principal banking subsidiaries in Hong Kong are The Hongkong and Shanghai Banking Corporation Limited and Hang Seng Bank Limited. The former is the largest bank incorporated in Hong Kong and is our flagship bank in Asia.

We offer a wide range of banking and financial services in mainland China, through our local subsidiaries HSBC Bank (China) Company Limited and Hang Seng Bank (China) Limited. We also participate indirectly in mainland China through our associate, Bank of Communications.

Outside Hong Kong and mainland China, we conduct business in 18 countries and territories in Asia, with particularly strong coverage in Australia, India, Indonesia, Malaysia and Singapore.

	2014 US$m	2013 US$m	2012 US$m
Net interest income	**12,273**	11,432	10,707
Net fee income	**5,910**	5,936	5,418
Net trading income	**2,622**	2,026	2,516
Other income	**2,872**	5,038	6,691
Net operating income[4]	**23,677**	24,432	25,332
LICs[43]	**(647)**	(498)	(510)
Net operating income	**23,030**	23,934	24,822
Total operating expenses	**(10,427)**	(9,936)	(9,980)
Operating profit	**12,603**	13,998	14,842
Income from associates[44]	**2,022**	1,855	3,188
Profit before tax	**14,625**	15,853	18,030
Cost efficiency ratio	**44.0%**	40.7%	39.4%
RoRWA[36]	**3.1%**	3.8%	4.4%
Year-end staff numbers	**118,322**	113,701	112,766

10%

Growth in customer lending balances

excluding the effect of currency translation

Market leader for

Asia ex-Japan Bonds

(Bloomberg)

Best Bank in Asia

(The Euromoney Awards of Excellence 2014)

For footnotes, see page 109.

Economic background

Hong Kong s real GDP growth slowed in 2014 relative to 2013 due to weaker domestic demand, partly attributable to the slowdown in the annual growth of retail sales. Labour market conditions softened with unemployment rising, albeit from historically low levels. Tourism arrivals to Hong Kong held up overall, up by 16% in the year compared with 2013, driven by the growth of visitors from mainland China. Headline CPI inflation averaged just over 4% for 2014, with a number of expiring government subsidies offsetting lower inflation in fuel and food prices.

In mainland **China**, real GDP growth slowed from 7.7% in 2013 to 7.4% in 2014, largely due to a slowdown in activity in construction and manufacturing investment which was only partially offset by resilient infrastructure investment. Headline annual CPI inflation fell steadily to 1.5% in December, significantly below the government s target of 3.5%. The People s Bank of China eased monetary policy in November by cutting policy interest rates for the first time since July 2012. The one-year deposit rate was lowered by 25bps to 2.75% and the one-year lending rate by 40bps to 5.6%. Further measures were announced in December to support bank lending and spur economic activity.

Japan experienced significant economic volatility during 2014 from the imposition of a 3 percentage point consumption tax increase, which took effect on 1 April. The economy recorded annualised GDP growth of 5.8% in the first quarter of 2014, but growth slowed sharply after the tax rise, as government stimuli and exports were unable to offset the decline in private consumption. GDP grew at an annualised rate of 2.2% in the fourth quarter after falls of 6.7% and 1.9% in the preceding quarters. The Bank of Japan announced another round of quantitative easing on 31 October 2014, prompting further depreciation of the yen.

In **India**, a new government with a strong mandate for reform boosted market sentiment regarding the long-term prospects for the country s economy. However, the recovery remained constrained in 2014 with many infrastructure projects delayed pending government clearance. The steep decline in international commodity prices during the second half of the year helped push down goods price inflation and reduce the current account deficit. Following an interest rate rise early in 2014, the central bank kept monetary policy stable throughout the year.

The downward trend in global commodity prices permitted **Indonesia** and **Malaysia** to cut costly fuel subsidies, which is expected to reduce external imbalances and improve their fiscal position. Domestic demand in these countries remained relatively robust throughout 2014, supporting economic growth. In **Singapore**, GDP growth slowed in 2014 from weaker export growth and domestic economic restructuring. The Monetary Authority maintained its policy of gradual currency appreciation.

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Profit/(loss) before tax by country within global businesses

	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Total US$m
Hong Kong	**3,727**	**2,264**	**1,807**	**146**	**198**	**8,142**
Australia	**78**	**126**	**232**		**(4)**	**432**
India	**4**	**121**	**442**	**11**	**122**	**700**
Indonesia	**10**	**53**	**110**		**25**	**198**
Mainland China	**292**	**1,533**	**954**	**(3)**	**175**	**2,951**
Malaysia	**156**	**122**	**190**		**28**	**496**
Singapore	**129**	**168**	**243**	**57**	**(8)**	**589**
Taiwan	**19**	**35**	**166**		**1**	**221**
Other	**57**	**320**	**432**		**87**	**896**
Year ended 31 December 2014	**4,472**	**4,742**	**4,576**	**211**	**624**	**14,625**
Hong Kong	3,742	2,110	1,971	208	58	8,089
Australia	100	131	189		26	446
India	(21)	113	418	7	136	653
Indonesia	12	106	126		36	280
Mainland China	223	1,536	842	(4)	1,644	4,241
Malaysia	148	105	236		25	514
Singapore	147	120	262	74	22	625
Taiwan	7	30	158		5	200
Other	61	207	473	(1)	65	805
Year ended 31 December 2013	4,419	4,458	4,675	284	2,017	15,853
Hong Kong	3,694	2,188	1,518	249	(67)	7,582
Australia	97	38	184		(44)	275
India	41	89	497	7	175	809
Indonesia	29	124	146		7	306
Mainland China	838	1,724	1,257	(4)	2,525	6,340
Malaysia	183	131	242		8	564
Singapore	201	139	296	97	(65)	668
Taiwan	62	36	136			234

Other	66	321	567	59	239	1,252
Year ended 31 December 2012	5,211	4,790	4,843	408	2,778	18,030

In **Australia,** real GDP growth rose to an annual rate of around 2.8% in 2014 and unemployment remained roughly unchanged at 6.1%. Mining investment fell sharply and was only partly offset by an improvement in other sectors of the economy. Low interest rates continued to drive an increase in housing market activity and credit growth picked up modestly. The Australian dollar weakened during the year but remained well above its long-run average level.

In **Taiwan**, economic activity accelerated with the level of GDP in 2014 rising 3.5% in the year as a whole. This was the strongest annual rate of growth since 2011 and an improvement on the 2.1% growth seen in 2013. Growth was driven by a combination of strong exports and domestic consumption thanks to low unemployment and rising wage growth. The central bank in Taiwan kept its key policy rate unchanged throughout 2014 at 1.875%, which is the level it has been since 2011.

Financial overview

Profit before tax (US$m)

Our operations in Asia reported a profit before tax of US$14.6bn in 2014 compared with US$15.9bn in 2013, a decrease of 8%. The reduction reflected a decrease in revenue and an increase in costs and LICs, partly offset by a higher share of profits from associates. Revenue included the effect of a number of significant items, notably in 2013, an accounting gain arising from the reclassification of Industrial Bank as a financial investment (US$1.1bn) and the net gain on completion of the Ping An disposal (US$553m).

Analysis of mainland China profit/(loss) before tax

	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Total US$m
BoCom and other associates	**255**	**1,421**	**296**		**1**	**1,973**
Mainland China operations	**37**	**112**	**658**	**(3)**	**174**	**978**
Industrial Bank						
Ping An						
Year ended 31 December 2014	**292**	**1,533**	**954**	**(3)**	**175**	**2,951**
BoCom and other associates	247	1,360	284		(38)	1,853
Mainland China operations	(24)	176	558	(4)	40	746
Industrial Bank					1,089	1,089
Ping An					553	553
Year ended 31 December 2013	223	1,536	842	(4)	1,644	4,241
BoCom and other associates	214	1,193	248			1,655
Mainland China operations	(52)	176	606	(4)	66	792
Industrial Bank	54	273	343			670
Ping An	622	82	60		2,459	3,223
Year ended 31 December 2012	838	1,724	1,257	(4)	2,525	6,340

In 2014, significant items included the gain on sale of our investment in Bank of Shanghai (US$428m) and an impairment of our investment in Industrial Bank (US$271m). See page 42 for further details of significant items.

On an adjusted basis, profit before tax rose by US$326m or 2%, driven by higher revenue partly offset by increased operating expenses and LICs.

Country business highlights

We continued to focus on our strategic priorities for Asia, using our international network to drive organic growth and connect customers across borders. We completed the sale of our investment in Bank of Shanghai and implemented a discretionary incentive framework that removes the formulaic link between product sales and remuneration. We also saw continued adoption of our mobile banking applications, extended the contact-less payment systems to Android phones and enhanced our digital banking capabilities.

In **Hong Kong**, average mortgage balances in RBWM increased by 7%, with average LTV ratios of 47% on new mortgage drawdowns and an estimated 29% on the portfolio as a whole. In November 2014, to coincide with the launch of the Hong Kong-Shanghai Stock Connect platform, we rolled out new services allowing retail customers to trade and invest in eligible shares that are listed on the Shanghai Stock Exchange. We strengthened our cards offering with the launch of the Visa Signature card product in Hong Kong and continued building new merchant partnerships across the region. We also re-launched our Advance offering to emerging affluent customers in Hong Kong and nine other regional markets. We were awarded International Retail Bank of the Year by *Asian Banking and Finance.*

In CMB, we were one of the first foreign banks to announce renminbi cross-border pooling capability in the Shanghai Free Trade Zone. The collaboration between CMB and GB&M continued throughout the year, as a

consequence of which 157 primary markets transactions were completed in 2014, up from 122 in 2013, primarily for debt capital market issuances and leveraged asset finance mandates. In addition, we were named Best Commercial Bank by *FinanceAsia Achievement Awards 2014.*

In GB&M, we maintained our market leadership in Asia ex-Japan G3 currency and investment grade bonds, and led the market in Hong Kong dollar bond issuances. We were involved in three of the five largest equity capital market transactions during 2014, as well as the first Sukuk sovereign bond issuance in Hong Kong. Furthermore, we continued to lead the market in offshore renminbi bond issuance in Hong Kong, becoming one of the Hong Kong Monetary Authority s primary liquidity providers for offshore renminbi. We also acted as a joint book runner for an offshore preference share issuance for a mainland Chinese bank, the first mainland Chinese Basel III compliant additional tier-1 capital offering. We remain well-positioned to service our institutional investors using Stock Connect through our integrated Custody Plus platform.

In **mainland China**, we continued to develop our branch network, which comprised 173 HSBC outlets, 25 HSBC rural bank outlets and 50 Hang Seng Bank outlets at the end of the year. In RBWM, we were one of the first foreign banks to launch renminbi derivative products linked to the US dollar/renminbi rate and were awarded Best Foreign Retail Bank by *The Asian Banker* for the sixth consecutive year. During 2014, we were the first foreign custodian bank to service renminbi qualified foreign institutional investors based in Singapore and South Korea. We also became a member of the Shanghai Gold Exchange s international board, a newly established trading platform connecting mainland China s gold market to global investors. In addition, we received regulatory approval to be one of the first market makers to directly trade renminbi, euro and Singaporean dollars in mainland China s interbank foreign exchange market.

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In Payments and Cash Management, we launched the Global Payments System which supports all cross-border payments in and out of mainland China in all currencies, including renminbi. In Global Trade and Receivables Finance, we launched trade link initiatives to connect mainland China with the rest of Asia, Germany and the US, to enhance international connectivity and promote activity between key trade routes. In mergers and acquisitions (M&A), we were adviser to a number of state owned enterprises on significant overseas investments and acquisitions.

Elsewhere in Asia, in **India**, we continued to grow our balance sheet in CMB, including term lending and Payments and Cash Management deposits, particularly helping UK corporations to invest in India. In GB&M, we were adviser on two of the largest M&A transactions in 2014, and in Wealth Management we launched Managed Solutions, a multi-asset fund series. In **Australia**, we were a mandated lead arranger for the largest mining project financing deal and for the largest transport infrastructure project during 2014. In CMB, we also announced an A$250m (US$225m) International Growth Fund, providing credit facilities to local SMEs to explore business opportunities abroad.

Review of adjusted performance[45]

Revenue (US$m)

Revenue was US$1.2bn or 5% higher, driven by Hong Kong and mainland China, mainly in CMB and RBWM from balance sheet growth, as well as in GB&M from portfolio growth in Balance Sheet Management and increased term lending. Revenue was also higher in India and Australia.

Country view of adjusted revenue

	2014 US$m	2013 US$m
Hong Kong	**13,725**	13,211
Australia	**975**	898
India	**1,826**	1,666
Indonesia	**561**	559
Mainland China	**2,463**	1,948
Malaysia	**1,066**	1,063
Singapore	**1,339**	1,319
Taiwan	**491**	501
Other	**1,183**	**1,289**
Year ended 31 December	**23,629**	**22,454**

In *Hong Kong*, revenue increased by 4%, primarily in CMB and RBWM and, to a lesser extent, in GB&M. Higher revenue in CMB was due to increased net interest income from growth in term lending across a range of sectors, higher average Payments and Cash Management deposit balances and higher fees from remittance volumes, as well as improved lending spreads.

In RBWM, revenue growth was driven by higher net interest income from increased average lending balances, mainly credit cards and other personal lending, and from growth in average deposit balances, though the benefit of higher volumes was partly offset by spread compression. Net fee income also increased, principally from volume growth in unit trusts, credit card transactions and securities brokerage. In our insurance operations, revenue growth reflected higher premium income, which also contributed to growth in the debt securities portfolio, although this was partly offset by less favourable movements in the PVIF asset from annual actuarial assumption updates.

Revenue in GB&M also increased, mainly in Balance Sheet Management due to portfolio growth, and in Capital Financing from higher average term lending balances. This was partly offset by lower net fee income in Markets due to reduced client flows and in Capital Financing reflecting fee compression.

In *mainland China*, revenue increased by 26% compared with 2013. In GB&M, we reported greater net interest income from Balance Sheet Management due to portfolio growth and higher reinvestment rates, and a rise in average term lending balances. Additionally, trading income improved in Rates from higher interest income on debt securities and revaluation gains on trading bonds as yields fell, and in Foreign Exchange from increased client flows. Revenue in RBWM increased, mainly from wider deposit spreads as market interest rates rose in the first half of 2014, while in CMB revenue growth was driven by higher average deposit and lending balances.

Elsewhere in Asia, revenue in India rose by 10%, primarily in GB&M from higher Rates trading income due to favourable credit valuation adjustments (CVA s) on derivatives, coupled with higher net interest income from portfolio growth in Balance Sheet Management. In Australia, we reported an increase in revenue of 9%, predominantly in GB&M from higher trading income in Rates and Foreign Exchange. This was partly offset by lower revenue in South Korea following the run-off of our RBWM operations in 2013.

LICs rose by US$167m or 35%, principally in GB&M and CMB from a rise in a small number of individually assessed impairment charges in Hong Kong and mainland China. This was partly offset by a reduction in individually assessed impairment charges in CMB in New Zealand, Malaysia and Vietnam.

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Operating expenses (US$m)

Operating expenses rose by US$753m following investment in the region, notably in Regulatory Programmes and Compliance, and increased use of our Global Services Centres across the Group. Cost growth also reflected wage inflation and additional headcount, notably in Hong Kong and mainland China to support business growth, mainly in CMB, as well as increased marketing activity. These factors were partly offset by around US$270m of sustainable cost savings achieved in 2014.

Share of profit from associates and joint ventures rose by US$71m, mainly from BoCom, reflecting higher revenue from balance sheet growth and trading income, partly offset by increases in operating expenses and LICs.

Report of the Directors: Financial Review (continued)

2013 compared with 2012

Economic background

Hong Kong s GDP grew at a faster pace in 2013 than in 2012. This was driven mainly by domestic demand, which offset an ongoing weakness in external orders. Labour market conditions remained resilient and strong nominal wage growth continued to support private consumption. Measures announced in February 2013 by the government and the Hong Kong Monetary Authority to dampen demand in the property market led to a softening in prices and some moderation of demand in the third quarter of the year. Headline CPI inflation fell in the fourth quarter, largely due to lower food prices and housing costs. Underlying inflation averaged 4% in 2013, lower than it was in 2012.

In **mainland China**, the annual pace of GDP growth was unchanged at 7.7% in 2013, above the official GDP growth target of 7.5%. The rebound in activity in the second half of the year was mainly due to measures announced by the government during the summer. Export growth remained moderate through most of 2013, only accelerating in the final months. Annual growth in fixed asset investment remained steady at an annual rate of nearly 20% and consumer spending remained resilient. Headline annual CPI inflation rose modestly to 2.6%, remaining below the government s target of 3.5%. The People s Bank of China maintained a relatively restrictive credit policy but overall liquidity conditions remained loose as the M2 measure of money growth expanded by 13.6% on the year.

Economic activity in **Japan** picked up considerably in 2013, thanks to large-scale stimuli from both the government and the Bank of Japan. Annualised growth slowed to just over 1% in the third quarter although it accelerated in the final months of the year as consumer spending rose in advance of the sales tax increase due in April 2014.

Singapore s economic recovery also gathered pace, led by net external demand.

During the course of the summer, there were concerns in financial markets that global liquidity may become more expensive and less abundant as the US Federal Reserve Board indicated it may begin to taper its purchases of financial assets. Interest rates on US Treasuries rose, attracting global capital back to developed markets. Some emerging economies suffered considerable capital outflows with large declines in the value of their currencies against the US dollar and central banks were forced to raise interest rates to attract capital. This in turn led to a slowdown in activity.

In Asia, India and Indonesia were most affected. The current account positions of both economies had significantly deteriorated in recent years, leaving them vulnerable to changes in external financing conditions. In **India**, structural constraints on growth, including infrastructure bottlenecks, also contributed to a slowdown in activity. The central bank tightened monetary policy during the second half of 2013 in

response to concerns over inflation.

Similar constraints in **Indonesia** saw GDP growth slow in 2013. However, concerted measures to reduce fuel subsidies and narrow the current account deficit should make the economy more resilient to any tightening in monetary conditions in the West. Economic activity also reduced in **Malaysia** as the boost to growth in 2012 from public spending abated.

Taiwan s trade-dependent economy was weak in the first half of 2013, but strengthened in the second half as global trade improved.

Australian GDP growth slowed to an annual rate of around 2.5% in 2013 and unemployment rose to 5.7% towards the end of the year. This reflected a slowdown in mining investment after years of strong growth. To stimulate growth elsewhere, the Reserve Bank of Australia cut its cash rate from 3.0% to 2.5% during the year. Low interest rates drove a strong rise in housing prices. The Australian dollar remained well above its long run average levels in 2013, but fell towards the end of the year.

Review of performance

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. Adjusted profit before tax would have been US$14.3bn and US$13.1bn for 2013 and 2012, respectively, as compared with constant currency profit before tax of US$15.9bn and US$17.8bn for 2013 and 2012, respectively. Constant currency, underlying and adjusted are reconciled on pages 105(b) to 105(au).

Our operations in Asia reported a pre-tax profit of US$15.9bn compared with US$18.0bn in 2012, a decrease of 12%. The reduction reflected a 2012 gain following the disposal of our shareholding in Ping An of US$3.0bn, together with a reduction in our share of profit from associates of US$1.4bn as a result of this disposal and the effect of the reclassification of Industrial Bank as a financial investment following its issue of share capital to third parties. These items were partly offset by an accounting gain of US$1.1bn in 2013 on the reclassification of Industrial Bank.

On an underlying basis, which excludes the items above as well as other disposals and the results of disposed-of operations, profit before tax increased by 16% due to the net gain of US$553m on completion of the sale of our investment in Ping An in 2013, compared with adverse fair value movements of US$553m on the Ping An contingent forward sale contract recorded in 2012. Excluding these items, underlying profit before tax increased by 7%, driven by higher net interest income and net fee income in Hong Kong.

The implementation of our strategy to reduce fragmentation across the region continued, leading to the disposal of non-core insurance businesses in Vietnam, South Korea, Taiwan and Singapore, and we announced the closure of a retail brokerage in India and our retail banking operations in South Korea. We also completed the sale of our investment in Ping An in mainland China.

Report of the Directors: Financial Review (continued)

In Hong Kong, we grew our average mortgage balances by 8% with average loan-to-value ratios of 44% on new mortgage drawdowns and an estimated 32% on the portfolio as a whole. We continued to develop our digital capabilities and launched our mobile banking application in Hong Kong. We also developed our wealth management capabilities, growing revenue by over 10%. In addition, we enhanced our wealth management systems, simplified the product range and implemented the Global Wealth Incentive Plan to better align customer and business interests.

We further strengthened the collaboration between CMB and GB&M, raising financing for our clients of over US$14bn from debt capital markets and nearly US$4bn from equity capital markets, including the largest IPO in Hong Kong for a mainland Chinese consumer company. In addition, we were awarded Best Trade Finance Bank in Hong Kong by *Global Finance*.

In GB&M, we continued to lead the market in Hong Kong dollar bond issuance and are now one of the top five houses for both equity capital markets and mergers and acquisitions in Hong Kong. We were voted Best Debt House in Hong Kong in the *Euromoney* 2013 Awards for Excellence and were involved in seven of the ten largest IPOs in Hong Kong this year.

We led the market in offshore renminbi (RMB) bond issuance in Hong Kong, including the RMB3bn (US$491m) government bond issue in December 2013 by mainland China s Ministry of Finance, and were voted Best provider of offshore renminbi products and services for the second year running by *Asiamoney*. We also won the award for RMB House of the Year from *Asia Risk*.

We announced the sale of our shareholding in Bank of Shanghai in 2013, a transaction which is expected to complete in the first half of 2014.

In mainland China, where we continued to expand our branch network, we had 162 HSBC outlets, 23 HSBC rural bank outlets and 48 Hang Seng Bank outlets at the end of the year. We were also one of the first foreign banks to be approved to distribute domestic funds to retail investors. In addition, we were the market leader in mainland China s state-owned enterprise bond issuances and we were awarded Best Foreign Commercial Bank in China by *FinanceAsia*.

We continued to promote the internationalisation of the renminbi as regulations developed. We were the first foreign bank in mainland China to implement a customised renminbi cross-border centralised settlement solution and were also the first foreign bank to complete a two-way cross-border renminbi lending transaction.

In India, we revised our Wealth Management product offering to ensure customers needs were being met and to improve customer satisfaction levels. In Payments and Cash Management, we were awarded the Best Domestic Cash Management Bank in 2013 by *Euromoney*. Our strength in debt capital markets (DCM) continued, acting as a joint lead manager and bookrunner for the

largest US dollar-denominated single tranche bond issuance by an Indian corporate in 2013.

In Singapore, we led the market in foreign currency DCM issuance, continuing to demonstrate our ability to structure DCM transactions. In CMB, we began to offer a renminbi settlement service.

We continued to develop our Payments and Cash Management product offering across the region and were awarded the Best Cash Management House in Asia by *Euromoney*. We also strengthened our Project and Export Finance capabilities and were named the Best Project Finance House in Asia by *Euromoney* for the third consecutive year. Our strength in DCM continued, and we were the No.1 bookrunner in Asia-ex Japan bonds. We were awarded the Domestic Bond House of the Year by *IFR Asia*.

Net interest income rose by US$839m, primarily in Hong Kong, led by RBWM and supported by GB&M and CMB. The increase was mainly due to higher average lending balances, wider spreads on mortgages in RBWM reflecting lower funding costs, and growth in the insurance debt securities portfolio. Mortgage lending in RBWM in Hong Kong increased, although the rate of growth began to slow during 2013 as transaction volumes in the property market reduced.

Average residential mortgage balances also grew in mainland China and Australia, as we focused on secured lending, and in Singapore reflecting growth in 2012.

In addition, there was strong loan growth in both CMB and GB&M, driven by trade-related lending in the first half of 2013 and an increase in commercial real estate and other property-related lending in the second half of the year, though the benefit of this growth was partly offset by spread compression reflecting competition and increased liquidity in the markets.

Average deposit balances increased, in part reflecting new Premier customers in RBWM and increased Payments and Cash Management balances in CMB, though the benefit of this growth was more than offset by narrower deposit spreads due to a fall in short-term interbank interest rates.

Net fee income rose by US$595m in 2013, led by RBWM in Hong Kong as strong customer demand and favourable market sentiment led to higher fees from unit trusts and increased brokerage income. Fee income also increased due to a rise in debt and equity underwriting and corporate finance activity compared with 2012, in part reflecting collaboration between GB&M and CMB. In CMB, fee income growth reflected an increase in trade and Payments and Cash Management volumes.

Net trading income was US$434m lower, in part from further adverse fair value movements in mainland China on the Ping An contingent forward sale contract of US$682m, compared with US$553m in 2012. In addition, in GB&M, net trading income included a favourable DVA of US$40m in 2013, while 2012 included a favourable DVA of US$136m, arising from a change in estimation methodology reflecting evolving market practices. Rates revenues decreased, largely from reduced bond holdings

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in a number of countries and revaluation losses as bond yields rose, notably in mainland China. Foreign Exchange revenues also fell as market conditions in 2012 were not repeated. This was partly offset by favourable movements on the CVA in 2013, compared with adverse movements in 2012 arising from the change in estimation methodology as noted above.

Net income from financial instruments designated at fair value was US$314m compared with US$554m in 2012, primarily due to lower net investment returns on assets held by the insurance business reflecting weaker equity markets and falling bond prices. To the extent that these investment returns were attributed to policyholders holding unit-linked insurance policies and insurance contracts with DPF, there was a corresponding movement in *Net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments were US$936m higher, primarily in mainland China due to the gain on completion of disposal of our investment in Ping An of US$1.2bn, which was partly offset by the adverse fair value movement of US$682m on the contingent forward sale contract included in Net trading income leading to a net gain of US$553m. *Gains less losses from financial investments* were also partly offset by the non-recurrence of the gain on sale of our shares in four Indian banks in 2012.

We reported a *gain on disposal of Ping An* of US$3.0bn in 2012.

Dividend income was US$153m compared with US$26m in 2012, mainly due to the dividend from Industrial Bank following its reclassification as a financial investment during the year.

Net earned insurance premiums grew by 2%, driven by Hong Kong, due to increased renewals of deferred annuity and unit-linked insurance contracts, partly offset by the absence of non-life insurance premiums following the disposal of the HSBC and Hang Seng Bank general insurance businesses in 2012, and lower new business premiums. The growth in premiums resulted in a corresponding increase in *Net insurance claims incurred and movement in liabilities to policyholders*.

Other operating income increased by US$812m. We recorded an accounting gain of US$1.1bn on the reclassification of Industrial Bank as a financial investment following its issue of additional share capital to third parties, and a gain on the disposal of our investment in Bao Viet Holdings of US$104m. In 2012, we recorded gains totalling US$305m on a reported basis following the sales of our RBWM business in Thailand, our GPB business in Japan and our interest in a property company in the Philippines.

LICs were in line with 2012 as higher charges in Hong Kong due to a revision to the assumptions used in our collective assessment models in RBWM and a rise in individual impairment charges in CMB, were broadly offset by the non-recurrence of a large individually assessed impairment of a corporate exposure in Australia and a credit risk provision on an available-for-sale debt security in GB&M.

Operating expenses rose by US$139m in 2013, primarily in Hong Kong, reflecting higher marketing expenditure, costs relating to the introduction of updated payment cards and information technology platforms, as well as increased property rental and maintenance costs. In addition, staff costs increased as a result of changes to the recognition of pension costs. Costs rose in India from increased use of the service centres and in mainland China from wage inflation, higher staff numbers and branch expansion. These increases were offset by the partial write back of a litigation provision in Singapore and Australia compared with a charge in 2012.

Share of profit from associates and joint ventures reduced by US$1.4bn following the disposal of Ping An, the reclassification of Industrial Bank as a financial investment and an impairment charge of US$106m on our banking associate in Vietnam. Excluding these factors, income from associates rose, primarily in BoCom as a result of balance sheet growth and increased fee income, partly offset by higher operating expenses and a rise in loan impairment charges.

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Profit before tax and balance sheet data Asia

	2014						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit before tax							
Net interest income/(expense)	5,003	3,439	3,579	177	(16)	91	12,273
Net fee income	2,792	1,529	1,311	272	6		5,910
Trading income/(expense) excluding net interest income	216	382	1,220	142	(5)		1,955
Net interest income/(expense) on trading activities	(13)	(9)	771		9	(91)	667
Net trading income[50]	203	373	1,991	142	4	(91)	2,622
Changes in fair value of long-term debt issued and related derivatives					(4)		(4)
Net income/(expense) from other financial instruments designated at fair value	543	(6)	(2)		2		537
Net income/(expense) from financial instruments	543	(6)	(2)		(2)		533

designated at fair value							
Gains less losses from financial investments	1	5	46		148		200
Dividend income	1		1		177		179
Net insurance premium income	6,596	794					7,390
Other operating income	516	95	141	3	2,734	(1,158)	2,331
Total operating income	**15,655**	**6,229**	**7,067**	**594**	**3,051**	**(1,158)**	**31,438**
Net insurance claims[56]	(6,979)	(782)					(7,761)
Net operating income[4]	**8,676**	**5,447**	**7,067**	**594**	**3,051**	**(1,158)**	**23,677**
Loan impairment (charges)/ recoveries and other credit risk provisions	(317)	(228)	(103)	1			(647)
Net operating income	**8,359**	**5,219**	**6,964**	**595**	**3,051**	**(1,158)**	**23,030**
Total operating expenses	(4,191)	(1,897)	(2,686)	(384)	(2,427)	1,158	(10,427)
Operating profit	**4,168**	**3,322**	**4,278**	**211**	**624**		**12,603**
Share of profit in associates and joint ventures	304	1,420	298				2,022
Profit before tax	**4,472**	**4,742**	**4,576**	**211**	**624**		**14,625**
	%	%	%	%	%		%
Share of HSBC s profit before tax	23.9	25.4	24.5	1.1	3.4		78.3
Cost efficiency ratio	48.3	34.8	38.0	64.6	79.5		44.0
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	115,643	132,509	99,934	12,894	1,975		362,955
Total assets	166,577	158,747	548,865	14,905	79,477	(89,848)	878,723
Customer accounts[27]	286,670	155,608	104,896	29,847	470		577,491

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	2013						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit before tax							
Net interest income/(expense)	4,895	3,103	3,245	205	(124)	108	11,432
Net fee income/(expense)	2,758	1,518	1,419	249	(8)		5,936
Trading income/(expense) excluding net interest income	238	377	1,483	175	(739)		1,534
Net interest income/(expense) on trading activities	(16)	(6)	608		14	(108)	492
Net trading income/(expense)[50]	222	371	2,091	175	(725)	(108)	2,026
Changes in fair value of long-term debt issued and related derivatives					(1)		(1)
Net income/(expense) from other financial instruments designated at fair value	315		7		(7)		315
Net income/(expense) from financial instruments designated at fair value	315		7		(8)		314
Gains less losses from financial investments	(1)		58	14	1,204		1,275
Dividend income		1	6		145		152

Net insurance premium income	6,263	654	1				6,918
Other operating income	764	97	163	12	3,871	(1,232)	3,675
Total operating income	15,216	5,744	6,990	655	4,355	(1,232)	31,728
Net insurance claims[56]	(6,609)	(687)					(7,296)
Net operating income[4]	8,607	5,057	6,990	655	4,355	(1,232)	24,432
Loan impairment charges and other credit risk provisions	(347)	(144)	(3)	(4)			(498)
Net operating income	8,260	4,913	6,987	651	4,355	(1,232)	23,934
Total operating expenses	(4,138)	(1,786)	(2,560)	(367)	(2,317)	1,232	(9,936)
Operating profit	4,122	3,127	4,427	284	2,038		13,998
Share of profit/(loss) in associates and joint ventures	297	1,331	248		(21)		1,855
Profit before tax	4,419	4,458	4,675	284	2,017		15,853
	%	%	%	%	%		%
Share of HSBC s profit before tax	19.6	19.8	20.7	1.3	8.9		70.3
Cost efficiency ratio	48.1	35.3	36.6	56.0	53.2		40.7
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	111,769	122,882	89,722	10,904	1,620		336,897
Total assets	158,456	146,898	515,023	12,994	82,453	(84,033)	831,791
Customer accounts[27]	278,392	141,958	96,546	31,250	337		548,483

For footnotes, see page 109.

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Profit before tax and balance sheet data Asia (continued)

	2012						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit before tax							
Net interest income/(expense)	4,638	3,025	3,243	251	(345)	(105)	10,707
Net fee income	2,623	1,349	1,214	226	6		5,418
Trading income/(expense) excluding net interest income	272	351	1,668	237	(594)		1,934
Net interest income/(expense) on trading activities	4	(1)	452		22	105	582
Net trading income/(expense)[49]	276	350	2,120	237	(572)	105	2,516
Changes in fair value of long-term debt issued and related derivatives					(4)		(4)
Net income/(expense) from other financial instruments designated at fair value	620	(52)	20		(31)		557
Net income/(expense) from financial instruments designated at fair value	620	(52)	20		(35)		553
	(1)	2	(8)	7	338		338

Gains less losses from financial investments							
Dividend income		1	6		22		29
Net insurance premium income	5,863	898	8				6,769
Gain on disposal of Ping An					3,012		3,012
Other operating income	922	317	159	81	2,723	(1,128)	3,074
Total operating income	14,941	5,890	6,762	802	5,149	(1,128)	32,416
Net insurance claims[56]	(6,280)	(797)	(7)				(7,084)
Net operating income[1]	8,661	5,093	6,755	802	5,149	(1,128)	25,332
Loan impairment (charges)/ recoveries and other credit risk provisions	(331)	(151)	(31)	3			(510)
Net operating income	8,330	4,942	6,724	805	5,149	(1,128)	24,822
Total operating expenses	(4,057)	(1,712)	(2,542)	(397)	(2,400)	1,128	(9,980)
Operating profit	4,273	3,230	4,182	408	2,749		14,842
Share of profit/(loss) in associates and joint ventures	938	1,560	661		29		3,188
Profit before tax	5,211	4,790	4,843	408	2,778		18,030
	%	%	%	%	%		%
Share of HSBC s profit before tax	25.2	23.2	23.5	2.0	13.4		87.3
Cost efficiency ratio	46.8	33.6	37.6	49.5	46.6		39.4
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	108,542	106,912	83,895	9,702	1,614		310,665
Total assets	151,694	131,179	458,069	32,847	105,619	(74,699)	804,709
Customer accounts[27]	264,879	135,017	98,488	30,661	709		529,754

For footnotes, see page 109.

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Middle East and North Africa

The network of branches of HSBC Bank Middle East Limited, together with HSBC s subsidiaries and associates, gives us wide coverage in the region. Our associate in Saudi Arabia, The Saudi British Bank (40% owned), is the Kingdom s sixth largest bank by total assets.

	2014 US$m	2013 US$m	2012 US$m
Net interest income	**1,519**	1,486	1,470
Net fee income	**650**	622	595
Net trading income	**314**	357	390
Other income	**65**	38	(25)
Net operating income[4]	**2,548**	2,503	2,430
LICs[43]	**6**	42	(286)
Net operating income	**2,554**	2,545	2,144
Total operating expenses	**(1,216)**	(1,289)	(1,166)
Operating profit	**1,338**	1,256	978
Income from associates[44]	**488**	438	372
Profit before tax	**1,826**	1,694	1,350
Cost efficiency ratio	**47.7%**	51.5%	48.0%
RoRWA[36]	**2.9%**	2.7%	2.2%
Year-end staff numbers	**8,305**	8,618	8,765

Best Investment Bank in the

Middle East

(Euromoney 2014)

Record reported profit before tax of

US$1.8bn

Completed disposal of our operations in

Jordan and Pakistan

in line with the Group s

six filters investment criteria

For footnotes, see page 109.

For footnotes, see page 109.

Economic background

Economic activity across the Middle East and North Africa remained strong during 2014, despite heightened geopolitical uncertainties and weaker global oil prices towards the end of the year. The region s energy exporters fared particularly well, buoyed by an oil-funded fiscal stimulus and an expansionary monetary stance. **Saudi Arabia**, the Middle East s largest oil exporter, grew strongly as the Kingdom pushed ahead with its infrastructure and industrial expansion programme. The **United Arab Emirates (UAE)**, however, showed the most significant gains in momentum, boosted by growth in both its export-orientated non-oil sector and an increasingly expansionary fiscal stance. Though showing some gains as growth picked up speed, inflation remained muted at under 5% across the Gulf.

Egypt showed further signs of stabilisation in 2014. Although still below the trend levels that prevailed prior to the 2011 revolution, some momentum in growth was achieved in the second half of the year, boosted by the receipt of further concessional funding and an improvement in political order and policy making following the May presidential election. Inflation rose and the budget deficit remained high, recording a third successive double-digit deficit as a percentage of GDP. International reserves fell in the latter months of the year, highlighting ongoing pressure on the currency which remained subject to significant controls.

Financial overview

Profit before tax (US$m)

Our operations in the Middle East and North Africa reported a profit before tax of US$1.8bn, an increase of 8% on a reported basis, despite the effects of business disposals, including the loss on sale of our Pakistan business. See page 42 for further details of our significant items.

On an adjusted basis, profit before tax grew by 11% driven by higher revenue and increased income from our associate, The Saudi British Bank.

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Report of the Directors: Financial Review (continued)

Profit/(loss) before tax by country within global businesses

	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Total US$m
Egypt	**64**	**94**	**177**			**335**
United Arab Emirates	**154**	**190**	**364**		**(46)**	**662**
Saudi Arabia	**91**	**168**	**203**	**19**	**5**	**486**
Other	**14**	**152**	**182**		**(5)**	**343**
Year ended 31 December 2014	**323**	**604**	**926**	**19**	**(46)**	**1,826**
Egypt	31	37	166		(29)	205
United Arab Emirates	142	290	275	1	(72)	636
Saudi Arabia	82	146	188	15	7	438
Other	3	172	240			415
Year ended 31 December 2013	258	645	869	16	(94)	1,694
Egypt	67	71	157		(5)	290
United Arab Emirates	143	235	141	1	(56)	464
Saudi Arabia	60	120	170	9	18	377
Other	(18)	161	113		(37)	219
Year ended 31 December 2012	252	587	581	10	(80)	1,350

Country business highlights

In the **UAE**, we made significant progress in executing the strategic plan we announced in 2013. In RBWM, we expanded our range of products in Wealth Management, including the launch of the International Bonds and Portfolio Advisory Service to widen our offering for Premier clients. The introduction of a financial health check to better understand customer needs coupled with the opening of a Customer Service Unit in Abu Dhabi illustrated our focus on putting the customer first.

In CMB, we enhanced our services to customers that trade internationally by completing the implementation of our International Subsidiary Business model across the region in order to better meet their cross-border banking requirements and cement our strategic relationships. We also launched a second tranche of the International Growth

Fund for AED1bn (US$272m). We continued to invest in our Payments and Cash Management business including recruiting client-facing and specialised staff and won the Best Regional Cash Management Provider in the Middle East award.

In GB&M, we advised a major regional airline on its investment in a European air carrier and a large investment company in Dubai on its inaugural US$1bn bond issue. In addition, we increased our collaboration with CMB, particularly in Capital Financing, focusing on existing clients and taking advantage of our connectivity with other regions.

The drop in oil prices did not have a material impact on our financial performance in the UAE.

In **Egypt**, in RBWM, we expanded our product offering with enhanced features and reduced pricing for credit cards, and were ranked number one in the customer recommendation index. In GB&M, we acted as the global coordinator, structuring bank, mandated lead arranger and facility agent for a government entity. This reflected our commitment to supporting the Egyptian

government s plan for the development of the country s infrastructure.

In **Saudi Arabia**, through our associates, The Saudi British Bank and HSBC Saudi Arabia Limited, we acted as joint financial advisor, joint lead manager and a receiving bank on the US$6bn National Commercial Bank initial public offering (IPO). This was the Middle East s largest ever IPO and the world s second largest in 2014.

Review of adjusted performance[45]

Revenue (US$m)

Revenue increased in the majority of our markets, most notably in Egypt in all global businesses and in the UAE.

Country view of adjusted revenue

	2014 US$m	2013 US$m
UAE	**1,448**	1,401
Egypt	**531**	451
Rest of MENA	**566**	550
Year ended 31 December	**2,545**	2,402

In *Egypt*, revenue increased by US$80m, reflecting higher net interest income in RBWM due to improved deposit spreads as a result of re-pricing, and the non-recurrence of losses on disposal of available-for-sale debt securities

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Report of the Directors: Financial Review (continued)

in GB&M in 2013. In addition, the Central Bank resumed interest payments on overnight placements during 2014, which contributed to the rise in revenue in all global businesses.

In the *UAE*, revenue increased by US$47m, primarily in GB&M reflecting a rise in Capital Financing due to increased advisory mandates in Project and Export Finance and a gain on restructuring a specific loan in Credit and Lending. In addition, revenue rose in our Equities and Securities Services businesses from increased customer flows, which in part reflected the upgrade of the UAE to emerging markets status in the MSCI Index. In RBWM, revenue increased, but to a lesser extent, reflecting higher net interest income as mortgage balances rose and deposit spreads improved due to re-pricing initiatives. This was partially offset by reduced revenue in CMB from lower spreads on lending balances, reflecting a highly liquid and competitive market coupled with lower charges on foreign exchange transactions in Payments and Cash Management.

In the rest of the region, revenue was higher with increases in *Oman* and *Qatar* partly offset by a reduction in *Algeria*. Higher revenue in Oman in part reflected growth in customer advances in CMB. The increase in Qatar was driven by fees in GB&M reflecting increased customer flows in our Securities Services business, which in part reflected the upgrade of Qatar to emerging markets status in the MSCI Index. The reduction in Algeria reflected regulatory restrictions on foreign exchange spreads charged on corporate customer transactions.

Net loan impairment releases were lower by US$44m, primarily driven by lower impairment releases for a particular UAE-related exposure in GB&M.

Operating expenses (US$m)

Operating expenses of US$1,183m decreased by US$31m, mainly due to reductions in Egypt and the UAE. In Egypt, expenses fell following charges recorded in 2013 relating to changes in the interpretation of tax regulations. In the UAE, expenses reduced due to the non-recurrence of charges incurred in 2013 on customer redress programmes in RBWM relating to fees charged on overseas credit card transactions. This was partly offset by wage inflation, investment in Regulatory Programmes and Compliance, growth in customer-facing staff in RBWM and increased service and product support staff in CMB.

Share of profits from associates and joint ventures increased by 12%, mainly from The Saudi British Bank. This was driven by higher revenue resulting from strong balance sheet growth.

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Report of the Directors: Financial Review (continued)

2013 compared with 2012

Economic background

Real GDP in the Middle East and North Africa grew by an estimated 4.0% in 2013, led by the Gulf Cooperation Council (GCC) and Saudi Arabia s expansionary fiscal policy and infrastructure investment programme. With oil prices steady in the US$100-110 per barrel range throughout the year, revenues were more than sufficient to fund this spending, and the region ended 2013 with both current and fiscal accounts amply in surplus. The **UAE** saw an accelerating recovery in 2013 led by real estate and services, but boosted towards the end of the year by an increasingly expansionary fiscal policy. Despite strong demand and loose fiscal policy, inflation remained very subdued across the region throughout 2013, apart from UAE real estate.

For **Egypt**, political uncertainty gave rise to a third year of sub-par growth and rising unemployment. Real GDP grew by 2.2% in the 2012/13 fiscal year, while the budget deficit widened to 14% of GDP. The country s external position improved substantially in July, following the receipt of concessionary financing from the GCC. However, while reserves and the currency stabilised, stringent exchange rate and capital controls were still in place at the end of December 2013.

Review of performance

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. For comparison, adjusted profit before tax would have been US$1.7bn and US$1.4bn for 2013 and 2012 respectively as compared with constant currency profit before tax of US$1.7bn and US$1.3bn for 2013 and 2012 respectively. Constant currency, underlying and adjusted are reconciled on pages 105(b) to 105(au).

Our operations in the Middle East and North Africa reported a profit before tax of US$1.7bn, an increase of 25% compared with 2012. On a constant currency basis, pre-tax profits increased by 29%.

Our reported results in 2013 included adverse movements of US$4m on our own debt designated at fair value resulting from tightening of credit spreads. Our reported results in 2012 included an investment loss on a subsidiary of US$85m and adverse movements of US$12m on our own debt designated at fair value resulting from tightening credit spreads, partly offset by gains recognised on acquisitions totalling US$21m. On an underlying basis, excluding the items noted above and the results of a deconsolidated subsidiary and the Private Equity business disposed of in 2012, profit before tax increased by 26%, mainly due to lower loan impairment charges and higher income from our associate, The Saudi British Bank.

In the UAE, we inaugurated a new strategic plan for growth with investment committed across all businesses, and with commensurate investment in the risk management functions including Regulatory and Financial Crime Compliance. In RBWM, we focused on

improving our retail customer experience through the new Customer at the Heart campaign and were ranked number one in the Customer Recommendation Index for banks in the UAE. We also invested in mobile and digital technologies to enhance our Wealth Management offering and to grow our retail foreign exchange revenues.

In CMB, our fourth international trade fund for SMEs of AED1bn (US$272m) was launched to support new and existing customers with cross-border trading requirements or with aspirations to grow internationally.

In GB&M, there was a focus on cross-border connectivity and CMB collaboration, with tailored risk management solutions. We supported sovereign wealth funds and government-related entities and won several *Euromoney* awards including The Best Investment Bank in Middle East , The Best Risk Advisor in Middle East , Best Cash Management House in the Middle East and No 1 Debt House for MENA and GCC issuer bonds .

We were awarded the Best Trade Bank in the MENA region by *GTR Leaders in Trade 2013* and we enhanced Global Trade and Receivables Finance by investing in sales staff and giving priority to commodity structured trade finance and receivables finance. The level of service provided by our Payments and Cash Management business was reflected in our fifth consecutive *Euromoney* award.

In Egypt, we continued to manage risk in the uncertain political and economic environment. Surplus liquidity levels in Egyptian pounds, which arose following the introduction of foreign currency restrictions at the end of 2012, were managed through the downward re-pricing of deposits. Despite these difficult operating conditions, we continued to invest in the business, through the deployment of new automated teller machines (ATMs) and the launch of a new mobile banking application. Our RBWM business was ranked number 1 in the Customer Recommendation Index while our CMB business launched an Egypt SME Fund for EGP300m (US$44m) targeting international SME growth and trade customers.

We renewed our primary dealer licence for trading in Government of Egypt treasury bills and bonds, ranking as one of the largest primary dealers in the Egyptian market.

In Oman, following the completion of the merger in June 2012 with OIB, we completed the conversion to HSBC systems of our merged operation. We made a number of improvements to our mobile banking and internet banking applications, introducing enhanced security features including the HSBC secure key for internet banking. We also upgraded our e-platform for cash management services for our corporate banking customers. HSBC Bank Oman won *Euromoney* s Best Domestic Cash Management Bank in Oman award for the second consecutive year.

In Saudi Arabia, our associate, The Saudi British Bank, won *The Banker* magazine s award as The Best Bank in Saudi Arabia, 2013 and achieved a record net profit before tax exceeding US$1bn.

Report of the Directors: Financial Review (continued)

In line with our commitment to drive growth and improve returns in businesses that do not meet our six filters criteria (see page 15), we entered into an agreement to sell our operation in Jordan. The transaction is expected to complete in 2014.

Net interest income rose by 4%, mainly in Egypt in GB&M, driven by higher yields and balances on available-for-sale investment portfolios and higher balances on corporate deposits as more liquid assets were held in the volatile political environment. In Oman, net interest income increased, notably in RBWM, following the merger with OIB in June 2012. The higher net interest income in the UAE from growth in GB&M in the Credit and Lending portfolio and in RBWM from the Lloyds business acquired in 2012, was more than offset by a decline in CMB, where the business was repositioned to lower risk segments.

Net fee income increased by 7%, primarily in the UAE in GB&M due to an increase in advisory mandates in Capital Financing and higher institutional equities fee income from increased deal volumes, partially offset by lower fees from reduced volumes on Global Trade and Receivables Finance products in CMB. In Egypt, net fee income increased, notably in RBWM from cards and consumer loan fees.

Net trading income decreased by 6%, notably in Egypt from lower foreign exchange revenues, reflecting the political instability, and lower Rates trading income driven by a reduction in deal volumes. The decrease in trading income also reflected the deconsolidation of a subsidiary in 2012. These factors were partly offset by CVA releases on trading positions relating to a small number of exposures in the UAE in GB&M, compared with charges in 2012.

Gains less losses from financial investments decreased by US$27m, driven by losses on the disposal of the available-for-sale debt securities in Egypt in the first half of 2013 as we adjusted our risk positions.

Other operating income increased by US$76m, due to the non-recurrence of an US$85m investment loss on a subsidiary in 2012.

A net *loan impairment release* of US$42m was recorded in 2013 compared with a charge of US$282m in 2012. There were provision releases, mainly in GB&M, for a small number of UAE related exposures, reflecting an overall improvement in the loan portfolio compared with charges in 2012. In addition, loan impairment charges declined, due to lower individually assessed loan impairments in the UAE in CMB and lower provisions in RBWM on residential mortgages following a repositioning of the book towards higher quality lending and improved property prices.

Operating expenses increased by 13%, mainly in the UAE from the Lloyds business acquired in 2012, expenses for regulatory projects, operational losses and charges from a customer redress programme in RBWM relating to fees charged on overseas credit card transactions. Expenses also increased in Egypt from changes in the interpretation of tax regulations and in Oman following the merger with OIB. These factors were partly offset by approximately US$40m of sustainable savings from our organisational effectiveness programmes.

Share of profits from associates and joint ventures increased by 18%, mainly from The Saudi British Bank. This was driven by higher revenue resulting from strong balance sheet growth, and the effective management of costs.

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Profit/(loss) before tax and balance sheet data *Middle East and North Africa*

	2014						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Tota US$r
ofit/(loss) before							
t interest income	615	467	410		3	24	1,51
t fee ome/(expense)	152	268	240		(10)		65
ading ome/(expense) cluding net erest income	58	68	207		(5)		32
t interest income trading activities			10			(24)	(1
t trading ome/(expense)[50]	58	68	217		(5)	(24)	31
t expense from ancial instruments signated at fair ue					(3)		(
ins less losses m financial estments	1	1	20				2
vidend income	1	1	12				1
her operating ome	8		27		108	(111)	3
tal operating come	835	805	926		93	(111)	2,54
t insurance ims[56]							
	835	805	926		93	(111)	2,54

t operating come[4]							
an impairment arges)/recoveries d other credit risk ovisions	**(26)**	**(21)**	**53**				
t operating come	**809**	**784**	**979**		**93**	**(111)**	**2,55**
tal operating penses	**(578)**	**(348)**	**(256)**		**(145)**	**111**	**(1,21**
erating ofit/(loss)	**231**	**436**	**723**		**(52)**		**1,33**
are of profit in ociates and joint ntures	**92**	**168**	**203**	**19**	**6**		**48**
ofit/(loss) before	**323**	**604**	**926**	**19**	**(46)**		**1,82**
	%	%	%	%	%		%
are of HSBC s ofit before tax	**1.7**	**3.2**	**5.0**	**0.1**	**(0.2)**		**9.**
st efficiency ratio	**69.2**	**43.2**	**27.6**		**155.9**		**47.**

lance sheet data[40]

	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$**
ans and advances customers (net)[27]	**6,318**	**13,104**	**9,641**				**29,06**
tal assets	**7,073**	**14,911**	**39,229**	**77**	**2,900**	**(1,773)**	**62,41**
stomer accounts[27]	**18,024**	**11,809**	**9,630**		**257**		**39,72**

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Report of the Directors: Financial Review (continued)

	2013						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income	585	486	390		4	21	1,486
Net fee income/(expense)	161	269	197		(5)		622
Trading income excluding net interest income	59	85	220				364
Net interest income on trading activities			14			(21)	(7)
Net trading income[50]	59	85	234			(21)	357
Net expense from financial instruments designated at fair value					(2)		(2)
Gains less losses from financial investments			(18)				(18)
Dividend income			9				9
Other operating income	25	30	15		99	(120)	49
Total operating income	830	870	827		96	(120)	2,503
Net insurance claims[56]							
Net operating income[4]	830	870	827		96	(120)	2,503
	(49)	(20)	110	1			42

Loan impairment (charges)/ recoveries and other credit risk provisions							
Net operating income	781	850	937	1	96	(120)	2,545
Total operating expenses	(606)	(350)	(256)		(197)	120	(1,289)
Operating profit/(loss)	175	500	681	1	(101)		1,256
Share of profit in associates and joint ventures	83	145	188	15	7		438
Profit/(loss) before tax	258	645	869	16	(94)		1,694
	%	%	%	%	%		%
Share of HSBC s profit before tax	1.1	2.9	3.8	0.1	(0.4)		7.5
Cost efficiency ratio	73.0	40.2	31.0		205.2		51.5
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	6,152	11,814	9,241		4		27,211
Total assets	7,016	13,776	39,302	64	3,340	(2,688)	60,810
Customer accounts[27]	18,771	12,402	7,432	1	77		38,683

For footnotes, see page 109.

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Report of the Directors: Financial Review (continued)

Profit/(loss) before tax and balance sheet data Middle East and North Africa (continued)

	2012						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income	597	492	367	1	42	(29)	1,470
Net fee income/(expense)	164	279	160	1	(9)		595
Trading income excluding net interest income	68	94	208		3		373
Net interest income/(expense) on trading activities		2	30		(44)	29	17
Net trading income/(expense)[50]	68	96	238		(41)	29	390
Net income from financial instruments designated at fair value					(12)		(12)
Gains less losses from financial investments			9				9
Dividend income			5				5
Other operating income/(expense)	(16)	21	14	1	47	(94)	(27)
Total operating income	813	888	793	3	27	(94)	2,430
Net insurance claims[56]							
	813	888	793	3	27	(94)	2,430

Net operating income[1]							
Loan impairment charges and other credit risk provisions	(55)	(110)	(119)	(2)			(286)
Net operating income	758	778	674	1	27	(94)	2,144
Total operating expenses	(561)	(311)	(264)		(124)	94	(1,166)
Operating profit/(loss)	197	467	410	1	(97)		978
Share of profit in associates and joint ventures	55	120	171	9	17		372
Profit/(loss) before tax	252	587	581	10	(80)		1,350
	%	%	%	%	%		%
Share of HSBC s profit before tax	1.2	2.8	2.8		(0.3)		6.5
Cost efficiency ratio	69.0	35.0	33.3		459.3		48.0
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	5,828	13,559	8,699				28,086
Total assets	6,562	15,651	36,582	50	6,840	(3,080)	62,605
Customer accounts[27]	19,802	12,826	6,880	3	72		39,583

For footnotes, see page 109.

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North America

Our principal North American businesses are located in the US and Canada. Operations in the US are primarily conducted through HSBC Bank USA, N.A., and HSBC Finance, a national consumer finance company. HSBC Markets (USA) Inc. is the intermediate holding company of, *inter alia*, HSBC Securities (USA) Inc. Canadian operations are conducted through HSBC Bank Canada.

	2014	2013	2012
	US$m	US$m	US$m
Net interest income	5,015	5,742	8,117
Net fee income	1,940	2,143	2,513
Net trading income	411	948	507
Gains on disposals of US branch network and cards business			4,012
Other income/(expense)	786	(30)	(456)
Net operating income[4]	8,152	8,803	14,693
LICs[43]	(322)	(1,197)	(3,457)
Net operating income	7,830	7,606	11,236
Total operating expenses	(6,429)	(6,416)	(8,940)
Operating profit	1,401	1,190	2,296
Income from associates[44]	16	31	3
Profit before tax	1,417	1,221	2,299
Cost efficiency ratio	78.9%	72.9%	60.8%
RoRWA[36]	0.6%	0.5%	0.8%
Year-end staff numbers	20,412	20,871	22,443

Best Export Finance Arranger in

North America

(Trade Finance Awards for Excellence 2014)

11%

increase in

CMB customer lending balances

on a reported basis

73%

decrease in

loan impairment charges

on a reported basis

For footnotes, see page 109.

Economic background

In the **US**, real GDP rose by 2.4% in 2014, after 2.2% growth in 2013. Both consumer spending and business fixed investment increased at a moderate pace in 2014, climbing 2.5% and 5.2%, respectively. Growth in residential investment slowed markedly, however, to 1.8% in 2014, from 11.9% in 2013. Government expenditure fell by 0.2% in 2014, as a decline in federal government spending more than offset an increase in state and local government expenditure. The unemployment rate fell from 6.7% at the end of 2013 to 5.6% at the end of 2014. CPI inflation averaged 1.6% in 2014, after averaging 1.5% in 2013. The Federal Reserve continued to pursue a highly accommodative monetary policy in 2014, keeping the federal funds rate in a 0.00% to 0.25% range. It gradually reduced its monthly purchases of longer-term Treasury securities and agency mortgage-backed securities during the first ten months of the year, bringing its asset purchase programme to a conclusion at the end of October.

Canadian real GDP grew at a 2.4% annual rate through the first three quarters of 2014, an improvement on the 1.8% increase observed during the comparable period in 2013. Exports were supported by US economic growth and rising oil production. Business investment was largely unchanged in 2014. The annual rate of CPI inflation rose to a peak of 2.4% in late 2013 and early 2014. However, as the oil price fell late in the year, fuel prices declined and the annual rate of inflation dropped to 1.5% in December, below the Bank of Canada s 2% inflation target. Monetary policy remained accommodative with the Bank of Canada keeping its policy rate at 1% throughout 2014, where it has been since September 2010.

Financial overview

Profit before tax (US$m)

Our operations in North America reported a profit before tax of US$1.4bn in 2014 compared with US$1.2bn in 2013. The increase of US$196m primarily reflected lower LICs, mainly in the US CML portfolio. This was partly offset by lower revenue, primarily reflecting continued CML run-off and a reduction in GB&M in the US. Costs were broadly unchanged as portfolio run-off broadly offset a US$550m charge in relation to a settlement with the Federal Housing Finance Authority.

See page 42 for further details of significant items.

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Profit/(loss) before tax by country within global businesses

	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Total US$m
US	**513**	**400**	**(403)**	**82**	**(60)**	**532**
Canada	**96**	**514**	**242**		**(23)**	**829**
Other	**23**	**(1)**	**49**	**3**	**(18)**	**56**
Year ended 31 December 2014	**632**	**913**	**(112)**	**85**	**(101)**	**1,417**
US	(358)	296	633	53	(350)	274
Canada	131	506	280		(3)	914
Other	20	(16)	16	4	9	33
Year ended 31 December 2013	(207)	786	929	57	(344)	1,221
US	2,746	637	661	72	(2,901)	1,215
Canada	207	577	314	(1)	(16)	1,081
Other	42	(15)	(18)	1	(7)	3
Year ended 31 December 2012	2,995	1,199	957	72	(2,924)	2,299

Adjusted profit before tax was US$63m higher , reflecting a reduction in LICs and operating expenses, partially offset by a decrease in revenue.

Country business highlights

In the **US**, CMB added US$4.0bn in 2014 to its SME fund which supports businesses that trade or aspire to trade internationally, raising the programme s total available funding to US$5.0bn. Of this, US$3.7bn was utilised at 31 December 2014. Corporate lending balances rose as we continued to be successful in our markets targeted for expansion, with balances in both the Midwest and the West Coast increasing by more than 25% year on year.

In RBWM, we continued to optimise the mortgage origination process to improve the customer experience and expanded our digital channel capabilities. The re-launch of our Global Premier programme along with other related campaigns led to approximately 22,000 new Premier customers being added in 2014, an increase of 25%.

Despite lower revenue in GB&M, we continued to execute our growth strategy utilising GB&M s unique client franchise, its geographical network and product capabilities to connect our markets. In addition collaboration with CMB resulted in revenue from its clients rising by 19%.

In **Canada**, CMB continued to focus on the acquisition of new clients, to whom advances reached over US$1.3bn. We created a dedicated International Subsidiary Banking team to manage and support our international clients on a consistent basis. GB&M focused on increasing its multinational client base, and the Project and Export Finance business continued to reflect growth. Our focus in RBWM continued to be on developing the Premier customer base, building mortgage, credit card, and deposit balances and growing assets under management.

We continued to make progress in our strategy to accelerate the run-off and sale of our US CML portfolio. We completed the sale of several tranches of real estate secured accounts with an aggregate unpaid principal

balance of US$2.9bn during 2014 and recognised a cumulative gain on sale of US$168m. Gross lending balances in the CML portfolio, including loans held for sale, were US$25bn at 31 December 2014, a decline of US$5.8bn from 2013.

Review of adjusted performance[45]

Revenue (US$m)

Revenue fell in the US in RBWM, partly reflecting continued CML run-off, and in GB&M. Revenue also reduced in Canada, mainly reflecting the continued run-off of the Consumer Finance business.

Country view of adjusted revenue

	2014	2013
	US$m	US$m
US	**6,083**	7,071
Canada	**1,921**	1,975
Other	**264**	293
Year ended 31 December	**8,268**	9,339

In the US, revenue decreased by US$988m, mainly in RBWM where lower average lending balances driven by the continued run-off and loan sales of the CML portfolio led to lower net interest income. In addition, loan yields fell, partly reflecting the sale of our higher yielding CML non-real estate personal loan portfolio, which resulted in a significant shift in product mix towards increased levels of lower yielding first lien real estate loans. Revenue also declined due to lower deposit volumes and narrower deposit spreads. The fall in revenue was partly offset by releases of mortgage loan repurchase obligations related to loans previously sold, which compared with provisions in 2013.

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Revenue decreased in GB&M, driven by a reduction in Balance Sheet Management income due to lower reported gains on sales of available-for-sale debt securities as a result of our ongoing portfolio repositioning for risk management purposes, and the adverse performance of economic hedges used to manage interest rate risk. Credit revenue also reduced, primarily in our legacy credit portfolio partly reflecting net adverse fair value movements on the portfolio.

By contrast, revenue increased in CMB, mainly reflecting increased lending balances in markets targeted for expansion and higher income in GB&M from increased collaboration in acquisition financing activity.

In *Canada*, revenue decreased by US$54m, mainly in RBWM reflecting a fall in net interest income due to lower average lending balances from the continued run-off of the Consumer Finance business. Excluding this, RBWM revenues rose, driven by higher fees partly reflecting increased sales of wealth management products. In CMB, revenues also increased, largely because of the non-recurrence of a reduction in the fair value of an investment property held for sale and recognised in 2013. By contrast, GB&M revenue decreased, reflecting lower trading income from foreign exchange and a reduction in reported gains on sales of available-for-sale debt securities.

LICs fell, mainly in the CML portfolio reflecting reduced levels of delinquency, new impaired loans and lower lending balances from the continued run-off and loan sales. This was partly offset by less favourable market value adjustments to underlying property prices because improvements in housing market conditions were less pronounced in 2014 than in 2013. LICs also fell in Principal RBWM, mainly reflecting lower levels of delinquency, and in Canada in CMB from lower individually and collectively assessed impairment charges.

Operating expenses (US$m)

Operating expenses decreased by US$285m, primarily in the US, reflecting lower divestiture costs as our former Cards business reached the end of the data separation process, and lower average staff numbers and costs resulting from the continued run-off and sales of tranches of our CML portfolio. In addition, we also achieved over US$185m of sustainable cost savings, primarily reflecting organisational effectiveness initiatives. Partly offsetting the lower operating expenses were higher legal costs and the growth in costs associated with Regulatory Programmes and Compliance, reflecting our continued investment in Global Standards.

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2013 compared with 2012

Economic background

In the **US**, real GDP rose by 1.9% in 2013, after 2.8% growth in 2012. Both consumer spending and business fixed investment grew at a moderate pace in 2013. Residential investment rose by 12.1% in 2013, following 12.9% growth in 2012. Sales of new and existing homes increased in 2013, and average national home prices rose over the course of the year. Export growth slowed to 2.8% in 2013 from 3.5% in 2012. Budgetary caps on federal spending contributed to a 5.1% decline in federal government expenditure in 2013, in real terms. State and local government expenditure also contracted, though by less than in 2012. The unemployment rate fell during the year reaching 6.7% in December although, in part, this reflected the long-term unemployed leaving the labour market rather than job creation. Both headline and core CPI inflation moderated in 2013 as subdued growth in hourly wages continued to constrain labour costs. A lack of consensus between the main political parties about how best to reduce the US fiscal deficit led to a government shutdown on 1 October. An agreement was finally reached on 16 October which allowed the US debt ceiling to be raised and ended the shutdown. The Federal Reserve Board continued to pursue a highly accommodative monetary policy in 2013, keeping the Federal Funds rate in a zero to 0.25% range. It continued with monthly purchases of longer-term treasury securities and agency mortgage-backed securities but announced in December that it would begin to taper asset purchases from January 2014.

The **Canadian** economy grew by 1.6% during the first three quarters of 2013, down from 1.9% in the comparable period in 2012. Led by auto sales, consumer spending rose by 1.8%, contributing 1.2 percentage points to the expansion in 2013. Exports grew by 1.0% in 2013, which was well below the 3% export growth in 2012. Housing starts fell by 14% in 2013 though the level of activity improved during the year after a very weak start. The annual rate of CPI inflation remained close to 1% throughout the year, well below the Bank of Canada s 2% inflation target. The Bank of Canada s policy rate has remained at 1% since September 2010.

Review of performance

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. For comparison, adjusted profit before tax would have been US$2.1bn and US$0.5bn for 2013 and 2012 respectively as compared with constant currency profit before tax of US$1.2bn and US$2.3bn for 2013 and 2012 respectively and underlying profit before tax of US$1.6bn and US$(1.5)bn for 2013 and 2012 respectively. Constant currency, underlying currency and adjusted are reconciled on pages 105(b) to 105(au).

Our operations in North America reported a profit before tax of US$1.2bn in 2013, compared with US$2.3bn in 2012 on both a reported and constant currency basis.

Reported profits in both years included gains and losses on disposal of businesses not aligned to our long-term strategy, notably gains in the US of US$3.1bn and US$864m following the sales of the CRS business and 195 non-strategic retail branches, respectively, in 2012.

On an underlying basis, pre-tax profit was US$1.6bn in 2013 compared with a pre-tax loss of US$1.5bn in 2012. This was mainly due to a decline in loan impairment charges in 2013 in the US, primarily in the CML portfolio, and a reduction in operating expenses, as 2012 included a US$1.5bn expense as part of the settlement of investigations into inadequate compliance with AML laws in the past. These were partly offset by losses on certain portfolio disposals described further below.

Underlying profit before tax in Canada reduced due to the closure to new business in 2012 of the Canadian consumer finance company and lower revenues, reflecting spread compression due to the low interest rate environment and competitive market. These were partly offset by lower costs following cost control and sustainable savings from organisational effectiveness initiatives.

We continued to make progress in our strategy to accelerate the run-off and sales of our CML portfolio, and simplify operations. We completed the sale of the CML non-real estate personal loan portfolio with an unpaid principal balance of US$3.7bn on 1 April 2013 and recognised a loss on sale of US$271m. We completed the sales of several tranches of real estate secured accounts with an aggregate unpaid principal balance of US$5.7bn during 2013 and recognised a cumulative loss on sale of US$153m. Gross lending balances in the CML portfolio, including loans held for sale, at 31 December 2013 were US$30.4bn, a decline of US$12.3bn from 31 December 2012.

We identified real estate secured loan balances with unpaid principal of US$3.5bn that we plan to actively market in multiple transactions over the next 15 months. The carrying value of these loans was approximately US$230m greater than their estimated fair value at 31 December 2013.

In the US, we made progress on re-engineering our processes, such as account opening and customer information management, creating standardisation and alignment with our target business and operating models and a simpler relationship experience for our customers. The US has been at the forefront of foundational work to implement Global Standards. We also launched a US$1bn SME fund in CMB to support those businesses that trade or aspire to trade internationally.

In Canada, we continued to deliver internationally oriented organic business growth and streamlined processes and procedures. In CMB, we focused on positioning ourselves as the leading international trade and business bank, and deployed several new Global Trade products to assist international clients with working capital management. In GB&M, we launched Project and Export Financing and had a strong pipeline of business going into 2014. In RBWM, we continued to work on increasing the Premier customer base, resulting in 3% growth.

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Net interest income decreased by 29% to US$5.7bn, primarily due to the sale of the CRS business and retail branches, lower average lending balances from the continued run-off of the CML portfolio and other portfolio disposals during the year, lower reinvestment rates in Balance Sheet Management and the closure of the Canada consumer finance company to new business in 2012.

Net fee income decreased by 14% to US$2.1bn, primarily due to the sale of the CRS business and the retail branches in 2012 and the expiry of the majority of the Transition Servicing Agreements with the buyer of the CRS business. This was partly offset by favourable adjustments to mortgage servicing rights valuations as a result of interest rate increases in 2013.

Net trading income was US$948m, an increase of 89%, primarily due to favourable fair value movements on non-qualifying hedges in HSBC Finance of US$315m in 2013 due to a rise in interest rates (compared with adverse movements of US$227m in 2012) and lower provisions for mortgage loan repurchase obligations related to loans previously sold. The increase was partly offset by a loss of US$199m arising from the early termination of qualifying accounting hedges in 2013 as a result of expected changes in funding.

Net trading income increased in GB&M as a result of favourable fair value movements on structured liabilities, in addition to higher Credit trading revenue from revaluation gains on securities, monoline reserve releases in the legacy portfolio and reduced losses from credit default swaps. Net trading income also benefited from the performance of economic hedges used to manage interest rate risk, which was positively affected by favourable interest rate movements. This was partly offset by lower Foreign Exchange revenue as a result of reduced trading volumes, and lower Rates trading revenue due to a decline in trading activities.

Net expense from financial instruments designated at fair value was US$288m compared with US$1.2bn in 2012. The increase was due to lower adverse fair value movements on our own debt designated at fair value as credit spreads tightened to a lesser extent in 2013 than in 2012.

Gains less losses from financial investments increased by 18% as Balance Sheet Management recognised higher

gains on sales of available-for-sale debt securities as a result of the continued re-balancing of the portfolio for risk management purposes in the low interest rate environment.

Net earned insurance premiums decreased by US$159m due to the sale of our US insurance business. The reduction in net earned insurance premiums resulted in a corresponding decrease in *Net insurance claims incurred and movement in liabilities to policyholders*.

Other operating expense was US$108m in 2013 compared with income of US$408m in 2012. This was primarily due to the loss of US$424m on the sales of the CML non-real estate personal loan portfolio and several tranches of real estate secured loans. In addition, the decrease reflected the sale of our US insurance business and the non-recurrence of the gain on sale of the full service retail brokerage business in Canada in 2012.

LICs decreased by US$2.3bn to US$1.2bn, mainly in the US due in part to improvements in housing market conditions. In addition, the decrease reflected lower lending balances from continued run-off and loan sales, and reduced levels of new impaired loans and delinquency in the CML portfolio. US$322m of the decline in loan impairment charges was due to the sale of the CRS business in 2012. These factors were partly offset by an increase of US$130m relating to a rise in the estimated average period of time from a loss event occurring to writing off real estate loans to 12 months (previously a period of 10 months was used). In CMB, loan impairment charges increased by US$77m, reflecting higher collectively assessed charges in the US as a result of increased lending balances in key growth markets and higher individually assessed impairments on a small number of exposures mainly in Canada.

Operating expenses were US$2.5bn, 28% lower than in 2012, primarily due to the non-recurrence of a US$1.5bn settlement of investigations into inadequate compliance with AML laws in the past, lower average staff numbers and costs following business disposals in the US and Canada, and a reduction in litigation provisions and consultancy expenses in relation to US mortgage foreclosure servicing matters. Resources working on the independent foreclosure review were no longer required following the February 2013 Independent Foreclosure Review Settlement Agreement. We also achieved over US$330m of sustainable cost savings, primarily reflecting organisational effectiveness initiatives.

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Report of the Directors: Financial Review (continued)

Profit/(loss) before tax and balance sheet data North America

	2014						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income	2,645	1,455	587	204	157	(33)	5,015
Net fee income/(expense)	497	572	775	130	(34)		1,940
Trading income/(expense) excluding net interest income	(165)	34	302	13	3		187
Net interest income/(expense) on trading activities	7	1	183			33	224
Net trading income/(expense)[50]	(158)	35	485	13	3	33	411
Changes in fair value of long-term debt issued and related derivatives					(99)		(99)
Net income from other financial instruments designated at fair value							
Net expense from financial instruments designated at fair value					(99)		(99)
Gains less losses from financial investments		15	237		5		257

Dividend income	**13**	**8**	**16**	**3**	**4**		**44**
Net insurance premium income							
Other operating income	**268**	**61**	**101**	**1**	**1,872**	**(1,719)**	**584**
Total operating income	**3,265**	**2,146**	**2,201**	**351**	**1,908**	**(1,719)**	**8,152**
Net insurance claims[56]							
Net operating income[4]	**3,265**	**2,146**	**2,201**	**351**	**1,908**	**(1,719)**	**8,152**
Loan impairment (charges)/recoveries and other credit risk provisions	**(117)**	**(148)**	**(63)**	**8**	**(2)**		**(322)**
Net operating income	**3,148**	**1,998**	**2,138**	**359**	**1,906**	**(1,719)**	**7,830**
Total operating expenses	**(2,516)**	**(1,101)**	**(2,250)**	**(274)**	**(2,007)**	**1,719**	**(6,429)**
Operating profit/(loss)	**632**	**897**	**(112)**	**85**	**(101)**		**1,401**
Share of profit in associates and joint ventures		**16**					**16**
Profit/(loss) before tax	**632**	**913**	**(112)**	**85**	**(101)**		**1,417**
	%	**%**	**%**	**%**	**%**		**%**
Share of HSBC s profit before tax	**3.4**	**4.9**	**(0.6)**	**0.5**	**(0.5)**		**7.6**
Cost efficiency ratio	**77.1**	**51.3**	**102.2**	**78.1**	**105.2**		**78.9**

Balance sheet data[40]

	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)[27]	**60,365**	**41,966**	**21,110**	**6,346**			**129,787**
Total assets	**74,680**	**48,411**	**319,819**	**8,386**	**16,823**	**(31,260)**	**436,859**
Customer accounts[27]	**51,258**	**45,275**	**30,301**	**12,050**			**138,884**

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Report of the Directors: Financial Review (continued)

	2013						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income	3,483	1,430	582	195	89	(37)	5,742
Net fee income	605	593	741	125	79		2,143
Trading income excluding net interest income	48	40	613	19	7		727
Net interest income on trading activities	11	1	172			37	221
Net trading income[50]	59	41	785	19	7	37	948
Changes in fair value of long-term debt issued and related derivatives					(288)		(288)
Net income from other financial instruments designated at fair value							
Net expense from financial instruments designated at fair value					(288)		(288)
Gains less losses from financial investments	4		282		8		294
Dividend income	12	9	48	4	4		77
Net insurance premium income	34						34

Other operating income/(expense)	(454)		229	1	1,829	(1,713)	(108)
Total operating income	3,743	2,073	2,667	344	1,728	(1,713)	8,842
Net insurance claims[56]	(39)						(39)
Net operating income[4]	3,704	2,073	2,667	344	1,728	(1,713)	8,803
Loan impairment charges and other credit risk provisions	(950)	(223)	(20)	(4)			(1,197)
Net operating income	2,754	1,850	2,647	340	1,728	(1,713)	7,606
Total operating expenses	(2,960)	(1,096)	(1,718)	(283)	(2,072)	1,713	(6,416)
Operating profit/(loss)	(206)	754	929	57	(344)		1,190
Share of profit/(loss) in associates and joint ventures	(1)	32					31
Profit/(loss) before tax	(207)	786	929	57	(344)		1,221
	%	%	%	%	%		%
Share of HSBC s profit before tax	(0.9)	3.5	4.1	0.3	(1.6)		5.4
Cost efficiency ratio	79.9	52.9	64.4	82.3	119.9		72.9
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	66,192	37,735	18,070	5,956			127,953
Total assets	82,530	45,706	313,701	8,542	13,211	(31,655)	432,035
Customer accounts[27]	53,600	49,225	24,113	13,871			140,809

For footnotes, see page 109.

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Profit/(loss) before tax and balance sheet data North America (continued)

	2012						
	Retail Banking and Wealth Management US$m	Commercial Banking[68] US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income	5,481	1,443	948	192	118	(65)	8,117
Net fee income	923	562	716	124	188		2,513
Trading income/(expense) excluding net interest income	(216)	47	466	20	16		333
Net interest income on trading activities	17	1	91			65	174
Net trading income/(expense)[50]	(199)	48	557	20	16	65	507
Changes in fair value of long-term debt issued and related derivatives					(1,219)		(1,219)
Net income from other financial instruments designated at fair value							
Net expense from financial instruments designated at fair value					(1,219)		(1,219)
Gains less losses from financial investments	27		223	(7)	8		251
Dividend income	15	11	32	3			61

Net insurance premium income	193						193
Gains on disposal of US branch network and cards business	3,735	277					4,012
Other operating income	173	149	191	5	1,787	(1,899)	406
Total operating income	10,348	2,490	2,667	337	898	(1,899)	14,841
Net insurance claims[56]	(148)						(148)
Net operating income[1]	10,200	2,490	2,667	337	898	(1,899)	14,693
Loan impairment (charges)/recoveries and other credit risk provisions	(3,241)	(148)	(71)	3			(3,457)
Net operating income	6,959	2,342	2,596	340	898	(1,899)	11,236
Total operating expenses	(3,966)	(1,144)	(1,639)	(268)	(3,822)	1,899	(8,940)
Operating profit/(loss)	2,993	1,198	957	72	(2,924)		2,296
Share of profit in associates and joint ventures	2	1					3
Profit/(loss) before tax	2,995	1,199	957	72	(2,924)		2,299
	%	%	%	%	%		%
Share of HSBC s profit before tax	14.5	5.8	4.6	0.3	(14.2)		11.1
Cost efficiency ratio	38.9	45.9	61.5	79.5	425.6		60.8
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	76,414	36,387	16,217	5,457			134,475
Total assets	101,103	48,604	345,040	8,828	12,659	(25,987)	490,247
Customer accounts[27]	57,758	48,080	22,258	13,553	51		141,700

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Latin America

Our operations in Latin America principally comprise HSBC Bank Brasil S.A.-Banco Múltiplo, HSBC México, S.A. and HSBC Bank Argentina S.A. In addition to banking services, we operate insurance businesses in Brazil, Mexico and Argentina.

	2014 US$m	2013 US$m	2012 US$m
Net interest income	**5,310**	6,186	6,984
Net fee income	**1,415**	1,701	1,735
Net trading income	**856**	936	971
Other income	**691**	1,745	1,261
Net operating income[4]	**8,272**	10,568	10,951
LICs[43]	**(2,124)**	(2,666)	(2,137)
Net operating income	**6,148**	7,902	8,814
Total operating expenses	**(5,932)**	(5,930)	(6,430)
Operating profit	**216**	1,972	2,384
Income from associates[44]			
Profit before tax	**216**	1,972	2,384
Cost efficiency ratio	**71.7%**	56.1%	58.7%
RoRWA[36]	**0.2%**	2.0%	2.4%
Year-end staff numbers	**41,201**	42,542	46,556

Further progress made in repositioning

our businesses in Brazil and Mexico

Loan House and Bond House of the Year

(LatinFinance, 2014)

#1

in Domestic Cash Management

in Argentina and Mexico

(Euromoney Cash Management Survey, 2014)

For footnotes, see page 109.

Economic background

Data for the third quarter of 2014 suggested that Latin America may have seen a material slowdown in its average real annual GDP growth in 2014 to nearly 1.0% from 2.6% in 2013.

A slowdown in the **Brazilian** economy explains much of this weakness. The level of economic activity was broadly unchanged in 2014 following growth of 2.5% in 2013, but deteriorating business confidence and the resulting contraction in business investment spending were the main factors behind the economic slowdown. To mitigate inflationary pressures from a weakening currency, the central bank raised the key policy rate by 75bps in the fourth quarter to 11.75%.

Mexico s economic growth accelerated in 2014 after low real GDP growth of only 1.1% in 2013**.** Consumer spending, the main area of weakness in 2013, accelerated during the year and the improvement in US demand served to boost exports. Inflationary pressures remained muted and the Mexican central bank cut its key policy rate to 3% from 3.5% at the start of the year.

The **Argentinian** economy contracted in 2014 due to falling commodity prices, a stagnant Brazilian economy and a technical default on the dollar-denominated external debt of the country. A significant devaluation of the Argentine peso at the beginning of 2014 fuelled higher inflation.

Financial overview

Profit before tax (US$m)

Latin America reported a profit before tax of US$216m in 2014 compared with US$2.0bn in 2013. The reduction was due to lower revenue, primarily driven by the non-recurrence of the US$1.1bn gain on sale of our operations in Panama in 2013 partly offset by a decrease in LICs.

Adjusted profit before tax decreased by US$326m, and included a loss before tax in Brazil. The reduction in profit primarily reflected higher operating expenses, mainly due to inflationary and union-agreed salary increases in Brazil and Argentina, and lower revenue in Mexico and Brazil as we progressed with repositioning our business. These factors were partly offset by an increase in revenue in Argentina and a reduction in LICs, primarily in Mexico.

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Report of the Directors: Financial Review (continued)

Profit/(loss) before tax by country within global businesses

	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Total US$m
Argentina	**52**	**135**	**219**		**(22)**	**384**
Brazil	**(174)**	**(153)**	**115**	**(2)**	**(33)**	**(247)**
Mexico	**36**	**(52)**	**89**	**(2)**	**(20)**	**51**
Other	**(4)**	**7**	**27**		**(2)**	**28**
Year ended 31 December 2014	**(90)**	**(63)**	**450**	**(4)**	**(77)**	**216**
Argentina	97	142	170		(1)	408
Brazil	(114)	(43)	514	5	(11)	351
Mexico	154	(160)	115	(3)	11	117
Other	289	525	368	(1)	(85)	1,096
Year ended 31 December 2013	426	464	1,167	1	(86)	1,972
Argentina	209	169	174		(46)	506
Brazil	94	359	696	17	(43)	1,123
Mexico	338	176	201	2	(18)	699
Other	(33)	47	82	1	(41)	56
Year ended 31 December 2012	608	751	1,153	20	(148)	2,384

Country business highlights

In 2014, in our priority growth markets of Brazil, Mexico and Argentina, we continued to implement strategic initiatives to improve future returns whilst we faced economic and inflationary pressures.

In **Brazil**, we made progress in our efforts to transform the business in order to ensure its long-term sustainability. In RBWM, we are updating our business model by concentrating RMs on specific client segments in order to better serve customer needs. We also updated certain features of our lending products to improve our competitiveness such as increasing the duration of some of our personal loans, and further strengthened our retail credit capabilities to improve the quality of originations. We continued to rationalise our branch network, closing 21 branches in areas with lower growth potential as we concentrated our efforts on city clusters with faster-growing revenue pools, and launching 60 client service units with a focus on sales and automated transactions. In CMB, we increased MME market presence and in RBWM we grew lending by 4% following contraction in the past two years. In addition, we saw increased client activity in GB&M, mainly in our Rates business.

In **Mexico**, we remained focused on achieving sustainable growth although revenue was subdued. In RBWM we introduced RMs dedicated to our Advance segment to improve productivity and customer experience. We launched a balance transfer campaign, selectively increased credit limits for lower risk customers and saw mortgage balances grow by 5% reflecting competitive pricing. In CMB we improved processes in the Business Banking segment to allow RMs to better support their clients. In GB&M, lending balances rose by 48% as a result of new business initiatives following energy reforms in the second half of 2014. We made strong progress on repositioning our business, which has reduced customer numbers, and continued to focus on streamlining, managing our cost

base and strengthening our risk management and controls.

In **Argentina**, we continued to manage our business conservatively as the economic environment remained challenging. We focused our growth on GB&M and corporate CMB customers and continued to follow cautious lending policies in RBWM and Business Banking. We retained leading market positions in Trade and Foreign Exchange.

Review of adjusted performance[45]

Revenue (US$m)

Revenue was higher in Argentina due to favourable results in GB&M and growth in RBWM and CMB. This was partly offset by reductions in Mexico across all global businesses and in Brazil, primarily in CMB and GB&M.

Country view of adjusted revenue

	2014 US$m	2013 US$m
Argentina	1,070	718
Brazil	4,821	4,932
Mexico	2,304	2,479
Other	58	(54)
Year ended 31 December	**8,253**	8,075

Report of the Directors: Financial Review (continued)

In *Argentina*, revenue increased by US$352m, primarily in GB&M, together with growth in RBWM and CMB. In GB&M, the increase reflected favourable trading results and higher revenue in Balance Sheet Management, as volumes and spreads related to short-term funds grew in a volatile market.

Revenue increased in RBWM, primarily due to growth in insurance revenue from higher investment income which reflected movements in the bond markets. In addition, revenue rose from increased net interest income, driven by wider spreads due to higher interest rates coupled with growth in average deposit balances. In CMB, revenue increased due to growth in net interest income reflecting wider spreads due to an increase in interest rates, higher average lending balances and growth in Payments and Cash Management deposit balances. Higher balances also led to increased fees from both Payments and Cash Management and Trade products.

In *Mexico*, revenue decreased by US$175m, mainly in RBWM and, to a lesser extent, in CMB and GB&M.

In RBWM, revenue fell primarily due to lower sales volumes in the insurance business. Revenue was also adversely affected as we continued to progress with repositioning the business. In addition, we experienced narrower liability spreads on current accounts, savings and deposits following a decrease in interest rates although the effect was partly offset by higher mortgage balances.

In CMB, net interest income decreased due to asset spread compression and a reduction in average lending balances. This was notably in Business Banking, where we continued to reposition the business, there were pre-payments by a small number of large corporates and a portion of loans to certain homebuilders were written off. Net interest income was also adversely affected by narrower deposit spreads following a decrease in interest rates. In addition, fee income decreased as a result of lower Account Services and Payments and Cash Management fees reflecting fewer customers, as we continued to reposition the business.

In GB&M, lower revenue was primarily due to market movements which affected counterparty credit spreads resulting in increased CVA charges, and lower gains on disposal of available-for-sale securities.

In *Brazil*, revenue decreased in CMB and GB&M, while RBWM remained broadly unchanged. In CMB, revenue was lower, despite growth in overall lending balances, as the portfolio mix changed to reflect an increase in lower-yielding MMEs.

In GB&M, revenue reduced in Balance Sheet Management, though this was partly offset by growth

in Rates revenue, driven by higher client activity. Revenue in RBWM was broadly unchanged. Insurance revenue increased due to favourable movements in the PVIF asset compared with adverse movements in 2013. This was offset by a decrease in fee income across a number of products, in part reflecting a change in mix by customers towards more secured, lower-yielding assets and strong market competition.

LICs fell, primarily in Mexico and, to a lesser extent, in Brazil.

In Mexico, LICs improved due to lower individually assessed charges in CMB, in particular relating to certain homebuilders following a change in the public housing policy in 2013, and in GB&M due to the non-recurrence of a large specific provision booked in 2013.

In Brazil, the fall was driven by changes to the impairment model and assumption revisions for restructured loan account portfolios which occurred in 2013 in both RBWM and CMB. In addition, collectively assessed impairments reduced in CMB, notably in Business Banking, reflecting improved delinquency rates. This was partly offset by an increase in GB&M driven by an individually assessed impairment and a provision made against a guarantee.

Operating expenses (US$m)

Operating expenses increased by US$796m, primarily in Brazil and Argentina, largely due to union-agreed salary increases and inflationary pressures. In addition, we saw higher transactional taxes in Argentina in line with a growth in revenue and increased infrastructure costs across the region. We also incurred specific costs in Brazil in 2014 relating to an accelerated depreciation charge and an impairment of an intangible asset in RBWM. Despite these factors, our strict cost control continued and we progressed with our strategic focus on streamlining, which resulted in sustainable cost savings of over US$155m.

Report of the Directors: Financial Review (continued)

2013 compared with 2012

Economic background

In Latin America, average GDP growth fell to 2.4% in 2013 from 2.9% in 2012. **Brazil** s GDP growth accelerated from 1% in 2012 to above 2% by the end of 2013. However, this was the third year of below-trend growth. Brazil s growing current account deficit raised concerns during the summer. The resulting capital flight and decline in the currency served to put further upward pressure on prices, pushing CPI inflation above the mid-point of the central bank s target for the fourth consecutive year.

Mexico saw a material slowdown in economic activity in 2013, with GDP growth likely to have slowed to 1.3% from 3.9% in 2012. Inflationary pressures remained subdued and Banco de México cut its key policy rate to 3.5% from 4.5% at the start of the year. However, a significant number of structural reforms should aid the long-term performance of the Mexican economy.

The **Argentinian** economy accelerated in 2013 following a good agricultural harvest and a modest recovery in the Brazilian economy. Structural problems became increasingly evident with high inflation and, eventually, currency weakness.

Review of performance

2013 compared with 2012 commentaries are on a constant currency basis and have not been updated to reflect our change to adjusted performance. For comparison, adjusted profit before tax would have been US$0.8bn and US$2.1bn for 2013 and 2012 respectively as compared with constant currency profit before tax of US$2.0bn and US$2.2bn for 2013 and 2012 respectively and underlying profit before tax of US$0.7bn and US$1.9bn for 2013 and 2012 respectively. Constant currency, underlying currency and adjusted are reconciled on pages 105(b) to 105(au).

In Latin America, reported profit before tax of US$2.0bn was US$412m lower than in 2012, and US$239m lower on a constant currency basis.

On an underlying basis, which excludes the US$1.1bn gain on the sale of our operations in Panama and the effect of other non-strategic business disposals, pre-tax profits decreased by US$1.2bn. This was driven by a US$714m rise in loan impairment charges and a decline in revenue of US$348m, in part reflecting adverse movements in the PVIF asset compared with 2012.

We made significant progress on repositioning our business in the region, with a particular focus on our priority growth markets of Brazil, Mexico and Argentina. We also completed the disposal of operations in Panama, Peru and Paraguay, along with the sale of a portfolio of our non-life insurance assets and liabilities and a non-strategic business in Mexico. We expect to complete the sale of our operations in Colombia and Uruguay in 2014, subject to regulatory approvals. While our performance was affected by slower economic growth and inflationary pressures, we continued to implement the Group s strategy in our core priority markets in order to reposition our portfolios. We made significant progress in exiting certain businesses and products, strengthening transaction monitoring and account opening, and investing in improved compliance across the region.

In Brazil, we focused on growing secured lending balances for corporates and Premier customers in order to increase connectivity and reduce our risk exposure. We tightened origination criteria in unsecured lending in RBWM, resulting in slower loan growth, and in Business Banking, where volumes declined. We were awarded Best Debt House in Brazil by *Euromoney*, and received the Best Infrastructure Financing in Brazil award from *LatinFinance* in GB&M.

In Mexico, we increased our market share in personal lending, and launched a successful residential mortgage campaign in RBWM. In CMB, we launched a new US$1bn SME fund to support businesses that trade or aspire to trade internationally, and approved lending of US$274m. We grew revenue from collaboration between CMB and GB&M by 11%, were awarded the Best Domestic Cash Manager award by *Euromoney* and won two awards for Infrastructure Financing from *LatinFinance*.

In Argentina, we continued to manage our business conservatively as the economic environment remained challenging. We focused on GB&M and corporate CMB customers, and tightened credit origination criteria and strengthened our collections capabilities in Business Banking and RBWM.

Net interest income decreased by US$358m, driven by the effect of the disposal of non-strategic businesses and a decline in Brazil, partly offset by growth in Argentina.

Net interest income decreased in Brazil due to a shift to lower yielding assets in CMB with reduced lending balances in Business Banking as we focused on growing secured balances for corporates. The reduction in net interest income in RBWM reflected lower average lending balances as a result of more restrictive origination criteria, which included reducing credit limits where appropriate, the rundown of non-strategic portfolios and a change in the product mix towards more secured assets. In addition, spreads were narrower in CMB reflecting competition, notably in working capital products. Net interest income also decreased in Balance Sheet Management due to lower reinvestment rates.

In Argentina, higher net interest income was driven by increased average credit card and personal lending balances, coupled with higher deposits in RBWM and CMB, both reflecting successful sales and marketing campaigns launched during 2013.

In Mexico, net interest income remained broadly unchanged. It decreased in CMB reflecting large prepayments relating to a small number of corporates, and in GB&M as maturing investments were renewed at lower reinvestment rates. These falls were offset by an increase in RBWM as the launch of successful sales campaigns resulted in higher average lending balances, notably in payroll and personal lending.

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Net fee income increased by 4%, mainly in Argentina. This was driven by business growth, notably in Payments and Cash Management, and the sale of the non-life insurance business which resulted in the non-recurrence of sales commissions previously paid to third party distribution channels. In Brazil and Mexico, fees rose, mainly in RBWM, where higher volumes and re-pricing initiatives drove fee increases in current accounts and credit cards.

Net trading income increased by US$39m, primarily reflecting favourable results in GB&M in Argentina and Brazil. This was partly offset by lower average trading assets as maturing investments in Brazil were not renewed.

Net income from financial instruments designated at fair value decreased by US$274m, notably in Brazil, as a result of lower investment gains due to market movements. To the extent that these investment gains were attributed to policyholders there was a corresponding movement in *Net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments fell by 62% due to lower gains on disposal of available-for-sale government debt securities in Balance Sheet Management and the non-recurrence of the gain on sale of shares in a non-strategic investment in 2012.

Net earned insurance premiums decreased by 19%, driven by lower sales of unit-linked pension products in Brazil. Premiums also fell in Argentina as a result of the sale of the non-life insurance business in 2012. The reduction in net earned insurance premiums resulted in a corresponding decrease in *Net insurance claims incurred and movement in liabilities to policyholders*.

Other operating income increased by US$910m, driven by the US$1.1bn gain on the sale of our operations in Panama. This was partly offset by a significant reduction in the PVIF asset due to an increase in lapse rates and interest rate movements in Brazil and Mexico, and the non-recurrence of the favourable effect of the recognition of a PVIF asset in Brazil in 2012.

LICs increased by US$693m, primarily in Mexico due to specific impairments in CMB relating to homebuilders from a change in the public housing policy, and higher collective impairments in RBWM as a result of increased volumes and higher delinquency in our unsecured lending portfolio. In Brazil, LICs increased due to changes to the impairment model and assumption revisions for restructured loan account portfolios in RBWM and CMB, following a realignment of local practices to Group standard policy. LICs were also adversely affected by higher specific impairments in CMB across a number of corporate exposures. These factors were partly offset by improvements in credit quality in Brazil following the modification of credit strategies in previous years to mitigate rising delinquency rates.

Operating expenses decreased by US$112m as a result of business disposals, continued strict cost control and progress with our organisational effectiveness programmes which resulted in sustainable cost savings of over US$200m. The decrease was largely offset by the effect of inflationary pressures, union-agreed salary increases in Brazil and Argentina, and higher compliance and risk costs from the implementation of Global Standards and portfolio repositioning, notably in Mexico.

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Profit/(loss) before tax and balance sheet data *Latin America*

	2014						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income	3,323	1,529	490	19	9	(60)	5,310
Net fee income	771	469	147	28			1,415
Trading income/(expense) excluding net interest income	123	103	391	3	(1)		619
Net interest income/(expense) on trading activities	1	4	174		(2)	60	237
Net trading income/(expense)[50]	124	107	565	3	(3)	60	856
Changes in fair value of long-term debt issued and related derivatives							
Net income from other financial instruments designated at fair value	516	175					691
Net income from financial instruments designated at fair value	516	175					691
Gains less losses from financial investments			84				84

Dividend income	**6**	**2**	**1**				**9**
Net insurance premium income	**1,233**	**285**	**5**				**1,523**
Other operating income	**54**	**47**	**19**		**213**	**(184)**	**149**
Total operating income	**6,027**	**2,614**	**1,311**	**50**	**219**	**(184)**	**10,037**
Net insurance claims[56]	**(1,410)**	**(352)**	**(3)**				**(1,765)**
Net operating income[4]	**4,617**	**2,262**	**1,308**	**50**	**219**	**(184)**	**8,272**
Loan impairment (charges)/ recoveries and other credit risk provisions	**(1,091)**	**(776)**	**(252)**	**(5)**			**(2,124)**
Net operating income	**3,526**	**1,486**	**1,056**	**45**	**219**	**(184)**	**6,148**
Total operating expenses	**(3,616)**	**(1,549)**	**(606)**	**(49)**	**(296)**	**184**	**(5,932)**
Operating profit/(loss)	**(90)**	**(63)**	**450**	**(4)**	**(77)**		**216**
Share of profit in associates and joint ventures							
Profit/(loss) before tax	**(90)**	**(63)**	**450**	**(4)**	**(77)**		**216**
	%	**%**	**%**	**%**	**%**		**%**
Share of HSBC s profit before tax	**(0.5)**	**(0.3)**	**2.4**		**(0.5)**		**1.1**
Cost efficiency ratio	**78.3**	**68.5**	**46.3**	**98.0**	**135.2**		**71.7**

Balance sheet data[40]

	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)[27]	**12,306**	**20,078**	**10,642**	**96**			**43,122**
Total assets	**29,074**	**29,851**	**55,827**	**298**	**1,155**	**(851)**	**115,354**
Customer accounts[27]	**23,056**	**15,125**	**8,219**	**2,188**			**48,588**

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	2013						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income/(expense)	3,776	1,828	775	24	(12)	(205)	6,186
Net fee income	952	548	168	32	1		1,701
Trading income/(expense) excluding net interest income	138	117	456	4	(4)		711
Net interest income on trading activities			20			205	225
Net trading income/(expense)[50]	138	117	476	4	(4)	205	936
Changes in fair value of long-term debt issued and related derivatives							
Net income from other financial instruments designated at fair value	264	61	1				326
Net income from financial instruments designated at fair value	264	61	1				326
Gains less losses from financial investments		1	81				82
Dividend income	5	3	1				9
Net insurance premium income	1,464	360	6				1,830
	312	485	310	1	196	(189)	1,115

Other operating income							
Total operating income	6,911	3,403	1,818	61	181	(189)	12,185
Net insurance claims[56]	(1,323)	(291)	(3)				(1,617)
Net operating income[4]	5,588	3,112	1,815	61	181	(189)	10,568
Loan impairment charges and other credit risk provisions	(1,552)	(1,062)	(52)				(2,666)
Net operating income	4,036	2,050	1,763	61	181	(189)	7,902
Total operating expenses	(3,610)	(1,586)	(596)	(60)	(267)	189	(5,930)
Operating profit/(loss)	426	464	1,167	1	(86)		1,972
Share of profit in associates and joint ventures							
Profit/(loss) before tax	426	464	1,167	1	(86)		1,972
	%	%	%	%	%		%
Share of HSBC s profit before tax	1.9	2.0	5.2		(0.4)		8.7
Cost efficiency ratio	64.6	51.0	32.8	98.4	147.5		56.1
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	13,616	19,923	10,304	75			43,918
Total assets	30,584	30,001	52,977	337	634	(534)	113,999
Customer accounts[27]	23,943	16,593	8,994	1,859			51,389

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Profit/(loss) before tax and balance sheet data Latin America (continued)

	2012						
	Retail Banking and Wealth Management US$m	Commercial Banking US$m	Global Banking and Markets US$m	Global Private Banking US$m	Other US$m	Inter-segment elimination[55] US$m	Total US$m
Profit/(loss) before tax							
Net interest income/(expense)	4,145	2,173	993	30	(2)	(355)	6,984
Net fee income	873	622	207	33			1,735
Trading income excluding net interest income	85	99	398	3	1		586
Net interest income on trading activities			29		1	355	385
Net trading income[50]	85	99	427	3	2	355	971
Changes in fair value of long-term debt issued and related derivatives							
Net income from other financial instruments designated at fair value	503	163	1				667
Net income from financial instruments designated at fair value	503	163	1				667
Gains less losses from financial	75	21	131				227

investments							
Dividend income	9	5	1				15
Net insurance premium income	1,985	450	17				2,452
Other operating income/(expense)	309	(9)	6	3	134	(190)	253
Total operating income	7,984	3,524	1,783	69	134	(190)	13,304
Net insurance claims[56]	(1,875)	(469)	(9)				(2,353)
Net operating income[1]	6,109	3,055	1,774	69	134	(190)	10,951
Loan impairment charges and other credit risk provisions	(1,541)	(581)	(13)	(2)			(2,137)
Net operating income	4,568	2,474	1,761	67	134	(190)	8,814
Total operating expenses	(3,960)	(1,723)	(608)	(47)	(282)	190	(6,430)
Operating profit/(loss)	608	751	1,153	20	(148)		2,384
Share of profit in associates and joint ventures							
Profit/(loss) before tax	608	751	1,153	20	(148)		2,384
	%	%	%	%	%		%
Share of HSBC s profit before tax	2.9	3.6	5.6	0.1	(0.7)		11.6
Cost efficiency ratio	64.8	56.4	34.3	68.1	210.4		58.7
Balance sheet data[40]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)[27]	17,236	25,379	10,899	91			53,605
Total assets	36,141	35,507	58,272	570	1,110	(323)	131,277
Customer accounts[27]	28,688	20,834	11,192	4,430			65,144

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Reconciliation of reported and adjusted items for 2014

Global businesses

Retail Banking and Wealth Management

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**24,594**	26,740	(8)
Currency translation adjustment[74]		(393)	
Acquisitions, disposals and dilutions	**(16)**	(572)	
Other significant items	**893**	477	
Adjusted	**25,471**	26,252	(3)
LICs			
Reported	**(1,819)**	(3,227)	44
Currency translation adjustment[74]		152	
Acquisitions, disposals and dilutions	**2**	65	
Other significant items			
Adjusted	**(1,817)**	(3,010)	40
Operating expenses			
Reported	**(17,522)**	(17,248)	(2)
Currency translation adjustment[74]		262	
Acquisitions, disposals and dilutions	**21**	275	
Other significant items	**1,097**	1,031	
Adjusted	**(16,404)**	(15,680)	(5)
Adjusted cost efficiency ratio	**64.4%**	59.7%	
Share of profit in associates and joint ventures			
Reported	**398**	384	4
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions		13	

Other significant items			
Adjusted	**398**	397	
Profit before tax			
Reported	**5,651**	6,649	(15)
Currency translation adjustment[74]		21	
Acquisitions, disposals and dilutions	**7**	(219)	
Other significant items	**1,990**	1,508	
Adjusted	**7,648**	7,959	(4)

Reconciliation of reported and adjusted average risk-weighted assets

	2014	2013	
	US$bn	US$bn	
Average RWAs			
Average reported RWAs	**220**	252	(13)
Currency translation adjustment[77]		(2)	
Acquisitions, disposals and dilutions	**(1)**	(4)	
Other significant items		(4)	
Average adjusted RWAs	**219**	242	(10)

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Principal RBWM business

The Principal RBWM business measure excludes the effects of the US run-off portfolio. We believe that looking at the Principal RBWM business without the run-off business allows management to more clearly discuss the cause of material changes from year to year in the

ongoing business and assess the factors and trends in the business which are expected to have a material effect in future years. Tables which reconcile reported RBWM financial measures to Principal RBWM financial measures are provided below.

Reconciliation of reported and adjusted items

US run-off

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**1,337**	1,672	(20)
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions		105	
Other significant items	**149**	278	
Adjusted	**1,486**	2,055	(28)
LICs			
Reported	**(30)**	(705)	96
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**(30)**	(705)	96
Operating expenses			
Reported	**(738)**	(1,166)	37
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions		14	
Other significant items	**19**	113	
Adjusted	**(719)**	(1,039)	31

Adjusted cost efficiency ratio	**48.4%**	50.6%	
Profit/(loss) before tax			
Reported	**569**	(200)	
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions		120	
Other significant items	**168**	391	
Adjusted	**737**	311	137

Reconciliation of reported and adjusted average risk-weighted assets

US run-off

	2014	2013	
	US$bn	US$bn	
Average RWAs			
Average reported RWAs	**67**	92	(27)
Currency translation adjustment[77]			
Acquisitions, disposals and dilutions			
Other significant items		(4)	
Average adjusted RWAs	**67**	88	(24)

Card and Retail Services

	2014	2013	
	US$bn	US$bn	
Average RWAs			
Average reported RWAs		4	(100)
Currency translation adjustment[77]			
Acquisitions, disposals and dilutions			
Other significant items			
Average adjusted RWAs		4	(100)

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Principal RBWM[78]

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**23,257**	25,068	(7)
Currency translation adjustment[74]		(393)	
Acquisitions, disposals and dilutions	**(16)**	(677)	
Significant items			
Other significant items	**744**	199	
Adjusted	**23,985**	24,197	(1)
LICs			
Reported	**(1,789)**	(2,522)	29
Currency translation adjustment[74]		152	
Acquisitions, disposals and dilutions	**2**	65	
Other significant items			
Adjusted	**(1,787)**	(2,305)	22
Operating expenses			
Reported	**(16,784)**	(16,082)	(4)
Currency translation adjustment[74]		262	
Acquisitions, disposals and dilutions	**21**	261	
Other significant items	**1,078**	918	
Adjusted	**(15,685)**	(14,641)	(7)
Adjusted cost efficiency ratio	**65.4%**	60.5%	
Profit before tax			
Reported	**5,082**	6,849	(26)
Currency translation adjustment[74]		21	
Acquisitions, disposals and dilutions	**7**	(339)	
Other significant items	**1,822**	1,117	
Adjusted	**6,911**	7,648	(10)

Reconciliation of reported and adjusted average risk-weighted assets

Principal RBWM

	2014	2013	
	US$bn	US$bn	
Average RWAs			
Average reported RWAs	**152**	156	(3)
Currency translation adjustment[77]		(2)	
Acquisitions, disposals and dilutions		(4)	
Other significant items			
Average adjusted RWAs	**152**	150	1

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Commercial Banking

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**16,303**	16,365	
Currency translation adjustment[74]		(243)	
Acquisitions, disposals and dilutions	**(14)**	(643)	
Other significant items	**23**		
Adjusted	**16,312**	15,479	5
LICs			
Reported	**(1,675)**	(2,384)	30
Currency translation adjustment[74]		42	
Acquisitions, disposals and dilutions	**(2)**	2	
Other significant items			
Adjusted	**(1,677)**	(2,340)	28
Operating expenses			
Reported	**(7,489)**	(7,049)	(6)
Currency translation adjustment[74]		164	
Acquisitions, disposals and dilutions	**14**	101	
Other significant items	**175**	19	
Adjusted	**(7,300)**	(6,765)	(8)
Adjusted cost efficiency ratio	**44.8%**	43.7%	
Share of profit in associates and joint ventures			
Reported	**1,605**	1,509	6
Currency translation adjustment[74]		8	
Acquisitions, disposals and dilutions		19	
Other significant items			
Adjusted	**1,605**	1,536	4
Profit before tax			
Reported	**8,744**	8,441	4

Currency translation adjustment[74]		(29)	
Acquisitions, disposals and dilutions	**(2)**	(521)	
Other significant items	**198**	19	
Adjusted	**8,940**	7,910	13

Reconciliation of reported and adjusted average risk-weighted assets

	2014	2013	
	US$bn	US$bn	
Average RWAs			
Average reported RWAs	**419**	389	8
Currency translation adjustment[77]		(3)	
Acquisitions, disposals and dilutions	**(1)**	(11)	
Other significant items			
Average adjusted RWAs	**418**	375	12

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Global Banking and Markets

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**17,778**	19,176	(7)
Currency translation adjustment[74]		(62)	
Acquisitions, disposals and dilutions	**(12)**	(494)	
Other significant items	**340**	(88)	
Adjusted	**18,106**	18,532	(2)
LICs			
Reported	**(365)**	(207)	(76)
Currency translation adjustment[74]		(23)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**(365)**	(230)	(59)
Operating expenses			
Reported	**(12,028)**	(9,960)	(21)
Currency translation adjustment[74]		(44)	
Acquisitions, disposals and dilutions	**5**	78	
Other significant items	**1,892**	364	
Adjusted	**(10,131)**	(9,562)	(6)
Adjusted cost efficiency ratio	**56.0%**	51.6%	
Share of profit in associates and joint ventures			
Reported	**504**	432	17
Currency translation adjustment[74]		2	
Acquisitions, disposals and dilutions		34	
Other significant items			
Adjusted	**504**	468	8
Profit before tax			
Reported	**5,889**	9,441	(38)

Currency translation adjustment[74]		(127)	
Acquisitions, disposals and dilutions	**(7)**	(382)	
Other significant items	**2,232**	276	
Adjusted	**8,114**	9,208	(12)

Reconciliation of reported and adjusted average risk-weighted assets

	2014	2013	
	US$bn	US$bn	
Average RWAs			
Average reported RWAs	**511**	417	23
Currency translation adjustment[77]		(3)	
Acquisitions, disposals and dilutions	**(1)**	(5)	
Other significant items			
Average adjusted RWAs	**510**	409	25

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Legacy Credit

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**(2)**	149	
Currency translation adjustment[74]		(3)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**(2)**	146	
LICs			
Reported	**349**	206	69
Currency translation adjustment[74]		7	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**349**	213	64
Operating expenses			
Reported	**(708)**	(170)	
Currency translation adjustment[74]		(3)	
Acquisitions, disposals and dilutions			
Other significant items	**533**		
Adjusted	**(175)**	(173)	(1)
Profit/(loss) before tax			
Reported	**(361)**	185	
Currency translation adjustment[74]		1	
Acquisitions, disposals and dilutions			
Other significant items	**533**		
Adjusted	**172**	186	(8)

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Global Banking and Markets excluding Legacy Credit

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**17,780**	19,027	(7)
Currency translation adjustment[74]		(59)	
Acquisitions, disposals and dilutions	**(12)**	(494)	
Other significant items	**340**	(88)	
Adjusted	**18,108**	18,386	(2)
LICs			
Reported	**(714)**	(413)	(73)
Currency translation adjustment[74]		(30)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**(714)**	(443)	(61)
Operating expenses			
Reported	**(11,320)**	(9,790)	(16)
Currency translation adjustment[74]		(41)	
Acquisitions, disposals and dilutions	**5**	78	
Other significant items	**1,359**	364	
Adjusted	**(9,956)**	(9,389)	(6)
Adjusted cost efficiency ratio	**55.0%**	51.1%	
Profit before tax			
Reported	**6,250**	9,256	(32)
Currency translation adjustment[74]		(128)	
Acquisitions, disposals and dilutions	**(7)**	(382)	
Other significant items	**1,699**	276	
Adjusted	**7,942**	9,022	(12)

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Global Private Banking

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**2,377**	2,439	(3)
Currency translation adjustment[74]		12	
Acquisitions, disposals and dilutions		(5)	
Other significant items	**41**	279	
Adjusted	**2,418**	2,725	(11)
LICs			
Reported	**8**	(31)	
Currency translation adjustment[74]		(2)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**8**	(33)	
Operating expenses			
Reported	**(1,778)**	(2,229)	20
Currency translation adjustment[74]		(6)	
Acquisitions, disposals and dilutions		4	
Other significant items	**71**	425	
Adjusted	**(1,707)**	(1,806)	5
Adjusted cost efficiency ratio	**70.6%**	66.3%	
Share of profit in associates and joint ventures			
Reported	**19**	14	36
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**19**	14	36
Profit before tax			
Reported	**626**	193	224

Currency translation adjustment[74]		4	
Acquisitions, disposals and dilutions		(1)	
Other significant items	**112**	704	
Adjusted	**738**	900	(18)

Reconciliation of reported and adjusted average risk-weighted assets

	2014 **US$bn**	2013 US$bn
Average RWAs		
Average reported RWAs	**22**	22
Currency translation adjustment[33]		
Acquisitions, disposals and dilutions		
Other significant items		
Average adjusted RWAs	**22**	22

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Other

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**6,365**	5,651	13
Currency translation adjustment[74]		(60)	
Own credit spread[75]	**(417)**	1,246	
Acquisitions, disposals and dilutions	**33**	(1,043)	
Other significant items	**(117)**	(1,262)	
Adjusted	**5,864**	4,532	29
Operating expenses			
Reported	**(8,601)**	(7,796)	(10)
Currency translation adjustment[74]		32	
Acquisitions, disposals and dilutions		30	
Other significant items	**120**	199	
Adjusted	**(8,481)**	(7,535)	(13)
Adjusted cost efficiency ratio	**144.6%**	166.3%	
Loss before tax			
Reported	**(2,230)**	(2,159)	(3)
Currency translation adjustment[74]		(28)	
Own credit spread[75]	**(417)**	1,246	
Acquisitions, disposals and dilutions	**33**	(992)	
Other significant items	**3**	(1,063)	
Adjusted	**(2,611)**	(2,996)	13

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Geographical regions

Europe

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**21,571**	20,967	3
Currency translation adjustment[74]		651	
Own credit spread[75]	**(393)**	1,015	
Acquisitions, disposals and dilutions		(51)	
Other significant items	**1,101**	(379)	
Adjusted	**22,279**	22,203	
LICs			
Reported	**(764)**	(1,530)	50
Currency translation adjustment[74]		(54)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**(764)**	(1,584)	52
Operating expenses			
Reported	**(20,217)**	(17,613)	(15)
Currency translation adjustment[74]		(376)	
Acquisitions, disposals and dilutions		28	
Other significant items	**2,601**	1,637	
Adjusted	**(17,616)**	(16,324)	(8)
Adjusted cost efficiency ratio	**79.1%**	73.5%	
Profit before tax			
Reported	**596**	1,825	(67)
Currency translation adjustment[74]		221	
Own credit spread[75]	**(393)**	1,015	

Acquisitions, disposals and dilutions		(18)	
Other significant items	**3,702**	1,258	
Adjusted	**3,905**	4,301	(9)

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Asia[76]

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**23,677**	24,432	(3)
Currency translation adjustment[74]		(280)	
Own credit spread[75]	**4**	2	
Acquisitions, disposal and dilutions	**32**	(1,139)	
Other significant items	**(84)**	(561)	
Adjusted	**23,629**	22,454	5
LICs			
Reported	**(647)**	(498)	(30)
Currency translation adjustment[74]		18	
Acquisitions, disposal and dilutions			
Other significant items			
Adjusted	**(647)**	(480)	(35)
Operating expenses			
Reported	**(10,427)**	(9,936)	(5)
Currency translation adjustment[74]		127	
Acquisitions, disposal and dilutions		72	
Other significant items	**58**	121	
Adjusted	**(10,369)**	(9,616)	(8)
Adjusted cost efficiency ratio	**43.9%**	42.8%	
Share of profit in associates and joint ventures			
Reported	**2,022**	1,855	9
Currency translation adjustment[74]		14	
Acquisitions, disposal and dilutions		82	
Other significant items			
Adjusted	**2,022**	1,951	4
Profit before tax			

Reported	**14,625**	15,853	(8)
Currency translation adjustment[74]		(121)	
Own credit spread[75]	**4**	2	
Acquisitions, disposal and dilutions	**32**	(985)	
Other significant items	**(26)**	(440)	
Adjusted	**14,635**	14,309	2

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Middle East and North Africa

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**2,548**	2,503	2
Currency translation adjustment[74]		(13)	
Own credit spread[75]	**6**	4	
Acquisitions, disposals and dilutions	**(14)**	(90)	
Other significant items	**5**	(2)	
Adjusted	**2,545**	2,402	6
LICs			
Reported	**6**	42	(86)
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions	**(2)**	6	
Other significant items			
Adjusted	**4**	48	(92)
Operating expenses			
Reported	**(1,216)**	(1,289)	6
Currency translation adjustment[74]		6	
Acquisitions, disposals and dilutions	**31**	65	
Other significant items	**2**	4	
Adjusted	**(1,183)**	(1,214)	3
Adjusted cost efficiency ratio	**46.5%**	50.5%	
Share of profit in associates and joint ventures			
Reported	**488**	438	11
Currency translation adjustment[74]		(1)	
Acquisitions, disposal and dilutions			
Other significant items			
Adjusted	**488**	437	12
Profit before tax			
Reported	**1,826**	1,694	8
Currency translation adjustment[74]		(8)	

Own credit spread[75]	**6**	4	
Acquisitions, disposals and dilutions	**15**	(19)	
Other significant items	**7**	2	
Adjusted	**1,854**	1,673	11

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North America

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**8,152**	8,803	(7)
Currency translation adjustment[74]		(139)	
Own credit spread[75]	**(34)**	225	
Acquisitions, disposals and dilutions		89	
Other significant items	**150**	361	
Adjusted	**8,268**	9,339	(11)
LICs			
Reported	**(322)**	(1,197)	73
Currency translation adjustment[74]		13	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**(322)**	(1,184)	73
Operating expenses			
Reported	**(6,429)**	(6,416)	
Currency translation adjustment[74]		65	
Acquisitions, disposals and dilutions		14	
Other significant items	**578**	201	
Adjusted	**(5,851)**	(6,136)	5
Adjusted cost efficiency ratio	**70.8%**	65.7%	
Profit before tax			
Reported	**1,417**	1,221	16
Currency translation adjustment[74]		(63)	
Own credit spread[75]	**(34)**	225	
Acquisitions, disposals and dilutions		103	
Other significant items	**728**	562	
Adjusted	**2,111**	2,048	3

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Latin America

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**8,272**	10,568	(22)
Currency translation adjustment[74]		(914)	
Own credit spread[75]			
Acquisitions, disposals and dilutions	**(27)**	(1,566)	
Other significant items	**8**	(13)	
Adjusted	**8,253**	8,075	2
LICs			
Reported	**(2,124)**	(2,666)	20
Currency translation adjustment[74]		191	
Acquisitions, disposals and dilutions	**2**	61	
Other significant items			
Adjusted	**(2,122)**	(2,414)	12
Operating expenses			
Reported	**(5,932)**	(5,930)	
Currency translation adjustment[74]		535	
Acquisitions, disposals and dilutions	**9**	309	
Other significant items	**116**	75	
Adjusted	**(5,807)**	(5,011)	(16)
Adjusted cost efficiency ratio	**70.4%**	62.1%	
Profit before tax			
Reported	**216**	1,972	(89)
Currency translation adjustment[74]		(188)	
Acquisitions, disposals and dilutions	**(16)**	(1,196)	
Other significant items	**124**	62	
Adjusted	**324**	650	(50)

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Home markets

UK

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**15,727**	14,253	10
Currency translation adjustment[74]		789	
Own credit spread[75]	**(474)**	1,011	
Acquisitions, disposals and dilutions		(51)	
Other significant items	**827**	(637)	
Adjusted	**16,080**	15,365	5
LICs			
Reported	**(214)**	(1,003)	79
Currency translation adjustment[74]		(83)	
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**(214)**	(1,086)	80
Operating expenses			
Reported	**(15,576)**	(12,096)	(29)
Currency translation adjustment[74]		(455)	
Acquisitions, disposals and dilutions		28	
Other significant items	**2,553**	909	
Adjusted	**(13,023)**	(11,614)	(12)
Adjusted cost efficiency ratio	**81.0%**	75.6%	
Profit/(loss) before tax			
Reported	**(56)**	1,160	
Currency translation adjustment[74]		251	
Own credit spread[75]	**(474)**	1,011	
Acquisitions, disposals and dilutions		(18)	

Other significant items	**3,380**	272	
Adjusted	**2,850**	2,676	7

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Hong Kong

Reconciliation of reported and adjusted items

	2014 US$m	2013 US$m	Change[72] %
Revenue[73]			
Reported	**13,844**	13,203	5
Currency translation adjustment[74]		5	
Own credit spread[75]	**1**	1	
Acquisitions, disposals and dilutions			
Other significant items	**(120)**	2	
Adjusted	**13,725**	13,211	4
LICs			
Reported	**(320)**	(137)	(134)
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions			
Other significant items			
Adjusted	**(320)**	(137)	(134)
Operating expenses			
Reported	**(5,424)**	(5,045)	(8)
Currency translation adjustment[74]		(1)	
Acquisitions, disposals and dilutions			
Other significant items	**56**	41	
Adjusted	**(5,368)**	(5,005)	(7)
Adjusted cost efficiency ratio	**39.1%**	37.9%	
Profit before tax			
Reported	**8,142**	8,089	1
Currency translation adjustment[74]		3	
Own credit spread[75]	**1**	1	
Acquisitions, disposals and dilutions			
Other significant items	**(64)**	43	
Adjusted	**8,079**	8,136	(1)

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Other significant items affecting adjusted performance

	2014 UK	2014 Hong Kong
Revenue		
Debit valuation adjustment on derivative contracts	**203**	**26**
Fair value movements on non-qualifying hedges	**(8)**	**11**
Gain on sale of shareholding in Bank of Shanghai		**(428)**
Impairment on our investment in Industrial Bank		**271**
Provision arising from the ongoing review of compliance with the Consumer Credit Act in the UK	**632**	
	827	**(120)**
Operating expenses		
Settlements and provisions in connection with foreign exchange investigations	**1,187**	
Restructuring and other related costs	**91**	**7**
Regulatory provisions in GPB		**49**
UK customer redress programmes	**1,275**	
	2,553	**56**

	2013 UK	2013 Hong Kong
Revenue		
Debit valuation adjustment on derivative contracts	(78)	(12)
Fair value movements on non-qualifying hedges	(263)	14
FX gains relating to sterling debt issued by HSBC Holdings	(442)	
Loss on sale of an HFC Bank UK secured loan portfolio	146	
	(637)	2
Operating expenses		
Accounting gain arising from change in basis of delivering ill-health benefits in the UK	(430)	
Restructuring and other related costs	104	6
Regulatory provisions in GPB		35
UK customer redress programmes	1,235	
	909	41

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2013 compared with 2012

Use of non-GAAP financial measures

Our reported results are prepared in accordance with IFRSs as detailed in the Financial Statements starting on page 334. In measuring our performance, the financial measures that we use include those which have been derived from our reported results in order to eliminate factors which distort year-on-year comparisons. These are considered non-GAAP financial measures. Non-GAAP financial measures that we use throughout our Financial Review and are described below. Other non-GAAP financial measures are described and reconciled to the closest reported financial measure when used.

Constant currency

Foreign currency translation differences reflect the movements of the US dollar against most major currencies during 2013. We exclude the translation differences when using constant currency because it allows us to assess balance sheet and income statement performance on a like-for-like basis to better understand the underlying trends in the business.

Constant currency

Constant currency comparatives for 2012 referred to in the commentaries are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

- the income statements for 2012 at the average rates of exchange for 2013; and
- the balance sheet at 31 December 2012 at the prevailing rates of exchange on 31 December 2013.

No adjustment has been made to the exchange rates used to translate foreign currency denominated assets and liabilities into the functional currencies of any HSBC branches, subsidiaries, joint ventures or associates. When reference is made to constant currency in tables or commentaries, comparative data reported in the functional currencies of HSBC s operations have been translated at the appropriate exchange rates applied in the current year on the basis described above.

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Reconciliation of reported and constant currency profit before tax

	2013 compared with 2012					
	2012 as reported	Currency translation adjustment[74]	2012 at 2013 exchange rates	2013 as reported	Reported change[72]	Constant currency change[72]
HSBC	US$m	US$m	US$m	US$m	%	%
Net interest income	37,672	(682)	36,990	35,539	(6)	(4)
Net fee income	16,430	(203)	16,227	16,434		1
Net trading income	7,091	(164)	6,927	8,690	23	25
Own credit spread[75]	(5,215)	12	(5,203)	(1,246)	76	76
Other income/(expense) from financial instruments	2,989	(53)	2,936	2,014	(33)	(31)
Net income/(expense) from financial instruments designated at fair value	(2,226)	(41)	(2,267)	768		
Gains on disposal of US branch network, US cards business and Ping An	7,024		7,024		(100)	(100)
Gains less losses from financial investments	1,189	(17)	1,172	2,012	69	72
Net earned insurance	13,044	(118)	12,926	11,940	(8)	(8)

premiums						
Other operating income	2,321	(200)	2,121	2,954	27	39
Total operating income	82,545	(1,425)	81,120	78,337	(5)	(3)
Net insurance claims[81]	(14,215)	96	(14,119)	(13,692)	(4)	(3)
Net operating income[73]	68,330	(1,329)	67,001	64,645	(5)	(4)
Loan impairment charges and other credit risk provisions	(8,311)	201	(8,110)	(5,849)	30	28
Net operating income	60,019	(1,128)	58,891	58,796	(2)	
Operating expenses	(42,927)	683	(42,244)	(38,556)	10	9
Operating profit	17,092	(445)	16,647	20,240	18	22
Share of profit in associates and joint ventures	3,557	45	3,602	2,325	(35)	(35)
Profit before tax	20,649	(400)	20,249	22,565	9	11
By global business						
Retail Banking and Wealth Management	9,575	(26)	9,549	6,649	(31)	(30)
Commercial Banking	8,535	(96)	8,439	8,441	(1)	
Global Banking and Markets	8,520	(147)	8,373	9,441	11	13
Global Private Banking	1,009	(16)	993	193	(81)	(81)
Other	(6,990)	(115)	(7,105)	(2,159)	69	70
Profit before tax	20,649	(400)	20,249	22,565	9	11
By geographical region						
Europe	(3,414)	65	(3,349)	1,825		
Asia[76]	18,030	(228)	17,802	15,853	(12)	(11)
Middle East and North Africa	1,350	(36)	1,314	1,694	25	29
North America	2,299	(28)	2,271	1,221	(47)	(46)
Latin America	2,384	(173)	2,211	1,972	(17)	(11)
Profit before tax	20,649	(400)	20,249	22,565	9	11

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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. This does not include fair value changes due to own credit risk in respect of trading liabilities or derivative liabilities; and
- we adjust for acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses.

For acquisitions, disposals and changes of ownership levels of subsidiaries, associates, joint ventures and businesses, we eliminate the gain or loss on disposal or dilution and any associated gain or loss on reclassification or impairment recognised in the year incurred, and remove the operating profit or loss of the acquired, disposed of or diluted subsidiaries, associates, joint ventures and businesses from all the years presented so we can view results on a like-for-like basis. For example, if a disposal was made in the current year, any gain or loss on disposal, any associated gain or loss on reclassification or impairment recognised and the results of the disposed-of business would be removed from the results of the current year and the previous year as if the disposed-of business did not exist in those years. The disposal of investments other than those included in the above definition does not lead to underlying adjustments.

We use underlying performance to explain year-on-year changes when the effect of fair value movements on own debt, acquisitions, disposals or dilution is significant because we consider that this basis more appropriately reflects operating performance.

Adjusted performance

Adjusted performance is computed by adjusting reported results for the year-on-year effects of foreign currency translation differences and significant items which distort year-on-year comparisons.

In 2013 we used the non-GAAP financial measure of underlying performance , as described above. In 2014, we modified our approach to better align it with the way we view our performance internally and with feedback received from investors. Adjusted performance builds on underlying performance by maintaining the adjustment for currency translation differences and incorporating the adjustments for own credit spread and acquisitions, disposals and dilutions into the definition of significant items. We use the term significant items to collectively describe the group of individual adjustments which are excluded from reported results when arriving at adjusted performance. Significant items, which are detailed below, are those items which management and investors would ordinarily identify and consider separately when assessing performance in order to better understand the underlying trends in the business.

We believe adjusted performance provides useful information for investors by aligning internal and external reporting, identifying and quantifying items management believe to be significant and providing insight into how management assesses year-on-year performance.

We arrive at adjusted performance by excluding from our reported results:

- the year-on-year effects of foreign currency translation differences. This is done by comparing reported results for 2013 with reported results for 2012 retranslated at 2013 exchange rates. The foreign currency translation differences reflect the movements of the US dollar against most major currencies; and

- significant items which distort the year-on-year comparison of reported results by obscuring the underlying factors and trends which affect operations. Significant items include adjustments for own credit spread and acquisitions, disposals and dilutions which were previously part of our underlying measure and are as follows for 2013 as compared with 2012.

The following acquisitions, disposals and changes to ownership levels affected the underlying performance:

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Disposal gains/(losses) affecting underlying performance

	Date	Disposal gain/(loss) US$m
HSBC Bank Canada s disposal of HSBC Securities (Canada) Inc s full service retail brokerage business[70]	Jan 2012	83
The Hongkong and Shanghai Banking Corporation Limited s disposal of RBWM operations in Thailand[70]	Mar 2012	108
HSBC Finance Corporation, HSBC USA Inc. and HSBC Technology and Services (USA) Inc. s disposal of US Card and Retail Services business[70]	May 2012	3,148
HSBC Bank USA, N.A. s disposal of 138 non-strategic branches[70]	May 2012	661
HSBC Argentina Holdings S.A. s disposal of its non-life insurance manufacturing subsidiary[70]	May 2012	102
The Hongkong and Shanghai Banking Corporation Limited s disposal of its private banking business in Japan[70]	Jun 2012	67
The Hongkong and Shanghai Banking Corporation Limited s disposal of its shareholding in a property company in the Philippines[71]	Jun 2012	130
Hang Seng Bank Limited s disposal of its non-life insurance manufacturing subsidiary[70]	Jul 2012	46
HSBC Bank USA, N.A. s disposal of 57 non-strategic branches[70]	Aug 2012	203
HSBC Asia Holdings B.V. s investment loss on a subsidiary[70]	Aug 2012	(85)
HSBC Bank plc s disposal of HSBC Securities SA[71]	Aug 2012	(11)
HSBC Europe (Netherlands) B.V. s disposal of HSBC Credit Zrt[71]	Aug 2012	(2)
HSBC Europe (Netherlands) B.V. s disposal of HSBC Insurance (Ireland) Limited[71]	Oct 2012	(12)
HSBC Europe (Netherlands) B.V. s disposal of HSBC Reinsurance Limited[71]	Oct 2012	7
HSBC Private Bank (UK) Limited s disposal of Property Vision Holdings Limited[71]	Oct 2012	(1)
HSBC Investment Bank Holdings Limited s disposal of its stake in Havas Havalimanlari Yer Hizmetleri Yatirim Holding Anonim Sirketi[71]	Oct 2012	18
HSBC Insurance (Asia) Limited s disposal of its non-life insurance portfolios[70]	Nov 2012	117
HSBC Bank plc s disposal of HSBC Shipping Services Limited[71]	Nov 2012	(2)
HSBC Bank (Panama) S.A. s disposal of its operations in Costa Rica, El Salvador and Honduras[70]	Dec 2012	(62)
HSBC Insurance Holdings Limited and The Hongkong and Shanghai Banking Corporation Limited s disposal of their shares in Ping An[70]	Dec 2012	3,012
The Hongkong and Shanghai Banking Corporation Limited s disposal of its	Dec 2012	212

shareholding in Global Payments Asia-Pacific Limited[70]		
Reclassification gain in respect of our holding in Industrial Bank Co., Limited following the issue of additional share capital to third parties[70]	Jan 2013	1,089
HSBC Insurance (Asia-Pacific) Holdings Limited s disposal of its shareholding in Bao Viet Holdings[70]	Mar 2013	104
Household Insurance Group Holding company s disposal of its insurance manufacturing business[70]	Mar 2013	(99)
HSBC Seguros, S.A. de C.V., Grupo Financiero HSBC s disposal of its property and Casualty Insurance business in Mexico[70]	Apr 2013	20
HSBC Bank plc s disposal of its shareholding in HSBC (Hellas) Mutual Funds Management SA[71]	Apr 2013	(7)
HSBC Insurance (Asia-Pacific) Holdings Limited disposal of its shareholding in Hana HSBC Life Insurance Company Limited[70]	May 2013	28
HSBC Bank plc s disposal of HSBC Assurances IARD[71]	May 2013	(4)
The Hongkong and Shanghai Banking Corporation Limited s disposal of HSBC Life (International) Limited s Taiwan branch operations[71]	June 2013	(36)
HSBC Markets (USA) Inc. s disposal of its subsidiary, Rutland Plastic Technologies[71]	Aug 2013	17
HSBC Insurance (Singapore) Pte Ltd s disposal of its Employee Benefits Insurance business in Singapore[71]	Aug 2013	(8)
HSBC Investment Bank Holdings plc s disposal of its investment in associate FIP Colorado[71]	Aug 2013	(5)
HSBC Investment Bank Holdings plc group s disposal of its investment in subsidiary, Viking Sea Tech[70]	Aug 2013	54
HSBC Latin America Holdings UK Limited s disposal of HSBC Bank (Panama) S.A.[71]	Oct 2013	1,107
HSBC Latin America Holdings UK Limited s disposal of HSBC Bank (Peru) S.A.[71]	Nov 2013	(18)
HSBC Latin America Holdings UK Limited s disposal of HSBC Bank (Paraguay) S.A.[71]	Nov 2013	(21)
Reclassification loss in respect of our holding in Yantai Bank Co., Limited following an increase in its registered share capital[70]	Dec 2013	(38)

For footnotes, see page 109.

Acquisition gains/(losses) affecting the underlying performance[71]

	Date	Fair value gain on acquisition US$m
Gain on the merger of Oman International Bank S.A.O.G. and the Omani operations of HSBC Bank Middle East Limited	Jun 2012	3
Gain on the acquisition of the onshore retail and commercial banking business of Lloyds Banking Group in the UAE by HSBC Bank Middle East Limited	Oct 2012	18

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The following table reconciles selected reported items for 2013 and 2012 to the underlying basis. For comparison purposes the reconciliations have been updated to additionally reflect the adjusted basis.

The details of other significant items can be found on page 6.

Reconciliation of reported, underlying and adjusted items

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported	35,539	37,672	(6)
Currency translation adjustment[74]		(682)	
Acquisitions, disposals and dilutions	(273)	(2,015)	
Underlying	35,266	34,975	1
Other significant items			
Adjusted	35,266	34,975	
Other operating income			
Reported	2,632	2,100	25
Currency translation adjustment[74]		(195)	
Acquisitions, disposals and dilutions	(2,234)	(811)	
Underlying	398	1,094	(64)
Other significant items	819		
Adjusted	1,217	1,094	
Revenue[73]			
Reported	64,645	68,330	(5)
Currency translation adjustment[74]		(1,341)	
Own credit spread[75]	1,246	5,215	
Acquisitions, disposals and dilutions	(2,596)	(10,607)	
Underlying	63,295	61,597	3
Other significant items	(594)	17	
Adjusted	62,701	61,614	
LICs			

Reported	(5,849)	(8,311)	30
Currency translation adjustment[74]		201	
Acquisitions, disposals and dilutions	32	376	
Underlying	(5,817)	(7,734)	25
Other significant items			
Adjusted	(5,817)	(7,734)	
Total operating expenses			
Reported	(38,556)	(42,927)	10
Currency translation adjustment[74]		683	
Acquisitions, disposals and dilutions	353	1,490	
Underlying	(38,203)	(40,754)	6
Other significant items	2,038	5,239	
Adjusted	(36,165)	(35,515)	
Underlying cost efficiency ratio	60.4%	66.2%	
Adjusted cost efficiency ratio	57.7%	57.6%	
Share of profit in associates and joint ventures			
Reported	2,325	3,557	(35)
Currency translation adjustment[74]		45	
Acquisitions, disposals and dilutions	(14)	(1,425)	
Underlying	2,311	2,177	6
Other significant items			
Adjusted	2,311	2,177	

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	2013 US$m	2012 US$m	Change[72] %
Profit before tax			
Reported	22,565	20,649	9
Currency translation adjustment[74]		(412)	
Own credit spread[75]	1,246	5,215	
Acquisitions, disposals and dilutions	(2,225)	(10,166)	
Underlying	21,586	15,286	41
Other significant items	1,444	5,256	
Adjusted	23,030	20,542	

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Report of the Directors: Financial Review (continued)

The following table details the impact of other significant items in 2013 and 2012 for each of our geographical regions and global businesses.

Other significant items affecting adjusted performance Losses/(gains)

	2013					
	Europe US$m	Asia[76] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Revenue						
Net gain on completion of Ping An disposal		(553)				(553)
Debit valuation adjustment on derivative contracts	(65)	(40)	(2)	14	(13)	(106)
Fair value movements on non-qualifying hedges	(297)	32		(246)		(511)
FX gains relating to sterling debt issued by HSBC Holdings	(442)					(442)
Write-off of allocated goodwill relating to the GPB Monaco business	279					279
Gain/(loss) on sale of several tranches of real estate secured accounts in the US				123		123
Loss on sale of non-real estate secured accounts in the US				271		271
Loss on early termination of cash flow hedges in the US run-off portfolio				199		199
Loss on sale of an HFC Bank UK secured loan portfolio	146					146
	(379)	(561)	(2)	361	(13)	(594)
Operating expenses						
Restructuring and other related costs	217	86	4	101	75	483
UK customer redress programmes	1,235					1,235
Madoff-related litigation costs	298					298
Regulatory provisions in GPB	317	35				352
US customer remediation provisions relating to CRS				100		100
Accounting gain arising from change in basis of delivering ill-health benefits in the	(430)					(430)

UK						
	1,637	121	4	201	75	2,038
	RBWM US$m	CMB US$m	GB&M US$m	GPB US$m	Other US$m	Total US$m
Revenue						
Net gain on completion of Ping An disposal					(553)	(553)
Revenue						
Debit valuation adjustment on derivative contracts			(106)			(106)
Fair value movements on non-qualifying hedges	(262)		18		(267)	(511)
FX gains relating to sterling debt issued by HSBC Holdings					(442)	(442)
Write-off of allocated goodwill relating to the GPB Monaco business				279		279
Gain/(loss) on sale of several tranches of real estate secured accounts in the US	123					123
Loss on sale of non-real estate secured accounts in the US	271					271
Loss on early termination of cash flow hedges in the US run-off portfolio	199					199
Loss on sale of an HFC Bank UK secured loan portfolio	146					146
	477		(88)	279	(1,262)	(594)
Operating expenses						
Restructuring and other related costs	167	31	13	73	199	483
UK customer redress programmes	953	148	134			1,235
Madoff-related litigation costs			298			298
Regulatory provisions in GPB				352		352
US customer remediation provisions relating to CRS	100					100
Accounting gain arising from change in basis of delivering ill-health benefits in the UK	(189)	(160)	(81)			(430)
	1,031	19	364	425	199	2,038

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Report of the Directors: Financial Review (continued)

	2012					
	Europe US$m	Asia[76] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Revenue						
Debit valuation adjustment on derivative contracts	(303)	(136)	(4)	(58)	(17)	(518)
Fair value movements on non-qualifying hedges	51	51		194		296
Gain on sale of our shares in Indian banks		(314)				(314)
Loss on forward contract relating to Ping An sale		553				553
	(252)	154	(4)	136	(17)	17
Operating expenses						
Fines and penalties for inadequate compliance with anti-money laundering and sanction laws	375			1,546		1,921
North America mortgage foreclosure and servicing costs				104		104
Restructuring and related costs	299	162	27	221	167	876
UK customer redress charges	2,338					2,338
	3,012	162	27	1,871	167	5,239

	RBWM US$m	CMB US$m	GB&M US$m	GPB US$m	Other US$m	Total US$m
Revenue						
Debit valuation adjustment on derivative contracts			(518)			(518)
Fair value movements on non-qualifying hedges	193		42	(4)	65	296
Gain on sale of our shares in Indian banks					(314)	(314)
Loss on forward contract relating to Ping An sale					553	553
	193		(476)	(4)	304	17

Operating expenses						
Fines and penalties for inadequate compliance with anti-money laundering and sanction laws					1,921	1,921
North America mortgage foreclosure and servicing costs	104					104
Restructuring and related costs	266	62	63	58	427	876
UK customer redress charges	1,751	258	331	(2)		2,338
	2,121	320	394	56	2,348	5,239

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Report of the Directors: Financial Review (continued)

Reconciliation of reported to constant currency, underlying and adjusted items for 2013

Global businesses

Retail Banking and Wealth Management

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	20,298	(368)	19,930	18,339	(10)	(8)
Net fee income	7,205	(113)	7,092	7,021	(3)	(1)
Net trading income	304	(18)	286	686	126	140
Net income from financial instruments designated at fair value	1,893	(26)	1,867	1,638	(13)	(12)
Gains on disposal of US branch network and cards business	3,735		3,735		(100)	(100)
Gains less losses from financial investments	96	(7)	89	55	(43)	(38)
Net insurance premium	11,191	(68)	11,123	10,543	(6)	(5)

income						
Other operating income (including dividend income)	1,496	(34)	1,462	565	(62)	(61)
Total operating income	46,218	(634)	45,584	38,847	(16)	(15)
Net insurance claims and benefits paid and movement in liabilities to policyholders	(12,357)	44	(12,313)	(12,107)	2	2
Net operating income[73]	33,861	(590)	33,271	26,740	(21)	(20)
LICs	(5,515)	135	(5,380)	(3,227)	41	40
Net operating income	28,346	(455)	27,891	23,513	(17)	(16)
Operating expenses	(19,769)	415	(19,354)	(17,248)	13	11
Operating profit	8,577	(40)	8,537	6,265	(27)	(27)
Share of profit from associates and joint ventures	998	14	1,012	384	(62)	(62)
Profit before tax	9,575	(26)	9,549	6,649	(31)	(30)

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Report of the Directors: Financial Review (continued)

Reconciliation of reported, underlying and adjusted items RBWM

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported net interest income	18,339	20,298	(10)
Currency translation adjustment[74]		(368)	
Acquisitions, disposals and dilutions	(151)	(1,735)	
Underlying	18,188	18,195	
Other significant items			
Adjusted	18,188	18,195	
Other operating income			
Reported other operating income	544	1,472	(63)
Currency translation adjustment[74]		(33)	
Acquisitions, disposals and dilutions	(312)	(395)	
Underlying	232	1,044	(78)
Other significant items	540		
Adjusted	772	1,044	
Revenue[73]			
Reported revenue	26,740	33,861	(21)
Currency translation adjustment[74]		(590)	
Acquisitions, disposals and dilutions	(494)	(6,447)	
Underlying	26,246	26,824	(2)
Other significant items	477	193	
Adjusted	26,723	27,017	
LICs			
Reported LICs	(3,227)	(5,515)	41
Currency translation adjustment[74]		135	
Acquisitions, disposals and dilutions	33	377	
Underlying	(3,194)	(5,003)	36
Other significant items			
Adjusted	(3,194)	(5,003)	

Operating expenses			
Reported operating expenses	(17,248)	(19,769)	13
Currency translation adjustment[74]		415	
Acquisitions, disposals and dilutions	203	1,176	
Underlying	(17,045)	(18,178)	6
Other significant items	1,031	2,121	
Adjusted	(16,014)	(16,057)	
Underlying cost efficiency ratio	64.9%	67.8%	
Adjusted cost efficiency ratio	59.9%	59.4%	
Share of profit in associates and joint ventures			
Reported	384	998	(62)
Currency translation adjustment[74]		14	
Acquisitions, disposals and dilutions	(6)	(670)	
Underlying	378	342	11
Other significant items			
Adjusted	378	342	
Profit before tax			
Reported profit before tax	6,649	9,575	(31)
Currency translation adjustment[74]		(26)	
Acquisitions, disposals and dilutions	(264)	(5,565)	
Underlying	6,385	3,984	60
Other significant items	1,508	2,314	
Adjusted	7,893	6,298	

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Principal Retail Banking and Wealth Management business[76]

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	16,468	(368)	16,100	16,278	(1)	1
Net fee income	6,777	(113)	6,664	7,010	3	5
Other income[80]	3,403	(109)	3,294	1,780	(48)	(46)
Net operating income[73]	26,648	(590)	26,058	25,068	(6)	(4)
LICs	(2,624)	135	(2,489)	(2,522)	4	(1)
Net operating income	24,024	(455)	23,569	22,546	(6)	(4)
Total operating expenses	(17,937)	415	(17,522)	(16,082)	10	8
Operating profit	6,087	(40)	6,047	6,464	6	7
Share of profit from associates and joint ventures	996	14	1,010	385	(61)	(62)
Profit	7,083	(26)	7,057	6,849	(3)	(3)

before tax

For footnotes, see page 109.

Retail Banking and Wealth Management   HSBC Finance

Reconciliation of reported, underlying and adjusted items

	2013 US$m	2012 US$m	Change[72] %
Revenue[73]			
Reported revenue	1,672	7,251	(77)
Acquisitions, disposals and dilutions	105	(4,888)	
Underlying	1,777	2,363	(25)
Other significant items	278	227	
Adjusted	2,055	2,590	
Profit/(loss) before tax			
Reported profit/(loss) before tax	(200)	2,443	
Acquisitions, disposals and dilutions	120	(3,889)	
Underlying	(80)	(1,446)	94
Other significant items	391	323	
Adjusted	311	(1,123)	

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Commercial Banking

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	10,361	(220)	10,141	10,200	(2)	1
Net fee income	4,470	(69)	4,401	4,717	6	7
Net trading income	633	(15)	618	649	3	5
Net income from financial instruments designated at fair value	250	(17)	233	332	33	42
Gains on disposal of US branch network and cards business	277		277		(100)	(100)
Gains less losses from financial investments	22	(2)	20	1	(95)	(95)
Net insurance premium income	1,786	(49)	1,737	1,375	(23)	(21)
Other operating income (including dividend	554	(10)	544	636	15	17

income)						
Total operating income	18,353	(382)	17,971	17,910	(2)	
Net insurance claims and benefits paid and movement in liabilities to policyholders	(1,802)	53	(1,749)	(1,545)	15	12
Net operating income[73]	16,551	(329)	16,222	16,365	(1)	1
LICs	(2,099)	59	(2,040)	(2,384)	(14)	(17)
Net operating income	14,452	(270)	14,182	13,981	(3)	(1)
Operating expenses	(7,598)	149	(7,449)	(7,049)	7	5
Operating profit	6,854	(121)	6,733	6,932	1	3
Share of profit from associates and joint ventures	1,681	25	1,706	1,509	(10)	(12)
Profit before tax	8,535	(96)	8,439	8,441	(1)	

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Report of the Directors: Financial Review (continued)

Reconciliation of reported, underlying and adjusted items   CMB

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported net interest income	10,200	10,361	(2)
Currency translation adjustment[74]		(220)	
Acquisitions, disposals and dilutions	(92)	(211)	
Underlying	10,108	9,930	2
Other significant items			
Adjusted	10,108	9,930	
Other operating income			
Reported other operating income	621	536	16
Currency translation adjustment[74]		(10)	
Acquisitions, disposals and dilutions	(470)	(187)	
Underlying	151	339	(55)
Other significant items			
Adjusted	151	339	
Revenue[73]			
Reported revenue	16,365	16,551	(1)
Currency translation adjustment[74]		(329)	
Acquisitions, disposals and dilutions	(593)	(762)	
Underlying	15,772	15,460	2
Other significant items			
Adjusted	15,772	15,460	
LICs			
Reported LICs	(2,384)	(2,099)	(14)
Currency translation adjustment[74]		59	
Acquisitions, disposals and dilutions	(1)		
Underlying	(2,385)	(2,040)	(17)
Other significant items			
Adjusted	(2,385)	(2,040)	
Operating expenses			

Reported operating expenses	(7,049)	(7,598)	7
Currency translation adjustment[74]		149	
Acquisitions, disposals and dilutions	63	191	
Underlying	(6,986)	(7,258)	4
Other significant items	19	320	
Adjusted	(6,967)	(6,938)	
Underlying cost efficiency ratio	44.3%	46.9%	
Adjusted cost efficiency ratio	44.2%	44.9%	
Share of profit in associates and joint ventures			
Reported	1,509	1,681	(10)
Currency translation adjustment[74]		25	
Acquisitions, disposals and dilutions	(10)	(351)	
Underlying	1,499	1,355	11
Other significant items			
Adjusted	1,499	1,355	
Profit before tax			
Reported profit before tax	8,441	8,535	(1)
Currency translation adjustment[74]		(96)	
Acquisitions, disposals and dilutions	(541)	(922)	
Underlying	7,900	7,517	5
Other significant items	19	320	
Adjusted	7,919	7,837	

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Global Banking and Markets

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	6,960	(127)	6,833	6,766	(3)	(1)
Net fee income	3,329	(22)	3,307	3,482	5	5
Net trading income	5,690	(90)	5,600	6,780	19	21
Net income from financial instruments designated at fair value	1,094	(13)	1,081	599	(45)	(45)
Gains less losses from financial investments	730	(8)	722	747	2	3
Net insurance premium income	25	(3)	22	6	(76)	(73)
Other operating income (including dividend income)	461	9	470	799	73	70
Total operating income	18,289	(254)	18,035	19,179	5	6
	(16)	1	(15)	(3)	81	80

Net insurance claims and benefits paid and movement in liabilities to policyholders						
Net operating income[73]	18,273	(253)	18,020	19,176	5	6
LICs	(670)	5	(665)	(207)	69	69
Net operating income	17,603	(248)	17,355	18,969	8	9
Operating expenses	(9,907)	95	(9,812)	(9,960)	(1)	(2)
Operating profit	7,696	(153)	7,543	9,009	17	19
Share of profit from associates and joint ventures	824	6	830	432	(48)	(48)
Profit before tax	8,520	(147)	8,373	9,441	11	13

For footnotes, see page 109.

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Reconciliation of reported, underlying and adjusted items GB&M

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported net interest income	6,766	6,960	(3)
Currency translation adjustment[74]		(127)	
Acquisitions, disposals and dilutions	(26)	(56)	
Underlying	6,740	6,777	(1)
Other significant items			
Adjusted	6,740	6,777	
Other operating income			
Reported other operating income	670	313	114
Currency translation adjustment[74]		10	
Acquisitions, disposals and dilutions	(407)	(78)	
Underlying	263	245	7
Other significant items			
Adjusted	263	245	
Revenue[73]			
Reported revenue	19,176	18,273	5
Currency translation adjustment[74]		(253)	
Acquisitions, disposals and dilutions	(460)	(219)	
Underlying	18,716	17,801	5
Other significant items	(88)	(476)	
Adjusted	18,628	17,325	
LICs			
Reported LICs	(207)	(670)	69
Currency translation adjustment[74]		5	
Acquisitions, disposals and dilutions			
Underlying	(207)	(665)	69
Other significant items			
Adjusted	(207)	(665)	
Operating expenses			

Reported operating expenses	(9,960)	(9,907)	(1)
Currency translation adjustment[74]		95	
Acquisitions, disposals and dilutions	54	107	
Underlying	(9,906)	(9,705)	(2)
Other significant items	364	394	
Adjusted	(9,542)	(9,311)	
Underlying cost efficiency ratio	52.9%	54.5%	
Adjusted cost efficiency ratio	51.2%	53.7%	
Share of profit in associates and joint ventures			
Reported	432	824	(48)
Currency translation adjustment[74]		6	
Acquisitions, disposals and dilutions	2	(404)	
Underlying	434	426	2
Other significant items			
Adjusted	434	426	
Profit before tax			
Reported profit before tax	9,441	8,520	11
Currency translation adjustment[74]		(147)	
Acquisitions, disposals and dilutions	(404)	(516)	
Underlying	9,037	7,857	15
Other significant items	276	(82)	
Adjusted	9,313	7,775	

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Global Private Banking

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	1,294	(6)	1,288	1,146	(11)	(11)
Net fee income	1,232	1	1,233	1,150	(7)	(7)
Net trading income	490	(1)	489	394	(20)	(19)
Net income from financial instruments designated at fair value				4		
Gains less losses from financial investments	(3)		(3)	(3)		
Net insurance premium income	42	2	44	16	(62)	(64)
Other operating income/(expense) (including dividend income)	157	(13)	144	(231)		
Total operating income	3,212	(17)	3,195	2,476	(23)	(23)
Net insurance claims and benefits paid and movement in liabilities to policyholders	(40)	(2)	(42)	(37)	8	12
	3,172	(19)	3,153	2,439	(23)	(23)

Net operating income[73]						
LICs	(27)	1	(26)	(31)	(15)	(19)
Net operating income	3,145	(18)	3,127	2,408	(23)	(23)
Operating expenses	(2,143)	2	(2,141)	(2,229)	(4)	(4)
Operating profit	1,002	(16)	986	179	(82)	(82)
Share of profit from associates and joint ventures	7		7	14	100	100
Profit before tax	1,009	(16)	993	193	(81)	(81)

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Reconciliation of reported, underlying and adjusted items GPB

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported net interest income	1,146	1,294	(11)
Currency translation adjustment[74]		(6)	
Acquisitions, disposals and dilutions	(4)	(13)	
Underlying	1,142	1,275	(10)
Other significant items			
Adjusted	1,142	1,275	
Other operating income			
Reported other operating income	(239)	151	
Currency translation adjustment[74]		(13)	
Acquisitions, disposals and dilutions	(1)	(56)	
Underlying	(240)	82	
Other significant items	279		
Adjusted	39	82	
Revenue[73]			
Reported revenue	2,439	3,172	(23)
Currency translation adjustment[74]		(19)	
Acquisitions, disposals and dilutions	(5)	(72)	
Underlying	2,434	3,081	(21)
Other significant items	279	(4)	
Adjusted	2,713	3,077	
LICs			
Reported LICs	(31)	(27)	(15)
Currency translation adjustment[74]		1	
Acquisitions, disposals and dilutions			
Underlying	(31)	(26)	(19)
Other significant items			
Adjusted	(31)	(26)	
Operating expenses			

Reported operating expenses	(2,229)	(2,143)	(4)
Currency translation adjustment[74]		2	
Acquisitions, disposals and dilutions	4	15	
Underlying	(2,225)	(2,126)	(5)
Other significant items	425	56	
Adjusted	(1,800)	(2,070)	
Underlying cost efficiency ratio	91.4%	69.0%	
Adjusted cost efficiency ratio	66.3%	67.3%	
Profit before tax			
Reported profit before tax	193	1,009	(81)
Currency translation adjustment[74]		(16)	
Acquisitions, disposals and dilutions	(1)	(57)	
Underlying	192	936	(79)
Other significant items	704	52	
Adjusted	896	988	

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Other

Reconciliation of reported and constant currency loss before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	(730)	(4)	(734)	(737)	(1)	
Net fee income	194		194	64	(67)	(67)
Net trading income	(537)	(1)	(538)	6		
Own credit spread[75]	(5,215)	12	(5,203)	(1,246)	76	76
Other expense from financial instruments designated at fair value	(248)	7	(241)	(558)	(125)	(132)
Net expense from financial instruments designated at fair value	(5,463)	19	(5,444)	(1,804)	67	67
Gains on disposal of US branch network, US cards business and Ping An	3,012		3,012		(100)	(100)
Gains less losses from financial	344		344	1,212	252	252

investments						
Other operating income (including dividend income)	5,512	(210)	5,302	6,910	25	30
Total operating income	2,332	(196)	2,136	5,651	142	165
Net insurance claims and benefits paid and movement in liabilities to policyholders						
Net operating income[73]	2,332	(196)	2,136	5,651	142	165
LICs						
Net operating income	2,332	(196)	2,136	5,651	142	165
Operating expenses	(9,369)	81	(9,288)	(7,796)	17	16
Operating loss	(7,037)	(115)	(7,152)	(2,145)	70	70
Share of profit/(loss) from associates and joint ventures	47		47	(14)		
Loss before tax	(6,990)	(115)	(7,105)	(2,159)	69	70

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Report of the Directors: Financial Review (continued)

Reconciliation of reported, underlying and adjusted items Other

	2013 US$m	2012 US$m	Change[72] %
Revenue[73]			
Reported revenue	5,651	2,332	142
Currency translation adjustment[74]		(209)	
Own credit spread[75]	1,246	5,215	
Acquisitions, disposals and dilutions	(1,044)	(3,107)	
Underlying	5,853	4,231	38
Other significant items	(1,262)	304	
Adjusted	4,591	4,535	
Operating expenses			
Reported operating expenses	(7,796)	(9,369)	17
Currency translation adjustment[74]		81	
Acquisitions, disposals and dilutions	29	1	
Underlying	(7,767)	(9,287)	16
Other significant items	199	2,348	
Adjusted	(7,568)	(6,939)	
Underlying cost efficiency ratio	132.7%	219.5%	
Adjusted cost efficiency ratio	164.8%	153.0%	
Loss before tax			
Reported loss before tax	(2,159)	(6,990)	69
Currency translation adjustment[74]		(127)	
Own credit spread[75]	1,246	5,215	
Acquisitions, disposals and dilutions	(1,015)	(3,106)	
Underlying	(1,928)	(5,008)	62
Other significant items	(1,063)	2,652	
Adjusted	(2,991)	(2,356)	

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Geographical regions

Europe

Reconciliation of reported and constant currency profit/(loss) before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	10,394	(38)	10,356	10,693	3	3
Net fee income	6,169	1	6,170	6,032	(2)	(2)
Net trading income	2,707	(19)	2,688	4,423	63	65
Own credit spread[75]	(4,110)	12	(4,098)	(1,015)	75	75
Other income from financial instruments designated at fair value	1,895	12	1,907	1,433	(24)	(25)
Net income/(expense) from financial instruments designated at fair value	(2,215)	24	(2,191)	418		
Gains less losses from financial investments	364	(4)	360	379	4	5
Net earned insurance premiums	3,630	85	3,715	3,158	(13)	(15)

Other operating income (including dividend income)	1,189	49	1,238	604	(49)	(51)
Total operating income	22,238	98	22,336	25,707	16	15
Net insurance claims and benefits paid and movement in liabilities to policyholders	(4,630)	(121)	(4,751)	(4,740)	(2)	
Net operating income[73]	17,608	(23)	17,585	20,967	19	19
LICs	(1,921)	15	(1,906)	(1,530)	20	20
Net operating income	15,687	(8)	15,679	19,437	24	24
Operating expenses	(19,095)	74	(19,021)	(17,613)	8	7
Operating profit/(loss)	(3,408)	66	(3,342)	1,824		
Share of profit/(loss) from associates and joint ventures	(6)	(1)	(7)	1		
Profit/(loss) before tax	(3,414)	65	(3,349)	1,825		

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Report of the Directors: Financial Review (continued)

Reconciliation of reported, underlying and adjusted items Europe

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported	10,693	10,394	3
Currency translation adjustment[74]		(38)	
Acquisitions, disposals and dilutions	17	15	
Underlying	10,710	10,371	3
Other significant items			
Adjusted	10,710	10,371	
Other operating income			
Reported	529	1,080	(51)
Currency translation adjustment[74]		49	
Acquisitions, disposals and dilutions	(69)	(54)	
Underlying	460	1,075	(57)
Other significant items	425		
Adjusted	885	1,075	
Revenue[73]			
Reported	20,967	17,608	19
Currency translation adjustment[74]		(35)	
Own credit spread[75]	1,015	4,110	
Acquisitions, disposals and dilutions	(51)	(36)	
Underlying	21,931	21,647	1
Other significant items	(379)	(252)	
Adjusted	21,552	21,395	
LICs			
Reported	(1,530)	(1,921)	20
Currency translation adjustment[74]		15	
Acquisitions, disposals and dilutions			
Underlying	(1,530)	(1,906)	20
Other significant items			
Adjusted	(1,530)	(1,906)	

Operating expenses			
Reported	(17,613)	(19,095)	8
Currency translation adjustment[74]		74	
Acquisitions, disposals and dilutions	28	46	
Underlying	(17,585)	(18,975)	7
Other significant items	1,637	3,012	
Adjusted	15,948	(15,963)	
Underlying cost efficiency ratio	80.2%	87.7%	
Adjusted cost efficiency ratio	74.0%	74.6%	
Profit/(loss) before tax			
Reported	1,825	(3,414)	
Currency translation adjustment[74]		53	
Own credit spread[75]	1,015	4,110	
Acquisitions, disposals and dilutions	(18)	10	
Underlying	2,822	759	272
Other significant items	1,258	2,760	
Adjusted	4,080	3,519	

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Asia[76]

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	10,707	(119)	10,588	11,432	7	8
Net fee income	5,418	(77)	5,341	5,936	10	11
Net trading income	2,516	(56)	2,460	2,026	(19)	(18)
Own credit spread[75]	(3)		(3)	(2)	33	33
Other income from financial instruments designated at fair value	556	2	558	316	(43)	(43)
Net income from financial instruments designated at fair value	553	2	555	314	(43)	(43)
Gains on disposal of Ping An	3,012		3,012		(100)	(100)
Gains less losses from financial investments	338	(1)	337	1,275	277	278
Net insurance premium income	6,769		6,769	6,918	2	2

Other operating income (including dividend income)	3,103	(214)	2,889	3,827	23	32
Total operating income	32,416	(465)	31,951	31,728	(2)	(1)
Net insurance claims and benefits paid and movement in liabilities to policyholders	(7,084)		(7,084)	(7,296)	(3)	(3)
Net operating income[73]	25,332	(465)	24,867	24,432	(4)	(2)
LICs	(510)	12	(498)	(498)	2	
Net operating income	24,822	(453)	24,369	23,934	(4)	(2)
Operating expenses	(9,980)	179	(9,801)	(9,936)		(1)
Operating profit	14,842	(274)	14,568	13,998	(6)	(4)
Share of profit from associates and joint ventures	3,188	46	3,234	1,855	(42)	(43)
Profit before tax	18,030	(228)	17,802	15,853	(12)	(11)

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Reconciliation of reported, underlying and adjusted items Asia[76]

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported	11,432	10,707	7
Currency translation adjustment[74]		(119)	
Acquisitions, disposals and dilutions		(31)	
Underlying	11,432	10,557	8
Other significant items			
Adjusted	11,432	10,557	
Other operating income			
Reported	3,675	3,074	20
Currency translation adjustment[74]		(214)	
Acquisitions, disposals and dilutions	(1,139)	(674)	
Underlying	2,536	2,186	16
Other significant items			
Adjusted	2,536	2,186	
Revenue[73]			
Reported	24,432	25,332	(4)
Currency translation adjustment[74]		(465)	
Own credit spread[75]	2	3	
Acquisitions, disposals and dilutions	(1,139)	(3,787)	
Underlying	23,295	21,083	10
Other significant items	(561)	154	
Adjusted	22,734	21,237	
LICs			
Reported	(498)	(510)	2
Currency translation adjustment[74]		12	
Acquisitions, disposals and dilutions		(2)	
Underlying	(498)	(500)	
Other significant items			
Adjusted	(498)	(500)	

Operating expenses			
Reported	(9,936)	(9,980)	
Currency translation adjustment[74]		179	
Acquisitions, disposals and dilutions	72	145	
Underlying	(9,864)	(9,656)	(2)
Other significant items	121	162	
Adjusted	(9,743)	(9,494)	
Underlying cost efficiency ratio	42.3%	45.8%	
Adjusted cost efficiency ratio	42.9%	44.7%	
Share of profit in associates and joint ventures			
Reported	1,855	3,188	(42)
Currency translation adjustment[6]		46	
Acquisitions, disposals and dilutions	(19)	(1,425)	
Underlying	1,836	1,809	1
Other significant items			
Adjusted	1,836	1,809	
Profit before tax			
Reported	15,853	18,030	(12)
Currency translation adjustment[74]		(228)	
Own credit spread[75]	2	3	
Acquisitions, disposals and dilutions	(1,086)	(5,069)	
Underlying	14,769	12,736	16
Other significant items	(440)	316	
Adjusted	14,329	13,052	

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Middle East and North Africa

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
et interest ncome	1,470	(43)	1,427	1,486	1	4
et fee income	595	(11)	584	622	5	7
et trading ncome	390	(9)	381	357	(8)	(6)
wn credit pread[75]	(12)		(12)	(4)	67	67
ther income om financial nstruments esignated at fair alue				2		
et expense from nancial nstruments esignated at fair alue	(12)		(12)	(2)	83	83
ains less losses om financial nvestments	9		9	(18)		
et insurance remium income						
ther operating ncome/(expense) ncluding ividend income)	(22)		(22)	58		
otal operating ncome	2,430	(63)	2,367	2,503	3	6

et insurance aims and enefits paid and ovement in abilities to olicyholders						
et operating come[73]	2,430	(63)	2,367	2,503	3	6
ICs	(286)	4	(282)	42		
et operating come	2,144	(59)	2,085	2,545	19	22
perating xpenses	(1,166)	23	(1,143)	(1,289)	(11)	(13)
perating profit	978	(36)	942	1,256	28	33
hare of profit om associates nd joint ventures	372		372	438	18	18
rofit before tax	1,350	(36)	1,314	1,694	25	29

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Reconciliation of reported, underlying and adjusted items   Middle East and North Africa

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported	1,486	1,470	1
Currency translation adjustment[74]		(43)	
Acquisitions, disposals and dilutions		(8)	
Underlying	1,486	1,419	5
Other significant items			
Adjusted	1,486	1,419	
Other operating income			
Reported	49	(27)	
Currency translation adjustment[74]			
Acquisitions, disposals and dilutions		64	
Underlying	49	37	32
Other significant items			
Adjusted	49	37	
Revenue[73]			
Reported	2,503	2,430	3
Currency translation adjustment[74]		(63)	
Own credit spread[75]	4	12	
Acquisitions, disposals and dilutions		3	
Underlying	2,507	2,382	5
Other significant items	(2)	(4)	
Adjusted	2,505	2,378	
LICs			
Reported	42	(286)	
Currency translation adjustment[74]		4	
Acquisitions, disposals and dilutions			
Underlying	42	(282)	
Other significant items			
Adjusted	42	(282)	

Operating expenses			
Reported	(1,289)	(1,166)	(11)
Currency translation adjustment[74]		23	
Acquisitions, disposals and dilutions		15	
Underlying	(1,289)	(1,128)	(14)
Other significant items	4	27	
Adjusted	(1,285)	(1,101)	
Underlying cost efficiency ratio	51.4%	47.4%	
Adjusted cost efficiency ratio	51.3%	46.3%	
Profit before tax			
Reported	1,694	1,350	25
Currency translation adjustment[74]		(36)	
Own credit spread[75]	4	12	
Acquisitions, disposals and dilutions		18	
Underlying	1,698	1,344	26
Other significant items	2	23	
Adjusted	1,700	1,367	

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North America

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[7 %
et interest come	8,117	(42)	8,075	5,742	(29)	(29)
et fee income	2,513	(18)	2,495	2,143	(15)	(14)
et trading come	507	(6)	501	948	87	89
wn credit read[75]	(1,090)		(1,090)	(226)	79	79
her expense om financial struments signated at fair lue	(129)		(129)	(62)	52	52
et expense from ancial struments signated at fair lue	(1,219)		(1,219)	(288)	76	76
ins on disposal US branch twork and US rds business	4,012		4,012		(100)	(100)
ins less losses om financial vestments	251	(1)	250	294	17	18
et insurance emium income	193		193	34	(82)	(82)
her operating come/(expense)	467	3	470	(31)		

ncluding vidend income)						
otal operating come	14,841	(64)	14,777	8,842	(40)	(40)
et insurance aims and nefits paid and ovement in bilities to licyholders	(148)		(148)	(39)	74	74
et operating come[73]	14,693	(64)	14,629	8,803	(40)	(40)
Cs	(3,457)	6	(3,451)	(1,197)	65	65
et operating come	11,236	(58)	11,178	7,606	(32)	(32)
perating penses	(8,940)	30	(8,910)	(6,416)	28	28
perating profit	2,296	(28)	2,268	1,190	(48)	(48)
are of profit om associates d joint ventures	3		3	31	933	933
ofit before tax	2,299	(28)	2,271	1,221	(47)	(46)

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Reconciliation of reported, underlying and adjusted items North America

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported	5,742	8,117	(29)
Currency translation adjustment[74]		(42)	
Acquisitions, disposals and dilutions	(14)	(1,433)	
Underlying	5,728	6,642	(14)
Significant items			
Adjusted	5,728	6,642	
Other operating income/(expense)			
Reported	(108)	406	
Currency translation adjustment[74]		3	
Acquisitions, disposals and dilutions	97	(134)	
Underlying	(11)	275	
Significant items	394		
Adjusted	383	275	
Revenue[73]			
Reported	8,803	14,693	(40)
Currency translation adjustment[74]		(64)	
Own credit spread[75]	226	1,090	
Acquisitions, disposals and dilutions	89	(5,982)	
Underlying	9,118	9,737	(6)
Significant items	361	136	
Adjusted	9,479	9,873	
LICs			
Reported	(1,197)	(3,457)	65
Currency translation adjustment[74]		6	
Acquisitions, disposals and dilutions		325	
Underlying	(1,197)	(3,126)	62
Significant items			
Adjusted	(1,197)	(3,126)	

Operating expenses			
Reported	(6,416)	(8,940)	28
Currency translation adjustment[74]		30	
Acquisitions, disposals and dilutions	14	796	
Underlying	(6,402)	(8,114)	21
Significant items	201	1,871	
Adjusted	(6,201)	(6,243)	
Underlying cost efficiency ratio	70.2%	83.3%	
Adjusted cost efficiency ratio	65.4%	63.2%	
Profit/(loss) before tax			
Reported	1,221	2,299	(47)
Currency translation adjustment[74]		(28)	
Own credit spread[75]	226	1,090	
Acquisitions, disposals and dilutions	103	(4,861)	
Underlying	1,550	(1,500)	
Significant items	562	2,007	
Adjusted	2,112	507	

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Latin America

Reconciliation of reported and constant currency profit before tax

	2012 as reported US$m	Currency translation adjustment[74] US$m	2012 at 2013 exchange rates US$m	2013 as reported US$m	Reported change[72] %	Constant currency change[72] %
Net interest income	6,984	(440)	6,544	6,186	(11)	(5)
Net fee income	1,735	(98)	1,637	1,701	(2)	4
Net trading income	971	(74)	897	936	(4)	4
Own credit spread[75]						
Other income from financial instruments designated at fair value	667	(67)	600	326	(51)	(46)
Net income from financial instruments designated at fair value	667	(67)	600	326	(51)	(46)
Gains less losses from financial investments	227	(11)	216	82	(64)	(62)
Net insurance premium income	2,452	(203)	2,249	1,830	(25)	(19)
Other operating income (including	268	(49)	219	1,124	319	413

dividend income)						
Total operating income	13,304	(942)	12,362	12,185	(8)	(1)
Net insurance claims and benefits paid and movement in liabilities to policyholders	(2,353)	217	(2,136)	(1,617)	31	24
Net operating income[73]	10,951	(725)	10,226	10,568	(3)	3
LICs	(2,137)	164	(1,973)	(2,666)	(25)	(35)
Net operating income	8,814	(561)	8,253	7,902	(10)	(4)
Operating expenses	(6,430)	388	(6,042)	(5,930)	8	2
Operating profit	2,384	(173)	2,211	1,972	(17)	(11)
Share of profit from associates and joint ventures						
Profit before tax	2,384	(173)	2,211	1,972	(17)	(11)

For footnotes, see page 109.

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Report of the Directors: Financial Review (continued)

Reconciliation of reported, underlying and adjusted items Latin America

	2013 US$m	2012 US$m	Change[72] %
Net interest income			
Reported	6,186	6,984	(11)
Currency translation adjustment[74]		(440)	
Acquisitions, disposals and dilutions	(277)	(561)	
Underlying	5,909	5,983	(1)
Significant items			
Adjusted	5,909	5,983	
Other operating income			
Reported	1,115	253	341
Currency translation adjustment[74]		(48)	
Acquisitions, disposals and dilutions	(1,123)	(14)	
Underlying	(8)	191	
Significant items			
Adjusted	(8)	191	
Revenue[73]			
Reported	10,568	10,951	(3)
Currency translation adjustment[74]		(725)	
Acquisitions, disposals and dilutions	(1,495)	(805)	
Underlying	9,073	9,421	(4)
Significant items	(13)	(17)	
Adjusted	9,060	9,404	
LICs			
Reported	(2,666)	(2,137)	(25)
Currency translation adjustment[74]		164	
Acquisitions, disposals and dilutions	32	53	
Underlying	(2,634)	(1,920)	(37)
Significant items			
Adjusted	(2,634)	(1,920)	
Operating expenses			

Reported	(5,930)	(6,430)	8
Currency translation adjustment[74]		388	
Acquisitions, disposals and dilutions	239	488	
Underlying	(5,691)	(5,554)	(2)
Significant items	75	167	
Adjusted	(5,616)	(5,387)	
Underlying cost efficiency ratio	62.7%	59.0%	
Adjusted cost efficiency ratio	62.0%	57.3%	
Profit before tax			
Reported	1,972	2,384	(17)
Currency translation adjustment[74]		(173)	
Acquisitions, disposals and dilutions	(1,224)	(264)	
Underlying	748	1,947	(62)
Significant items	62	150	
Adjusted	810	2,097	

For footnotes, see page 109.

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Report of the Directors: Financial Review (continued)

Other information

Funds under management and assets held in custody

Funds under management[59]

	2014 US$bn	2013 US$bn
Funds under management		
At 1 January	**921**	910
Net new money	**38**	(18)

Value change	**40**	34
Exchange and other	**(45)**	(5)
At 31 December	**954**	921

	2014	2013
	US$bn	US$bn
Funds under management by business		
Global Asset Management	**445**	420
Global Private Banking	**275**	282
Affiliates	**5**	5
Other	**229**	214
At 31 December	**954**	921

For footnote, see page 109.

Funds under management (FuM) at 31 December 2014 amounted to US$954bn, an increase of 4%, primarily due to favourable market movements and net inflows in the year.

Global Asset Management FuM increased by 6% to US$445bn as we attracted US$29bn of net new money, notably in fixed income products from our customers in Europe and Asia, as well as from net inflows into liquidity funds in Europe and North America. In addition, we transferred FuM of US$18bn which had previously been reported within Other FuM and we benefited from favourable movements in equity and bond markets. These increases were partly offset by adverse foreign exchange movements reflecting the strengthening of the US dollar against all major currencies.

GPB FuM decreased by 3% to US$275bn due to the ongoing repositioning of our client base, which gave rise to disposals of a portfolio of assets in Switzerland to LGT Bank (Switzerland) Ltd and our HSBC Trinkaus & Burkhardt AG business in Luxembourg with a combined

FuM of US$8bn, and negative net new money in Europe. In addition, there were unfavourable foreign exchange movements, mainly in Europe. This was partly offset by favourable market movements, also principally in Europe, and from positive net new money in areas targeted for growth.

Other FuM increased by 7% to US$229bn, primarily due to strong net inflows and favourable market movements. This was partly offset by the transfer of FuM into Global Asset Management noted above.

Assets held in custody[59] and under administration

Custody is the safekeeping and servicing of securities and other financial assets on behalf of clients. At 31 December 2014, we held assets as custodian of US$6.4 trillion, 3% higher than the US$6.2 trillion held at 31 December 2013. This was mainly driven by incremental net asset inflows in Asia and Europe, and notably in Middle East and North Africa, partly offset by adverse foreign exchange movements.

Our assets under administration business, which includes the provision of bond and loan administration services and the valuation of portfolios of securities and other financial assets on behalf of clients, complements the custody business. At 31 December 2014, the value of assets held under administration by the Group amounted to US$3.2 trillion, which was 6% higher than at 31 December 2013. This was mainly driven by incremental net asset inflows in the Funds business in Europe and Asia, which was partly offset by adverse foreign exchange movements.

Taxes paid by region and country

The following tables reflect a geographical view of HSBC s operations and the basis of preparation is aligned to the Group s approach in meeting its country-by-country reporting obligations as laid out in Article 89 of the EU s CRD IV.

Breakdown of tax paid by region[60]

	2014	2013
	US$bn	US$bn
Region		
UK	**2.4**	2.1
Rest of Europe	**1.3**	1.5
Asia	**2.7**	2.5
Middle East and North Africa	**0.2**	0.3
North America	**(0.1)**	0.4
Latin America	**1.4**	1.8
Total	**7.9**	8.6

For footnote, see page 109.

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Report of the Directors: Financial Review (continued)

Taxes paid by country[60]

	2014 US$m	2013 US$m	2012 US$m
Total taxes paid analysed by regions			
Asia	**2,687**	2,536	2,639
Home and priority growth markets	**2,399**	2,185	2,225
Hong Kong	**1,273**	1,248	974
Mainland China	**278**	207	276
India	**290**	318	349
Australia	**204**	105	209
Malaysia	**133**	106	193
Indonesia	**76**	74	113
Singapore	**101**	88	89
Taiwan	**44**	39	22
Other markets	**288**	351	414
Europe	**3,709**	3,570	3,213
Home and priority growth markets	**3,466**	3,326	3,021
UK	**2,363**	2,107	1,906
France	**790**	844	679
Germany	**131**	151	200
Switzerland	**107**	142	160
Turkey	**75**	82	76
Other markets	**243**	244	192
Middle East and North Africa	**210**	251	284
Priority growth markets	**162**	213	234
UAE	**102**	98	120
Egypt	**60**	115	114
Other markets	**48**	38	50
North America	**(108)**	414	1,236
Priority growth markets			
US	**(377)**	125	798
Canada	**269**	285	434
Other markets		4	4
Latin America	**1,384**	1,836	1,977
Priority growth markets	**1,338**	1,645	1,835
Brazil	**804**	1,002	1,174

Argentina	**333**	318	391
Mexico	**201**	325	270
Other markets	**46**	191	142
Total	**7,882**	8,607	9,349

For footnote, see page 109.

Property

At 31 December 2014, we operated from some 7,885 operational properties worldwide, of which approximately 1,965 were located in Europe, 2,500 in Asia, 450 in North America, 2,700 in Latin America and 275 in the Middle East and North Africa. These properties had an area of approximately 54.3m square feet (2013: 56.6m square feet).

Our freehold and long leasehold properties, together with all our leasehold land in Hong Kong, were valued in 2014. The value of these properties was US$10.8bn

(2012: US$10.3bn) in excess of their carrying amount in the consolidated balance sheet on an historical cost based measure. In addition, properties with a net book value of US$1.6bn (2013: US$1.5bn) were held for investment purposes.

Our operational properties are stated at cost, being historical cost or fair value at the date of transition to IFRSs (their deemed cost) less any impairment losses, and are depreciated on a basis calculated to write off the assets over their estimated useful lives. Properties owned as a consequence of an acquisition are recognised initially at fair value.

Further details are included in Note 23 on the Financial Statements.

Our disclosure philosophy

HSBC strives to maintain the highest standards of disclosure in our reporting.

It has long been our policy to provide disclosures that help investors and other stakeholders understand the Group s performance, financial position and changes thereto. In accordance with this policy:

In order to make the financial statements and notes thereon easier to understand, we have undertaken an initiative to provide more focused information and to remove duplication where possible. As a result, we have changed the location and the wording used to describe certain accounting policies within the notes, removed certain immaterial disclosures and changed the order of certain sections. In applying materiality to financial statement disclosures, we consider both the amount and nature of each item. The main changes to the presentation of the financial statements and notes thereon in 2014 are described on pages 346 and 347.

The information provided in the Notes on the Financial Statements and the Report of the Directors goes beyond the minimum levels required by accounting standards, statutory and regulatory requirements and listing rules. In particular, we provide additional disclosures having regard to the recommendations of the Enhanced Disclosures Task Force (EDTF) report Enhancing the Risk Disclosures of Banks issued in October 2012. The report aims to help financial institutions identify areas that investors had highlighted needed better and more transparent information about banks risks, and how these risks relate to performance measurement and reporting. In addition, we continue to enhance our disclosures in line with good practice recommendations issued by relevant regulators and standard setters and in response to feedback received from users of our financial statements.

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Report of the Directors: Financial Review (continued)

Disclosures arising from EDTF recommendations

Type of risk	Recommendation	Disclosure	Page
General	1	The risks to which the business is exposed.	112 to 117
	2	Our risk appetite and stress testing.	117 to 118
	3	Top and emerging risks, and the changes during the reporting period.	118 to 124
	4	Discussion of future regulatory developments affecting our business model and Group profitability, and its implementation in Europe.	119 to 120 and 252 to 256
Risk governance, risk management and business model	5	Group Risk Committee, and their activities.	280 to 281
	6	Risk culture and risk governance and ownership.	111
	7	Diagram of the risk exposure by global business segment.	22
	8	Stress testing and the underlying assumptions.	117 to 118
Capital adequacy and risk-weighted assets	9	Pillar 1 capital requirements. For calculation of Pillar 1 capital requirements, see the *Pillar 3 Disclosures 2014* document.	258 to 259
	10	Reconciliation of the accounting balance sheet to the regulatory balance sheet.	249
	11	Flow statement of the movements in regulatory capital since the previous reporting period, including changes in the different tiers of	245

		regulatory capital.	
	12	Discussion of targeted level of capital, and the plans on how to establish this.	239 and 252 to 258
	13	Analysis of risk-weighted assets by risk type, global business and geographical region, and market risk RWAs.	240
	14	For analysis of the capital requirements for each Basel asset class, see the *Pillar 3 Disclosures 2014* document.	
	15	For analysis of credit risk for each Basel asset class, see the *Pillar 3 Disclosures 2014* document.	
	16	Flow statements reconciling the movements in risk-weighted assets for each risk-weighted asset type.	242 to 244
	17	For discussion of Basel credit risk model performance, see the *Pillar 3 Disclosures 2014* document.	
Liquidity	18	Analysis of the Group s liquid asset buffer.	165 to 166
Funding	19	Encumbered and unencumbered assets analysed by balance sheet category.	171 to 173
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by remaining contractual maturity at the balance sheet date.	426 to 435
	21	Analysis of the Group s sources of funding and a description of our funding strategy.	168
Market risk	22	Relationship between the market risk measures for trading and non-trading portfolios and the balance sheet, by business segment.	179 to 180
	23	Discussion of significant trading and non-trading market risk factors.	176 to 179
	24	VaR assumptions, limitations and validation.	223 to 224
	25	Discussion of stress tests, reverse stress tests and stressed VaR.	224 to 225

Credit risk	26	Analysis of the aggregate credit risk exposures, including details of both personal and wholesale lending.	129 to 130
	27	Discussion of the policies for identifying impaired loans, defining impairments and renegotiated loans, and explaining loan forbearance policies.	137 and 208 to 213
	28	Reconciliations of the opening and closing balances of impaired loans and impairment allowances during the year.	137 and 142 to 143
	29	Analysis of counterparty credit risk that arises from derivative transactions.	150 to 151
	30	Discussion of credit risk mitigation, including collateral held for all sources of credit risk.	146 to 150
Other risks	31	Quantified measures of the management of operational risk.	187 to 189
	32	Discussion of publicly known risk events.	118 to 124

The 32 recommendations listed above were made in the report Enhancing the Risk Disclosures of Banks issued by the Enhanced Disclosure Task Force of the Financial Stability Board in October 2012.

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Report of the Directors: Financial Review (continued)

Disclosure controls

The Group Chief Executive and Group Finance Director, with the assistance of other members of management, carried out an evaluation of the effectiveness of the design and operation of HSBC Holdings disclosure controls and procedures as at 31 December 2014. Based upon that evaluation, the Group Chief Executive and Group Finance Director concluded that our disclosure controls and procedures as at 31 December 2014 were effective to provide reasonable assurance that information required to be disclosed in the reports which the company files and submits under the US Securities Exchange Act of 1934, as amended, is recorded, processed, summarised and reported as and when required. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

There has been no change in HSBC Holdings internal controls over financial reporting during the year ended 31 December 2014 that has materially affected, or is reasonably likely to materially affect, HSBC Holdings internal controls over financial reporting.

Management s assessment of internal controls over financial reporting

Management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and has completed an assessment of the effectiveness of the Group s internal controls over financial reporting for the year ended 31 December 2014. In making the assessment, management used the framework for internal control evaluation contained in the Financial Reporting Council s Internal Control Revised Guidance for Directors, as well as the criteria established by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) in Internal Control-Integrated Framework (1992)[1] .

Based on the assessment performed, management concluded that as at 31 December 2014, the Group s internal controls over financial reporting were effective.

KPMG Audit Plc, which has audited the consolidated financial statements of the Group for the year ended 31 December 2014, has also audited the effectiveness of the Group s internal control over financial reporting under Auditing Standard No. 5 of the Public Company Accounting Oversight Board (United States) as stated in their report on pages 329 to 333.

1 *In May 2013, the Committee of Sponsoring Organisations of the Treadway Commission (COSO) issued the 2013 Internal Control Integrated Framework (Framework). The 2013 Framework superseded the original 1992 Framework on 15 December 2014. HSBC is in the process of finalising its migration to the 2013 Framework, which it plans to use with respect to the evaluation of its internal control over financial reporting for the year ending 31 December 2015. HSBC continued to evaluate its internal control over financial reporting under the Financial Reporting Council s Internal Control Revised Guidance for Directors and the original 1992 Framework for the*

year ended 31 December 2014.

Change in the Group s certifying accountant

In 2013 we conducted a tender process for HSBC Holdings plc (the Company) and its subsidiaries (the Group) statutory audit contract. Accordingly the engagement of KPMG Audit Plc (KPMG), HSBC s current auditor, will not be renewed in 2015. As a result of the audit tender process we announced on 2 August 2013 that following completion of the audit of the Group financial statements for the year ended 31 December 2014 and the audit of the effectiveness of internal control over financial reporting as of 31 December 2014, PricewaterhouseCoopers LLP will become the Group s statutory auditor for the financial year ending 31 December 2015, subject to approval by shareholders at the 2015 Annual General Meeting of the Company. This decision was taken by the Board of Directors on the recommendation of the Group Audit Committee.

During the years ended 31 December 2014 and 2013, (1) KPMG has not issued any reports on the financial statements of the Group or on the effectiveness of internal control over financial reporting that contained an adverse opinion or a disclaimer of opinion, nor were the auditors reports of KPMG qualified or modified as to uncertainty, audit scope, or accounting principles, (2) there has not been any disagreement over any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements if not resolved to KPMG s satisfaction would have caused it to make reference to the subject matter of the disagreement in connection with its auditors reports, or any reportable event as described in Item 16F(a)(1)(v) of Form 20-F.

Further in the years ended 31 December 2014 and 2013 we have not consulted with PricewaterhouseCoopers LLP regarding either (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered with respect to the consolidated financial statements of the Group; or (ii) any matter that was the subject of a disagreement as that term is used in Item 16F(a)(1)(iv) of Form 20-F or a reportable event as described in Item 16F(a)(1)(v) of Form 20-F.

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Report of the Directors: Financial Review (continued)

Footnotes to pages 40 to 108

Use of non-GAAP financial measures

1 *The operating results of these disposals were removed from adjusted results in addition to disposal gains and losses.*
2 *The operating results of these disposals and acquisitions were not removed from adjusted results as they were not significant.*
3 *Excludes items where there are substantial offsets in the income statement for the same year.*
4 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue.*
5 *Positive numbers are favourable: negative numbers are unfavourable.*
6 *Currency translation adjustment is the effect of translating the results of subsidiaries and associates for the previous year at the average rates of exchange applicable in the current year.*
7 *Own credit spread includes the fair value movements on our long-term debt attributable to credit spread where the net result of such movements will be zero upon maturity of the debt. This does not include fair value changes due to own credit risk in respect of trading liabilities or derivative liabilities.*
8 *From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (see Note 11 on the Financial Statements for further details). Comparative data have been represented accordingly.*

Consolidated income statement

9 *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. For further information, see footnote 3 on page 39.*
10 *Dividends per ordinary share expressed as a percentage of basic earnings per share.*
11 *Net interest income includes the cost of internally funding trading assets, while the related external revenues are reported in Trading income . In our global business results, the cost of funding trading assets is included with Global Banking and Market s net trading income as interest expense.*
12 *Gross interest yield is the average annualised interest rate earned on average interest-earning assets (AIEA).*
13 *Net interest spread is the difference between the average annualised interest rate earned on AIEA, net of amortised premiums and loan fees, and the average annualised interest rate paid on average interest-bearing funds.*
14 *Net interest margin is net interest income expressed as an annualised percentage of AIEA.*
15 *Interest income on trading assets is reported as Net trading income in the consolidated income statement.*
16 *Interest income on financial assets designated at fair value is reported as Net income from financial instruments designated at fair value in the consolidated income statement.*
17 *Including interest-bearing bank deposits only.*
18 *Interest expense on financial liabilities designated at fair value is reported as Net income on financial instruments designated at fair value in the consolidated income statement, other than interest on own debt which is reported in Interest expense .*

19 *Including interest-bearing customer accounts only.*

20 *Net trading income includes a favourable movement of US$15m (2013: unfavourable movement of US$66m; 2012: unfavourable movement of US$629m), associated with changes in the fair value of issued structured notes and other hybrid instrument liabilities arising from movements in HSBC issuance spreads.*

21 *Trading income also includes movements on non-qualifying hedges. These hedges are derivatives entered into as part of a documented interest rate management strategy for which hedge accounting was not, nor could be, applied. They are principally cross-currency and interest rate swaps used to economically hedge fixed rate debt issued by HSBC Holdings and floating rate debt issued by HSBC Finance. The size and direction of the changes in the fair value of non-qualifying hedges that are recognised in the income statement can be volatile from year-to-year, but do not alter the cash flows expected as part of the documented interest rate management strategy for both the instruments and the underlying economically hedged assets and liabilities if the derivative is held to maturity.*

22 *In 2013, we recorded a net gain on US$553m on the completion of the Ping An disposal. This represented the net effect of US$1,235m gain on de-recognition of equity securities classified as available for sale and recorded in Gains less losses from financial investments , partly offset by US$682m on a contingent forward sale contract, recorded in Net trading income .*

23 *Other changes in fair value include gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with HSBC s long-term debt issued.*

24 *Net insurance claims and benefits paid and movement in liabilities to policyholders arise from both life and non-life insurance business. For non-life business, amounts reported represent the cost of claims paid during the year and the estimated cost of incurred claims. For life business, the main element of claims is the liability to policyholders created on the initial underwriting of the policy and any subsequent movement in the liability that arises, primarily from the attribution of investment performance to savings-related policies. Consequently, claims rise in line with increases in sales of savings-related business and with investment market growth.*

25 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*

Consolidated balance sheet

26 *In 2013, GB&M changed the way it manages reverse repo and repo activities in the Credit and Rates business. This led to a decrease in amounts classified as Trading assets and Trading liabilities in the balance sheet and an increase in the amount classified as Non-trading reverse repos at amortised cost and Non-trading repos at amortised cost respectively.*

27 *From 1 January 2014, non-trading reverse repos and repos are presented as separate lines in the balance sheet. Previously, non-trading reverse repos were included within Loans and advances to banks and Loans and advances to customers and non-trading repos were included within Deposits by banks and Customer accounts . Comparative data have been re-presented accordingly. Non-trading reverse repos and repos have been presented as separate lines in the balance sheet to align disclosure with market practice and provide more meaningful information in relation to loans and advances. The extent to which reverse repos and repos represent loans to/from customers and banks is set out in Note 17 on the Financial Statements.*

28 *Net of impairment allowances.*

29 *On 1 January 2014, CRD IV came into force and the calculation of capital resources and risk-weighted assets at 31 December 2014 are calculated and presented on this basis. 2011 to 2013 comparatives are on a Basel 2.5 basis. 2010 comparatives are on a Basel II basis.*

30 *Capital resources are total regulatory capital, the calculation of which is set out on page 246.*

31 *Including perpetual preferred securities, details of which can be found in Note 30 on the Financial Statements.*

32 *The definition of net asset value per ordinary share is total shareholders equity, less non-cumulative preference shares and capital securities, divided by the number of ordinary shares in issue excluding shares the company has purchased and are held in treasury.*

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Report of the Directors: Financial Review (continued)

33 *Currency translation adjustment is the effect of translating the assets and liabilities of subsidiaries and associates for the previous year-end at the rates of exchange applicable at the current year-end.*
34 *Balance included in disposal groups of assets held for sale.*
35 *France primarily comprises the domestic operations of HSBC Finance, HSBC Assurances Vie and the Paris branch of HSBC Bank plc.*

Reconciliation of RoRWA measures

36 *Risk-weighted assets (RWA s) and pre-tax return on average risk-weighted assets (RoRWA).*
37 *Adjusted RoRWA is calculated using adjusted pre-tax return and reported average RWAs at constant currency and adjusted for the effects of significant items.*
38 *Other includes treasury services related to the US Consumer and Mortgage Lending business and commercial operations in run-off. US CML includes loan portfolios within the run-off business that are designated held for sale.*

Global businesses and geographical regions

39 *The main items reported under Other are the results of HSBC s holding company and financing operations, which includes net interest earned on free capital held centrally, operating costs incurred by the head office operations in providing stewardship and central management services to HSBC, along with the costs incurred by the Group Service Centres and Shared Service Organisations and associated recoveries. The results also include fines and penalties as part of the settlement of investigations into past inadequate compliance with anti-money laundering and sanctions laws, the UK bank levy together with unallocated investment activities, centrally held investment companies, gains arising from the dilution of interests in associates and joint ventures and certain property transactions. In addition, Other also includes part of the movement in the fair value of long-term debt designated at fair value (the remainder of the Group s movement on own debt is included in GB&M).*
40 *Assets by geographical region and global businesses include intra-HSBC items. These items are eliminated, where appropriate, under the heading Intra-HSBC items or inter-segment elimination , as appropriate.*
41 *For disposed of businesses, this includes the gain or loss on disposal and material results of operations as described on page 40.*
42 *Other income in this context comprises where applicable net trading income, net income/(expense) from other financial instruments designated at fair value, gains less losses from financial investments, dividend income, net insurance premium income and other operating income less net insurance claims and benefits paid and movement in liabilities to policyholders.*
43 *Loan impairment charges and other credit risk provisions.*
44 *Share of profit in associates and joint ventures.*
45 *See Use of non-GAAP financial measures on page 40. Reconciliation of adjusted results to reported results is provided in the Form 20-F filed with the Securities and Exchange Commission, which is available on www.hsbc.com.*

46

The Principal RBWM business measure excludes the effects of the US run-off portfolio and the disposed-of US CRS business. Concentrating on the Principal RBWM business allows management to identify material changes in the ongoing business and assess the factors and trends which are expected to have a material effect on it in future years. Tables which reconcile reported to adjusted financial measures for Principal RBWM are available on www.hsbc.com.

47 *Investment distribution includes Investments, which comprises mutual funds (HSBC manufactured and third party), structured products and securities trading, and Wealth Insurance distribution, consisting of HSBC manufactured and third-party life, pension and investment insurance products.*

48 *Other personal lending includes personal non-residential closed-end loans and personal overdrafts.*

49 *Other mainly includes the distribution and manufacturing (where applicable) of retail and credit protection insurance.*

50 *In the analysis of global businesses, net trading income/(expense) comprises all gains and losses from changes in the fair value of financial assets and financial liabilities classified as held for trading, related external and internal interest income and interest expense, and dividends received; in the statutory presentation internal interest income and expense are eliminated.*

51 *Markets products, Insurance and Investments and Other includes revenue from Foreign Exchange, insurance manufacturing and distribution, interest rate management and GCF products.*

52 *In 2014, Markets included a favourable fair value movement of US$15m on the widening of credit spreads on structured liabilities (2013: adverse fair value movement of US$66m; 2012: adverse fair value movement of US$629m).*

53 *Other in GB&M includes net interest earned on free capital held in the global business not assigned to products, allocated funding costs and gains resulting from business disposals. Within the management view of total operating income, notional tax credits are allocated to the businesses to reflect the economic benefit generated by certain activities which is not reflected within operating income, for example notional credits on income earned from tax-exempt investments where the economic benefit of the activity is reflected in tax expense. In order to reflect the total operating income on an IFRS basis, the offset to these tax credits are included within Other .*

54 *Client assets are translated at the rates of exchange applicable for their respective period-ends, with the effects of currency translation reported separately. The main components of client assets are funds under management (US$275bn as at 31 December 2014) which are not reported on the Group s balance sheet, and customer deposits (US$90bn as at 31 December 2014), of which US$85bn is reported on the Group s balance sheet and US$5bn are off-balance sheet deposits.*

55 *Inter-segment elimination comprises (i) the costs of shared services and Group Service Centres included within Other which are recovered from global businesses, and (ii) the intra-segment funding costs of trading activities undertaken within GB&M. HSBC s Balance Sheet Management business, reported within GB&M, provides funding to the trading businesses. To report GB&M s Net trading income on a fully funded basis, Net interest income and Net interest income/(expense) on trading activities are grossed up to reflect internal funding transactions prior to their elimination in the inter-segment column.*

56 *Net insurance claims and benefits paid and movement in liabilities to policyholders.*

57 *Employee expenses comprise costs directly incurred by each global business. The reallocation and recharging of employee and other expenses directly incurred in the Other category are shown in Other operating expenses .*

58 *RWAs are non-additive across geographical regions due to market risk diversification effects within the Group.*

59 *Funds under management and assets held in custody are not reported on the Group s balance sheet, except where it is deemed that we are acting as principal rather than agent in our role as investment manager, and these assets are consolidated as Structured entities (see Note 39 on the Financial Statements).*

60 *Taxes paid by HSBC relate to HSBC s own tax liabilities including tax on profits earned, employer taxes, bank levy and other duties/levies such as stamp duty. Numbers are reported on a cash flow basis.*

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Average balance sheet

61 *Interest income on trading assets is reported as Net trading income in the consolidated income statement.*
62 *Interest income on financial assets designated at fair value is reported as Net income from financial instruments designated at fair value in the consolidated income statement.*
63 *From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (see Note 11 on the Financial Statements for further details). Comparative data have been represented accordingly.*
64 *This includes interest-bearing bank deposits only. See page 60(n) for an analysis of all bank deposits.*
65 *Interest expense on financial liabilities designated at fair value is reported as Net income on financial instruments designated at fair value in the consolidated income statement, other than interest on own debt which is reported in Interest Expense .*
66 *This includes interest-bearing customer accounts only. See page 60(n) for an analysis of all customer accounts.*
67 *Net interest margin is calculated as net interest income divided by average interest earning assets.*
68 *In 2012 CMB results include US$128m of net operating income and US$43m of profit before tax related to low income housing tax credit investments in the US which are offset within the Other segment.*

Ratio of earnings to fixed charges

69 *For the purpose of calculating the ratios, earnings consist of income from continuing operations before taxation and non-controlling interests, plus fixed charges, and after deduction of the unremitted pre-tax income of associated undertakings. Fixed charges consist of total interest expense, including or excluding interest on deposits, as appropriate, dividends on preference shares and other equity instruments, as applicable, and the proportion of rental expense deemed representative of the interest factor.*

Reconciliations of non-GAAP financial measures

70 *The operating results of these disposals were removed from underlying results in addition to disposal gains and losses.*
71 *The operating results of these disposals and acquisitions were not removed from underlying results as they were not significant.*
72 *Positive numbers are favourable: negative numbers are unfavourable.*
73 *Net operating income before loan impairment charges and other credit risk provisions, also referred to as revenue .*
74 *Currency translation on adjustment is the effect of translating the results of subsidiaries and associates for the previous year at the average rates of exchange applicable in the current year.*
75 *Own credit spread includes the fair value movements on our long-term debt attributable to credit spread where the net result of such movements will be zero upon maturity of the debt. This does not include fair value changes*

due to own credit risk in respect of trading liabilities or derivative liabilities.

76 *From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (See Note11 on the Financial Statements for further details). Comparative data have been represented accordingly.*

77 *Currency translation adjustment is the effect of translating the assets and liabilities of subsidiaries and associates for the previous year-end at the rates of exchange applicable at the current year-end.*

78 *The Principal RBWM business measure excludes the effects of the US run-off portfolio and the disposed-of US CRS business. Concentrating on the Principal RBWM business allows management to identify material changes in the ongoing business and assess the factors and trends which are expected to have a material effect on it in future years. Tables which reconcile reported RBWM financial measures to Principal RBWM financial measures are available on www.hsbc.com.*

79 *Excludes items where there are substantial offsets in the income statement for the same year.*

80 *Other income in this context comprises where applicable net trading income, net income/(expense) from other financial instruments designated at fair value, gains less losses from financial investments, dividend income, net earned insurance premiums and other operating income less net insurance claims incurred and movement in liabilities to policyholders.*

81 *Net insurance claims incurred and movement in liabilities to shareholders.*

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Regulation and supervision

(Unaudited)

With listings of its ordinary shares in London, Hong Kong, New York, Paris and Bermuda, HSBC Holdings complies with the relevant requirements for listing and trading on each of these exchanges. In the UK, these are the Listing Rules of the Financial Conduct Authority (FCA) in its role as the UK Listing Authority; in Hong Kong, The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (HKSE); in the US, where the shares are traded in the form of ADS, HSBC Holdings shares are registered with the US Securities and Exchange Commission (SEC). As a consequence of its US listing, HSBC Holdings is also subject to the reporting and other requirements of the US Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and the New York Stock Exchange s (NYSE) Listed Company Manual, in each case as applied to foreign private issuers. In France and Bermuda, HSBC Holdings is subject to the listing rules of Euronext, Paris and the Bermuda Stock Exchange respectively, applicable to companies with secondary listings.

A statement of our compliance with the provisions of the UK Corporate Governance Code issued by the Financial Reporting Council and with the Hong Kong Corporate Governance Code set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited can be found in the Report of the Directors: Corporate Governance on page 263.

Our operations throughout the world are regulated and supervised by over 400 different central banks and other regulatory authorities in those jurisdictions in which we have offices, branches or subsidiaries. These authorities impose a variety of requirements and controls designed to provide financial stability, transparency in financial markets and a contribution to economic growth. These regulations and controls cover, *inter alia*, capital adequacy, depositor protection, market liquidity, governance standards, customer protection (for example, fair lending practices, product design and marketing and documentation standards), and financial crime and other obligations (for example, anti-money laundering, anti-bribery and corruption, and anti-terrorist financing measures). In addition, a number of countries in which we operate impose rules that affect, or place limitations on, foreign or foreign-owned or controlled banks and financial institutions. The rules include restrictions on the opening of local offices, branches or subsidiaries and the types of banking and non-banking activities that may be conducted by those local offices, branches or subsidiaries; restrictions on the acquisition of local banks or regulations requiring a specified percentage of local ownership; and restrictions on investment and other financial flows entering or leaving the country. Country supervisory and regulatory regimes will determine to some degree our ability to expand into new markets, the services and products that

we will be able to offer in those markets and how we structure specific operations. As a result of government interventions in response to global economic conditions, there has been (and it is expected that there will continue to be) a substantial increase in government regulation and supervision of the financial services industry, including the imposition of higher capital and liquidity requirements, heightened disclosure standards and restrictions on certain types of products or transaction structures.

The Prudential Regulation Authority (PRA) is the HSBC Group s consolidated lead regulator. The other UK regulator, the FCA, supervises 12 HSBC regulated entities in the UK, including 7 where the PRA is responsible for prudential supervision. The FCA also supervises the Group globally in relation to financial crime matters. Additionally, both the PRA and FCA have certain limited direct supervisory powers over our unregulated qualifying parent company HSBC Holdings plc, including (in the FCA s case) pursuant to the undertaking with the FSA (revised as the FCA Direction on 2 April 2013) in connection with HSBC Holdings plc and HSBC North America Holdings, Inc. having entered into agreements as part of a global settlement with a number of US authorities in relation to the Group s failure to comply with anti-money laundering (AML) rules, US sanctions requirements and related matters. In addition, each operating bank, finance company or insurance operation within HSBC is regulated by local supervisors.

The primary regulatory authorities are those in the UK, Hong Kong and the US, our principal jurisdictions of operation. However, and in addition, with the implementation of the EU s Single Supervisory Mechanism (SSM) in 19 EU member states on 4 November 2014, the European Central Bank (ECB) assumed direct supervisory responsibility for HSBC France and HSBC Malta as significant supervised entities within the Eurozone for the purposes of the EU s SSM Regulation. Under the SSM, the ECB will also increasingly engage with the relevant National Competent Authorities in relation to HSBC s businesses in other Eurozone countries and more widely with other HSBC regulators. It is therefore expected that we will continue to see changes in how the Group is regulated and supervised on a day-to-day basis in the Eurozone and more generally as the ECB and other of our regulators develop their powers having regard to some of the regulatory initiatives highlighted in this report.

UK regulation and supervision

The UK financial services regulatory structure is comprised of three regulatory bodies: the Financial Policy Committee (FPC), a committee of the Bank of England (BoE), the PRA, a subsidiary of the BoE and the FCA.

The FPC is responsible for macro-prudential supervision, focussing on systemic risk that may affect the UK s financial stability. The PRA and the FCA are micro-prudential supervisors. The Group s banking subsidiaries such as HSBC Bank plc (our principal authorised

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institution in the UK) are dual-regulated firms, subject to prudential regulation by the PRA and to conduct regulation by the FCA. Other (generally smaller, non-bank) UK based Group subsidiaries are solo regulated by the FCA (i.e. the FCA is responsible for both prudential and conduct regulation of those subsidiaries).

UK banking and financial services institutions are subject to multiple regulations. The primary UK statute in this context is the Financial Services and Markets Act 2000 (FSMA), as amended by subsequent legislation. Other UK financial services legislation includes that derived from EU directives and regulations relating to banking, securities, insurance, investments and sales of personal financial services.

The PRA and FCA are together responsible for authorising and supervising all our operating businesses in the UK which require authorisation under FSMA. These include deposit-taking, retail banking, life and general insurance, pensions, investments, mortgages, custody and share-dealing businesses and treasury and capital markets activity.

PRA and FCA rules establish the minimum criteria for the authorisation of banks and financial services businesses. In the UK and the PRA and FCA have the right to object, on prudential grounds, to persons who hold, or intend to hold, 10% or more of the voting power or shares of a financial institution that it regulates, or of its parent undertaking. PRA rules also set out reporting (and, as applicable, consent) requirements with regard to large individual exposures and large exposures to related borrowers. In its capacity as our supervisor on a consolidated basis, the PRA receives information on the capital adequacy of, and sets requirements for, the Group as a whole. Individual banking subsidiaries in the Group are directly regulated by their local banking supervisors, who set and monitor, *inter alia*, their capital adequacy requirements.

The PRA and FCA monitor authorised institutions through ongoing supervision and the review of routine and *ad hoc* reports relating to financial, prudential and conduct of business matters. They may also obtain independent reports from a skilled person on the adequacy of procedures and systems covering internal control and governing records and accounting. The PRA meet regularly with the Group s senior executives to discuss our adherence to the PRA s prudential guidelines. In addition, both the PRA and FCA regularly discuss fundamental matters relating to our business in the UK and internationally, including areas such as strategic and operating plans, risk control, loan portfolio composition and organisational changes, including succession planning and recovery and resolution arrangements.

With the rapid pace of regulatory change and market conditions, we continue to experience a high level of ongoing interaction with both the PRA and the FCA.

In 2013, we calculated capital at a Group level using the Basel II framework as amended for CRD III, commonly known as Basel 2.5 , and also estimated capital on an

end point CRD IV basis. On 1 January 2014, CRD IV came into force and capital and RWAs at 31 December 2014 are calculated and presented on the Group s interpretation of final CRD IV legislation and final rules issued by the PRA.

The Basel III framework, similarly to Basel II, is structured around three pillars : minimum capital requirements, supervisory review process and market discipline. CRD IV implemented Basel III in the EU and, in the UK, the PRA Rulebook CRR Firms Instrument 2013 transposed the various national discretions under CRD IV into UK law.

In its final rules, the PRA did not adopt most of the CRD IV transitional provisions available, instead opting for an acceleration of the CRD IV end point definition of common equity tier 1 (CET1). However CRD IV transitional provisions for unrealised gains were applied, such that unrealised gains on investment property and available-for-sale securities were not recognised for capital until 1 January 2015. As a result, in 2014, our transitional capital ratio is slightly lower than the comparable end point capital ratio.

In April 2014, the PRA published its rules and supervisory statements implementing some of the CRD IV provisions relating to capital buffers. In addition, in June 2014 the PRA published its expectations in relation to capital ratios for major UK banks and building societies, namely that from 1 July 2014, we are expected to meet a 7% CET1 ratio using CRD IV end point definition. This applies alongside CRD IV requirements. This also included a revised PRA expectation in relation to the leverage ratio for major UK banks and building societies, namely that from 1 July 2014, we are expected to meet a 3% end-point tier 1 leverage ratio, calculated using the CRD IV definition of capital for the numerator and the Basel 2014 exposure measure for the denominator.

In January 2015, the PRA issued a letter setting out the approach to be taken for calculating the leverage ratio for 2014 year end disclosures. While the numerator continues to be calculated using the final CRD IV end point tier 1 capital definition, the exposure measure is now calculated based the EU delegated act published in January 2015 (rather than the Basel 2014 definition used in the Interim Report 2014). Further details of this can be found in the Capital section on page 251.

Despite the rules published to date, there remains continued uncertainty around the amount of capital that UK banks will be required to hold. This relates specifically to the quantification and interaction of capital buffers and Pillar 2. The PRA is currently consulting on their revised approach to Pillar 2, the PRA buffer and its interaction with the CRD IV buffers. Furthermore, there are a significant number of draft and unpublished EBA regulatory and implementing technical standards due in 2015.

CRD IV establishes a number of capital buffers, to be met by CET1 capital, broadly aligned with the Basel III framework. CRD IV contemplates that these will be

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phased in from 1 January 2016, subject to national discretion. Automatic restrictions on capital distributions apply if a bank s CET1 capital falls below the level of its CRD IV combined buffer. This is defined as the total of the capital conservation buffer (CCB), the countercyclical capital buffer (CCyB), the global systemically important institutions (G-SIIs) buffer and the systemic risk buffer (SRB) as these become applicable. The PRA have proposed that the use of the PRA buffer will not result in automatic restrictions on capital distributions.

In April 2014, HM Treasury published the statutory instrument Capital Requirements (Capital Buffers and Macro-Prudential Measures) Regulations 2014 transposing into UK legislation the main provisions in CRD IV related to capital buffers, with the exception of the SRB. In January 2015, HM Treasury published amendments to this statutory instrument in order to transpose the SRB.

The PRA is the designated authority for the G-SII buffer, the other systemically important institutions (O-SII s) buffer and the CCB. In April 2014, they published rules and supervisory statements implementing the main CRD IV provisions in relation to these buffers. The BoE is the designated authority for the CCyB and macro-prudential measures. Whilst the PRA and the FCA are the designated authorities for applying and determining the SRB, the FPC is responsible for creating the SRB framework for calibration.

The G-SII buffer (which is the EU implementation of the Basel G-SIB buffer) is to be met with CET1 capital and will be phased in from 1 January 2016. In October 2014, finalised Regulatory Technical Standards (RTS) on the methodology for identification of G-SIIs were published in the EU s Official Journal and came into effect from 1 January 2015. In November 2014 the Financial Stability Board (FSB) and the Basel Committee updated the list of G-SIBs, using end-2013 data. The add-on of 2.5% previously assigned to HSBC was left unchanged.

Following direction from the PRA to UK banks in its Supervisory Statement issued in April 2014, and in accordance with the EBA final draft Implementing Technical Standards (ITS) and guidelines published in June 2014, we published the EBA template in July 2014. This disclosed the information used for the identification and scoring process which underpins our G-SIB designation. The final ITS for disclosure requirements were published in September 2014, and will form the basis of our future 2015 disclosure of G-SII indicators.

The CCB was designed to ensure banks build up capital outside periods of stress that can be drawn down when losses are incurred and is set at 2.5% of RWAs. The PRA will phase-in this buffer from 1 January 2016 to 1 January 2019.

CRD IV contemplates a countercyclical buffer in line with Basel III, in the form of an institution-specific CCyB and the application of increased requirements to address macro-prudential or systemic risk. In January 2014, the FPC issued a policy statement on its powers to

supplement capital requirements, through the use of the CCyB and the sectoral capital requirements (SCR) tools.

The CCyB is expected to be set in the range of 0-2.5% of relevant credit exposures RWAs, although it is uncapped. Under UK legislation, the FPC is required to determine whether to recognise any CCyB rates set by other EEA countries before 2016.

In June 2014, the FPC set the CCyB rate for UK exposures at 0%. At its September 2014 meeting, the FPC left the CCyB rate for UK exposures unchanged at 0% and recognised the 1% CCyB rates introduced by Norway and Sweden to become effective from 3 October 2015. In January 2015, the HKMA announced the application of a CCyB rate of 0.625% to Hong Kong exposures, to apply from 1 January 2016. In accordance with UK legislation and PRA supervisory statement PS 3/14, this rate will directly apply to the calculation of our institution-specific CCyB rate from 1 January 2016. The institution-specific CCyB rate for the Group will be based on the weighted average of the CCyB rates that apply in the jurisdictions where relevant credit exposures are located. Currently the Group s institution specific CCyB is zero. The SCR tool is not currently deployed in the UK.

In addition to the measures above, CRD IV sets out a SRB for the financial sector as a whole, or one or more sub-sectors, to be deployed as necessary by each EU member state with a view to mitigating structural macro-prudential risk.

In January 2015, the legislative changes necessary to transpose the SRB were implemented. The SRB is to be applied to ring-fenced banks and building societies (over a certain threshold), which are together defined as SRB institutions . The SRB can be applied on an individual, sub-consolidated or consolidated basis and is applicable from 1 January 2019. By 31 May 2016, the FPC is required to create a framework for identifying the extent to which the failure or distress of SRB institutions will pose certain long-term non-cyclical systemic or macro-prudential risks. The PRA will apply this framework to determine whether specific SRB institutions would be subject to an SRB rate, and the level at which the buffer would be applied and is able to exercise supervisory judgment to determine what the rate should be. Where applicable, the buffer rate must be set in the range of 1% to 3%. The buffer rate would apply to all the SRB institution s exposures unless the PRA has recognised a buffer rate set in another member state. If the SRB is applied on a consolidated basis it is expected that the higher of the G-SII or SRB would apply, in accordance with CRD IV.

Under the Pillar 2 framework, banks are already required to hold capital in respect of the internal capital adequacy assessment and supervisory review which leads to a final determination by the PRA of individual capital guidance under Pillar 2A and Pillar 2B. Pillar 2A was previously met by total capital, but since 1 January 2015, in accordance with the PRA supervisory statement SS 5/13, is met with at least 56% CET1.

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Pillar 2A guidance is a point in time assessment of the amount of capital the PRA considers that a bank should hold to meet the overall financial adequacy rule. It is therefore subject to change pending annual assessment and the supervisory review process. During 2014, the Group Pillar 2A guidance amounted to 1.5% of RWAs, of which 0.9% was to be met by CET1. In February 2015, this was revised to 2.0% of RWAs, of which 1.1% is to be met by CET1 and is effective immediately.

In January 2015, the PRA published a consultation on the Pillar 2 framework. This set out the methodologies that the PRA proposed to use to inform its setting of firms Pillar 2 capital requirements, including proposing new approaches for determining Pillar 2 requirements for credit risk, operational risk, credit concentration risk and pension obligation risk.

As part of CRD IV implementation, the PRA proposed to introduce a PRA buffer, to replace the capital planning buffer (CPB) (known as Pillar 2B), also to be held in the form of CET1 capital. This was reconfirmed in the recent PRA consultation on the Pillar 2 framework. It is proposed that a PRA buffer will avoid duplication with CRD IV buffers and will be set for a particular firm depending on its vulnerability in a stress scenario or where the PRA has identified risk management and governance failings. In order to address weaknesses in risk management and governance, the PRA propose a scalar applied to firms CET1 Pillar 1 and Pillar 2A capital requirements. Where the PRA considers there is overlap between the CRD IV buffers and the PRA buffer assessment, the PRA proposes to set the PRA buffer as the excess capital required over and above the CCB and relevant systemic buffers. The PRA buffer will however be in addition to the CCyB and sectoral capital requirements.

The PRA expects to finalise the Pillar 2 framework in July 2015, with implementation expected from 1 January 2016. Until this consultation is finalised and revised rules and guidance issued, there remains uncertainty as to the exact buffer rate requirements, and their ultimate capital impact.

The FPC has been granted powers to give directions to the FCA or the PRA on the exercise of their supervisory powers, and may make recommendations within the BoE, to HM Treasury, to the FCA or the PRA or to other persons .

Within the BoE, the FPC is responsible for setting the CCyB rate and the use of direction powers over SCR s. The UK legislation enabled use of the CCyB and SCR tools from 1 May 2014. In January 2014, the FPC issued a policy statement on its powers to supplement capital requirements, through the use of the CCyB and the SCR tools. The CCyB allows the FPC to raise capital requirements above the micro-prudential level for all exposures to borrowers in the UK. The SCR is a more targeted tool which allows the FPC to increase capital requirements above minimum regulatory standards for exposures to three broad sectors judged to pose a risk to the stability of the financial system as a whole;

residential and commercial property; and, other parts of the financial sector, potentially on a global basis

The CCyB and SCR tools are stated as broad powers designed to reduce the likelihood and severity of financial crises, their primary purpose being to tackle cyclical risks. Both tools provide the FPC with means to increase the amount of capital that banks must have when threats to financial stability are judged to be emerging.

In October 2014, the FPC published final recommendations on the design of a UK specific leverage ratio framework and calibration. This followed an earlier FPC consultation in July 2014 on the design of the framework. HM Treasury published a consultation paper in November 2014, which responded to and agreed with the FPC recommendations in relation to the design of the leverage ratio framework. Specifically, HM Treasury agreed that the FPC should be granted powers to direct the PRA on a minimum requirement, additional leverage ratio buffer (for G-SIBs, major UK banks and building societies including ring fenced banks) and a countercyclical leverage ratio buffer (CCLB). In February 2015, HM Treasury published a summary of responses, alongside the draft instrument which was laid before Parliament. Further details of this can be found in the Capital section on page 255.

In the third quarter of 2014, and in response to UK government proposals, the FPC also recommended that HM Treasury exercise its statutory power to enable the FPC to direct the PRA and FCA to require UK regulated lenders to place limits on residential mortgage lending, both owner occupied and buy-to-let by reference to loan-to-value, debt-to income and interest coverage ratios. In February 2015, HM Treasury published a summary of responses to an earlier consultation. As part of this, HM Treasury laid secondary legislation before Parliament to provide the FPC with a new power of direction over the housing market.

There are a substantial number of other on-going regulatory initiatives affecting the Group driven by or from the UK. These include the UK bank levy, on-going implementation of requirements regarding recovery and resolution plans (RRP) and of the recommendations of the UK Independent Commission on Banking (ICB) and the Parliamentary Commission on Banking Standards (PCBS) in relation to ring-fencing of retail banking activities.

Legislation in respect of the UK bank levy was substantively created in July 2011, in the form of the Finance Act 2011 and the levy has been applied since January 2011. HSBC is a UK banking group for these purposes and the UK levy is chargeable on the Group s consolidated balance sheet at the year end. A charge of US$1,108m for the UK bank levy on the 2014 balance sheet has been recognised of which US$641m does not relate to UK banking activity.

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In relation to recovery and resolution planning, following the financial crisis, G20 leaders requested the Financial Stability Board (FSB) to establish more effective arrangements for the recovery and resolution of 28 (now 30) designated G-SIBs resulting in a series of policy recommendations in relation to recovery and resolution planning, cross border cooperation agreements and measures to mitigate obstacles to resolution.

In December 2013, the PRA set out rules for recovery and resolution of UK banks and international banks operating in the UK, which came into effect on 1 January 2014. In January 2015, the PRA published a policy statement containing updated requirements for recovery and resolution planning in order to implement the EU Bank Recovery and Resolution Directive (BRRD) which came into effect from 1 January 2015.

In addition to the developing rules in the UK relevant to the Group as a whole, many individual legal entities outside the UK are (or may in future be) subject to their own local requirements regarding RRP.

In December 2013, the UK s Financial Services (Banking Reform) Act 2013 (Banking Reform Act) received royal assent. It implements most of the primary recommendations of the ICB, which *inter alia* require large banking groups to ring-fence UK retail banking activity in a separately incorporated banking subsidiary (a ring-fenced bank) that is prohibited from engaging in significant trading activity. For these purposes, the UK excludes the Crown Dependencies. Ring-fencing will take effect from 1 January 2019.

In July 2014, secondary legislation was finalised. This included provisions further detailing the applicable individuals and enterprises to be transferred to the ring-fenced bank by reference to gross worth and turnover levels respectively. In addition, the secondary legislation places restrictions on the activities and geographical scope of ring-fenced banks.

In October 2014, the PRA published a consultation paper on ring-fencing rules in relation to legal structure, governance and continuity of services and facilities. The PRA also published a discussion paper concerning operational continuity in resolution. The PRA intends to undertake further consultation and finalise ring-fencing rules in due course. The PRA also published a discussion paper concerning operational continuity in resolution. As required by the PRA s consultation paper, a provisional ring-fencing project plan was presented to the UK regulators in November 2014. This plan provided for ring-fencing of the activities prescribed in the legislation, broadly the retail and SME services that are currently part of HSBC Bank plc (HSBC Bank), in a separate subsidiary.

In addition, the plan reflected the operational continuity expectations of each of the PRA s consultation and discussion papers by providing for the proposed enhancement of the ServCo Group. The plan remains subject to further planning and approvals internally and is ultimately subject to the approval of the PRA, FCA and other applicable regulators.

Further reforms currently in the process of implementation as a result of ICB and PCBS proposals

include the introduction of a new framework for individuals aimed at strengthening accountability in banking (including a new Senior Managers Regime) and new remuneration rules intended to strengthen the alignment between risk and reward. Whilst proposed by the PRA and FCA, these initiatives may have some effect on HSBC s staff and operations outside the UK and HSBC is actively engaged in consultations on and preparation for these new regimes.

At a national level in the UK, other relevant regulatory initiatives include a continued high levels of focus by the FCA on the management of conduct of business including attention to sales processes and incentives, product and investment suitability, product governance, employee activities and accountabilities as well as the risks of market abuse in relation to benchmark, index, other rate setting processes and wider trading activities and the financial crime (AML, sanctions and anti-bribery) agenda. The FCA also continues work to establish a new Payment Systems Regulator (PSR) in the UK with the intention of the PSR being operational by 1 April 2015.

The FCA continues to make increasing use of existing and new powers of intervention and enforcement, including powers to consider past business undertaken and implement customer compensation and redress schemes or other, potentially significant, remedial work. The FCA is also now regulating areas of activity not previously regulated by them, such as consumer credit, and considering competition issues in the markets they regulate.

These ongoing changes mean that the FCA and other regulators increasingly take actions in response to customer complaints or where they see poor customer outcomes and/or market abuses, either specific to an institution or more generally in relation to a particular product. There have been recent examples of this approach by regulators in the context of the mis-selling of payment protection insurance (PPI), interest rate hedging products to SMEs and wealth management products.

The FCA is also involved (along with HM Treasury) in the Fair and Effective Financial Markets Review, established by the UK Government in June 2014 and led by the BoE. This review was established with the aim of reinforcing confidence in the fairness and effectiveness of wholesale financial market activity in the UK and to influence the international debate on trading practices. Work to date includes considering the fairness and effectiveness of the fixed income, foreign exchange and commodities markets and the Review is expected to produce its final report by June 2015.

In a similar vein, on 6 November 2014, and following an earlier consultation, the UK Competition and Markets Authority (CMA) announced an in depth investigation into the supply of retail banking services to personal current account and to SME customers in the UK. The investigation is based on the CMA concerns that there are features of both sectors that (alone or in combination) it suspects prevent, restrict or distort competition. The CMA has indicated that it intends to

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notify provisional findings and possible remedies in September 2015 and the statutory deadline for the CMA s final report is 5 May 2016.

Either or both of these reviews could lead to the imposition of new or additional requirements or remedies which could affect the scope or operation of HSBC s activities in the UK.

Similarly, the UK and other regulators may identify future industry-wide mis-selling, market conduct or other issues that could affect the Group. This may lead from time to time to: (i) significant direct costs or liabilities; and (ii) changes in the practices of such businesses. Further, decisions taken in the UK by the Financial Ombudsman Service in relation to customer complaints (or any overseas equivalent that has jurisdiction) could, if applied to a wider class or grouping of customers, have a material adverse effect on the operating results, financial condition and prospects of the Group.

The FCA also continues to apply close scrutiny to the Group s financial crime control framework both generally in conjunction with the exercise of its wider powers under FSMA and more specifically under the FCA Direction as described above. This includes ongoing consideration of the Group s progress in meeting its obligations under the Deferred Prosecution Agreement and other commitments outlined below.

Hong Kong regulation and supervision

Banking in Hong Kong is subject to the provisions of the Banking Ordinance and to the powers, functions and duties ascribed by the Banking Ordinance to the Hong Kong Monetary Authority (the HKMA). The principal function of the HKMA is to promote the general stability and effective working of the banking system in Hong Kong. The HKMA is responsible for supervising compliance with the provisions of the Banking Ordinance. The Banking Ordinance gives power to the Chief Executive of Hong Kong to give directions to the HKMA and the Financial Secretary with respect to the exercise of their respective functions under the Banking Ordinance.

The HKMA has responsibility for authorising banks, and has discretion to attach conditions to its authorisation. The HKMA requires that banks or their holding companies file regular prudential returns, and holds regular discussions with the management of the banks to review their operations. The HKMA may also conduct on-site examinations of banks and, in the case of banks incorporated in Hong Kong, of any local and overseas branches and subsidiaries. The HKMA requires all authorised institutions to have adequate systems of internal control and requires the institutions external auditors, upon request, to report on those systems and other matters such as the accuracy of information provided to the HKMA. In addition, the HKMA may from time to time conduct tripartite discussions with banks and their external auditors.

The HKMA has the power to serve a notice of objection on persons if they are no longer deemed to be fit and proper to be controllers of the bank, if they may otherwise threaten the interests of depositors or potential depositors, or if they have contravened any conditions specified by the HKMA. The HKMA may revoke authorisation in the event of an institution s non-compliance with the provisions of the Banking Ordinance. These provisions require, among other things, the furnishing of accurate reports. The HKMA has implemented Basel II for all authorised institutions incorporated in Hong Kong and subsequently adopted Basel III from 1 January 2013, implementing in accordance with the Basel Committee on Banking Supervision s timetable, including transitional arrangements.

The marketing of, dealing in and provision of advice and asset management services in relation to securities and futures in Hong Kong are subject to the provisions of the Securities and Futures Ordinance of Hong Kong. Entities engaging in activities regulated by the Ordinance are required to be licensed. The HKMA is the primary regulator for banks involved in the securities business, while the Securities and Futures Commission (SFC) is the regulator for securities and futures markets. Amongst other functions, the Securities and Futures Ordinance vested the SFC with powers to set and enforce market regulations, including investigating breaches of rules and market misconduct and taking appropriate enforcement action. The SFC is responsible for licensing and supervising intermediaries seeking to conduct SFC regulated activities, for example investment advisors, fund managers and brokers. Additionally the SFC authorises investment products and offering documents prior to their distribution to retail investors.

US regulation and supervision

The Group is subject to extensive federal and state supervision and regulation in the US. Banking laws and regulations of the Board of Governors of the Federal Reserve System (the Federal Reserve Board), the Office of the Comptroller of the Currency (the OCC) and the Federal Deposit Insurance Corporation (the FDIC) (collectively, the US banking regulators) govern many aspects of our US business. Furthermore, since we have substantial operations outside the US which conduct many of their day-to-day transactions in US dollars which are ultimately cleared and settled in the US, HSBC entities operations outside the US are also subject to the extra-territorial effects of US regulation in many respects. The requirements of the Deferred Prosecution Agreement entered into by HSBC in December 2012 and described in this section under Anti-money laundering and related regulation should also be noted in this context.

In July 2010, the US enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which provided a broad framework for significant regulatory changes extending to almost every area of US financial regulation. The implementation of Dodd-Frank has required further detailed rulemakings by different US regulators, including the Department of the Treasury, the Federal Reserve Board, the FDIC, the SEC, the

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Commodity Futures Trading Commission (CFTC), the Financial Stability Oversight Council (FSOC) and the Consumer Financial Protection Bureau (CFPB). Notwithstanding the time that has passed since Dodd-Frank was enacted, uncertainty remains about some of the final details, timing and impact of the rules.

The Federal Reserve Board, in consultation with the FSOC may take certain actions, including precluding mergers, restricting financial products offered, restricting or terminating activities, imposing conditions on activities or requiring the sale or transfer of assets, against any bank holding company with assets greater than US$50bn that is found to pose a grave threat to financial stability. The FSOC is supported by the Office of Financial Research (OFR) which may impose data reporting requirements on financial institutions. The cost of operating both the FSOC and OFR is paid for through an assessment on large bank holding companies.

In January 2014, the Federal Reserve Board implemented the Basel III capital framework for bank holding companies such as HSBC North America Holdings Inc. (HNAH), which will phase in many of the requirements, including a minimum supplementary leverage ratio (SLR) of 3% and an effective minimum total risk-based capital ratio of 10.5% over a transition period from 2014 to 2019. The 10.5% ratio includes the capital conservation buffer which is not a minimum requirement, per se, but rather a necessary condition to capital distributions. Additionally, failure to maintain minimum regulatory ratios in simulated stress conditions, as required by the Federal Reserve Board s Comprehensive Capital Analysis and Review (CCAR) programme, will restrict HNAH from engaging in capital distributions such as dividends or share repurchases. In addition, large bank holding companies such as HNAH (or their parent companies) are required to file resolution plans identifying material subsidiaries and core business lines domiciled in the US, describing what strategy would be followed in the event of significant financial distress and including identifying how insured bank subsidiaries are adequately protected from risk created by other affiliates. If the Federal Reserve Board and the FDIC were to determine that these plans are not credible (which, although not defined, is generally believed to mean the regulators do not believe the plans are feasible or would otherwise allow the regulators to resolve the US businesses in a way that protects systematically important functions without severed systematic disruption and without exposing taxpayers to loss), our failure to cure the deficiencies in the required time period would enable the US regulators to impose more stringent capital, leverage and liquidity requirements, restrict the growth, activities or operations of the company or, if such failure persists, require the company to divest assets or operations. The Federal Reserve Board has also adopted final rules requiring a series of increased supervisory standards to be followed by large bank holding companies, and certain foreign banking organisations that meet particular thresholds, including stress testing requirements and risk management standards. These rules also authorise the Federal

Reserve to impose a 15-to-1 debt-to-equity ratio limit on non-bank financial companies, bank holding companies and the US operations of foreign banking organisations that the FSOC determines to pose a grave threat to the financial stability of the US.

In October 2012, the US banking regulators published a final rule setting out stress testing requirements for banking organisations. HNAH became subject to the rule from October 2013 and was required to comply with CCAR beginning with its capital plan submission in January 2014. In addition to the CCAR stress testing requirements, these regulations also include the Dodd-Frank stress testing requirements (DFAST), which require HNAH to undergo regulatory stress tests conducted by the Federal Reserve Board annually, and, to conduct and publish the results of its own internal stress tests semi-annually.

Under the CCAR process, the Federal Reserve Board considers a bank holding company s overall financial condition, risk profile and capital adequacy over a nine-quarter forward-looking planning horizon. The Federal Reserve Board assesses a bank holding company s ability to meet qualitative aspects of capital planning and risk management, as well as maintaining minimum regulatory ratios including a 5% Basel I tier 1 common equity ratio, for each quarter of the planning horizon under baseline, adverse and severely adverse economic scenarios. The Federal Reserve Board also takes into account a bank holding company s planned capital actions (such as dividends or share repurchases) over the planning horizon when assessing capital adequacy. If, based on such assessment, the Federal Reserve Board were to issue an objection to a bank holding company s capital plan or planned capital actions, the bank holding company would generally not be able to undertake planned capital actions until approved by the Federal Reserve Board. The Federal Reserve Board will publicly release a summary of its CCAR assessments each year and bank holding companies are also required to publicly release a summary of their stress test results under the supervisory severely adverse scenario.

On 26 March 2014, the Federal Reserve Board informed HNAH that it did not object to HNAH s capital actions, including payment of dividends on outstanding preferred stock and trust preferred securities of HNAH and its subsidiaries. The Federal Reserve Board informed HNAH that it did object to its capital plan submitted for the 2014 CCAR submission due to weaknesses in its capital planning processes. The Federal Reserve Board does not permit bank holding companies to disclose confidential supervisory information including the reason for an objection to a capital plan submitted for CCAR. HNAH submitted its 2015 CCAR capital plan, incorporating enhancements to its processes and which also served as the required re-submission for CCAR 2014, on 5 January 2015.

In July 2014, HNAH submitted its mid-year company-run Dodd-Frank Act Stress Test (DFAST) results. HNAH publicly disclosed its mid-cycle DFAST results, as required, in September 2014.

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In October 2014, the US banking regulators finalised a proposal to revise certain aspects of their rules pertaining to CCAR and DFAST. These revisions include, among other changes, new limitations on the ability of a bank holding company subject to CCAR to make capital distributions in a given quarter if its actual capital issuances in that quarter are less than the amount included in its capital plan. The final rule also shifts the start date of the annual CCAR capital plan and DFAST stress test cycles back by one calendar quarter. The 2015 cycle began on 1 October 2014, with a capital plan submission date on 5 January 2015. However, the next annual cycle will begin 1 January 2016 with a capital plan submission date of 5 April 2016.

In December 2014, the Federal Reserve Board published a proposal to implement the G-SIB buffer in the US. The proposed rule will only apply to US G-SIBs and will not therefore apply to HNAH.

HSBC and its US operations are subject to supervision, regulation and examination by the Federal Reserve Board because HSBC is a bank holding company under the US Bank Holding Company Act of 1956 (BHCA), as a result of its control of HSBC Bank USA, N.A., McLean, Virginia (HSBC Bank USA); and HSBC Trust Company (Delaware), N.A., Wilmington, Delaware (HTCD). HNAH is also a bank holding company . Both HSBC and HNAH have elected to be financial holding companies pursuant to the provisions of the Gramm-Leach-Bliley Act (the GLB Act) and, accordingly, may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature.

Under regulations implemented by the Federal Reserve Board, if any financial holding company, or any depository institution controlled by a financial holding company, ceases to meet certain capital or management standards, the Federal Reserve Board may impose corrective capital and/or managerial requirements on the financial holding company and place limitations on its ability to conduct the broader financial activities permissible for financial holding companies. In addition, the Federal Reserve Board may require divestiture of the holding company s depository institutions or its affiliates engaged in broader financial activities in reliance on financial holding company status under the GLB Act if the deficiencies persist. The regulations also provide that if any depository institution controlled by a financial holding company fails to maintain a satisfactory rating under the Community Reinvestment Act of 1977, the Federal Reserve Board must prohibit the financial holding company and its subsidiaries from engaging in any additional activities other than those permissible for bank holding companies that are not financial holding companies. See page 120 for further information on the regulatory consent orders with which HSBC Bank USA must comply in accordance with the agreement entered into with the Office of the Controller of the Currency (OCC) in December 2012 (the GLBA Agreement).

The two US banks, HSBC Bank USA and HTCD, are subject to regulation and examination primarily by the OCC. HSBC Bank USA and HTCD are subject to additional regulation and supervision, secondly by the FDIC, and by the Federal Reserve Board and the CFPB. Banking laws and regulations restrict many aspects of their operations and administration, including the establishment and maintenance of branch offices, capital and reserve requirements, deposits and borrowings, investment and lending activities, payment of dividends and numerous other matters. In addition, the FDIC requires FDIC-insured banks with US$50bn or more in total assets (such as HSBC Bank USA) to submit resolution plans that should enable the FDIC to resolve the bank in a manner that ensures that depositors receive access to their insured deposits within one business day of the institution s failure (two business days if the failure occurs on a day other than Friday), maximises the value from the sale or disposition of its assets and minimises the amount of any loss to be realised by the institution s creditors. HSBC and HSBC Bank USA submitted their second annual resolution plan jointly to the Federal Reserve Board and the FDIC on 26 June 2014.

In February 2014, the Federal Reserve Board finalised its rule requiring enhanced supervision of the US operations of non-US banks such as HSBC Holdings. The rule requires certain large non-US banks with significant operations in the United States to establish a single intermediate holding company (IHC) to hold their US bank and non-bank subsidiaries. HSBC currently operates in the US through an IHC structure and HNAH will be designated its IHC. The implementation of this rule, from 1 July 2016, will not have a significant impact on HSBC s US operations. HNAH submitted its IHC implementation plan to the Federal Reserve Board on 31 December 2014, as required.

An IHC may calculate its capital requirements under the US standardised approach, even if it meets the asset thresholds that would require a bank holding company to use the advanced approach. IHCs meeting these thresholds will still be subject to other applicable capital requirements, including the SLR and the countercyclical buffer (if in effect). The rule also provides that IHCs may opt out of the advanced approach and become subject to the standardised approach immediately upon the Federal Reserve Board s approval. In December 2014, HNAH received approval to opt out of the advanced approach. IHCs will be subject to all other US risk-based capital requirements, stress testing requirements, enhanced risk management standards and enhanced governance and stress testing requirements for liquidity management, as well as other prudential standards.

During 2014, HNAH reported its capital ratios in accordance with the US Basel III capital rules, applying the phase in provisions, and Basel I RWAs. From 1 January 2015, HNAH will report its capital ratios using US Basel III standardised RWAs.

In September 2014, the US banking regulators adopted revisions to the SLR denominator in the US to align with the final Basel leverage framework adopted in January

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2014. The changes apply to all advanced approach banking organizations subject to the SLR, including HNAH. The SLR is generally consistent with the Basel leverage framework, but also contains certain modifications, including the methodology for averaging total leverage exposure. HNAH must begin publicly disclosing its SLR in 2015, but the SLR does not become a binding regulatory requirement until 1 January 2018.

The US banking regulators have partially implemented the Basel liquidity framework, which includes two minimum liquidity risk measures. On 3 September 2014 the US banking regulators issued a final rule to implement the first of these measures, the liquidity coverage ratio (LCR), which is designed to ensure that a banking organisation maintains an adequate level of unencumbered high-quality liquid assets equal to the entity s expected net cash outflow for a 30-day time horizon under an acute liquidity stress scenario. The rule, which will apply to HNAH, is more stringent than the Basel III LCR in several respects. Starting on 1 January 2015, covered companies, including HNAH and HSBC Bank USA, are required to maintain an LCR of 80%, increasing annually by 10% increments and reaching 100% on 1 January 2017.

HSBC Bank USA and HTCD are subject to risk-based assessments from the FDIC, which insures deposits generally to a maximum of US$250,000 per depositor for domestic deposits. Dodd-Frank changes the FDIC s risk-based deposit insurance assessment framework primarily by basing assessments on an FDIC-insured institution s total assets less tangible equity rather than US domestic deposits, which is expected to shift a greater portion of the aggregate assessments to large FDIC-insured institutions. The new large bank pricing system will result in higher assessment rates for banks with high-risk asset concentrations, less stable balance sheet liquidity, or potentially higher loss severity in the event of failure. On 18 November 2014, the FDIC adopted further changes to the deposit insurance assessment system for large banks to align the assessment system with the standardised approach capital regulations and to eliminate all use of internal models.

HSBC s US consumer finance operations are subject to extensive state-by-state regulation in the US, and to laws relating to consumer protection (both in general, and in respect of sub-prime lending operations, which have been subject to enhanced regulatory scrutiny); discrimination in extending credit; use of credit reports; privacy matters; disclosure of credit terms; and correction of billing errors. These operations are subject to regulations and legislation that limit operations in certain jurisdictions.

On 10 December 2013, US regulators issued final regulations implementing the Volcker Rule. The Volcker Rule limits the ability of banking entities (including HSBC group companies outside the US) to sponsor or invest in private equity or hedge funds or to engage in certain types of proprietary trading in the US. The final rule extended the conformance period for all banking

entities until 21 July 2015, during which Financial institutions subject to the rule must bring their activities and investments into compliance. In December 2014, the Federal Reserve Board further extended by order the conformance period to 21 July 2016 for investments in and relationship with covered funds and foreign funds that were in place prior to 31 December 2013 (legacy covered funds). The Federal Reserve Board also indicated that it intends to act next year to grant additional one-year extension, until 21 July 2017, for the same legacy covered fund investments and relationships. The Group continues to update its existing conformance plans, to finalise adjustments necessary to its businesses and risk management and control frameworks both in the US and elsewhere, including establishing a defined Volcker Compliance programme and related CEO attestation processes to comply with the final rule.

Furthermore, Dodd-Frank provides for an extensive framework for the regulation of over-the-counter (OTC) derivatives by the CFTC and the SEC, including mandatory clearing, exchange trading and public and regulatory transaction reporting of certain OTC derivatives, as well as rules regarding the registration of swap dealers and major swap participants, and related capital, margin, business conduct, record keeping and other requirements applicable to such entities.

The CFTC has completed many of these most significant rulemakings, which came into effect in 2013 and 2014. In particular, HSBC Bank USA and HSBC Bank plc are provisionally registered as Swap Dealers with the CFTC. Because HSBC Bank plc is a non-US swap dealer, the CFTC generally limits its direct regulation of HSBC Bank plc to swaps with US persons and certain affiliates of US persons. However, the CFTC is considering whether to apply mandatory clearing, exchange trading, public transaction reporting, margin and business conduct rules to swaps with non-US persons arranged, negotiated or executed by US personnel or agents. The CFTC is also considering whether to apply regulatory transaction reporting to all swaps entered into by a non-US swap dealer or instead to rely on transaction reporting under comparable EU rules. The application of CFTC rules to HSBC Bank plc s swaps with non-US persons could have an adverse effect on the willingness of non-US counterparties to trade swaps with HSBC Bank plc and we continue to assess how developments in these areas will affect our business.

In June 2014, the SEC finalised rules regarding the cross-border application of the security-based swap dealer and major security-based swap participant definitions. These definitions share many similarities with parallel guidance finalised by the CFTC in July 2013. In January 2015, the SEC also finalised rules regarding reporting and public dissemination requirements for security-based swap transaction data. It is expected that the SEC will finalise many of its other OTC derivatives rules during 2015. If the SEC s rules differ significantly from the CFTC s rules, those differences could increase the costs of our equity and credit derivatives businesses.

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In September 2014, the US banking regulators and the CFTC re-proposed margin rules for non-cleared swaps and security-based swaps entered into with swap dealers, security-based swap dealers, major swap participants and major security-based swap participants. Under the re-proposals, such dealers and major participants would be required to collect and post initial and variation margin for non-cleared swaps and security-based swaps with financial end users that exceed a minimum volume of transactional activity. The two re-proposals would also limit categories of eligible collateral to cash, for variation margin, and cash and certain asset types (subject to standardized haircuts), for initial margin. The two re-proposals would follow a phased implementation schedule, with variation margin requirements coming into effect on 1 December 2015, and initial margin requirements phasing in annually for different counterparties from 1 December 2015 until 1 December 2019, depending on the transactional volume of the parties and their affiliates. Once finalised, these rules, as well as parallel rules outside the United States, are likely to increase the costs and liquidity burden associated with trading non-cleared swaps and security-based swaps and may adversely affect our business in such products.

Dodd-Frank also included a swaps push-out provision that would have effectively limited the range of OTC derivatives activities in which an insured depository institution may engage, including HSBC Bank USA. The scope of this rule was significantly reduced in December 2014 and the provisions will now effectively only restrict HSBC Bank USA s ability to deal in certain structured finance swaps that it entered into after 16 July 2015 and are not entered into for hedging or risk mitigation purposes.

Furthermore, Dodd-Frank provides for an extensive framework for the regulation of over-the-counter (OTC) derivatives, including mandatory clearing, exchange trading and transaction reporting of certain OTC derivatives, as well as rules regarding the registration of swap dealers and major swap participants, and related capital, margin, business conduct, record keeping and other requirements applicable to such entities. These rules became effective in October 2012 and HSBC Bank USA and HSBC Bank plc are provisionally registered as Swap Dealers with the CFTC.

Dodd-Frank grants the SEC discretionary rule-making authority to modify the standard of care that applies to brokers, dealers and investment advisers when providing personalised investment advice to retail customers and to harmonise other rules applying to these regulated entities. Dodd-Frank also expands the extraterritorial jurisdiction of US courts over actions brought by the SEC or the US with respect to violations of the anti-fraud provisions in the Securities Act, the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940. In addition, regulations which the FSOC, the CFPB or other regulators may adopt could affect the nature of the activities which our FDIC-insured depository institution subsidiaries may conduct, and may impose restrictions and limitations on the conduct of such activities.

The ongoing implementation of Dodd-Frank and related final regulations could result in additional costs or limit or restrict the way we conduct our business, both in relation to our US operations and our non-US operations, although uncertainty remains about many of the details, impact and timing of these reforms and the ultimate effect they will have on HSBC.

Global and regional prudential and other regulatory developments

The Group is subject to regulation and supervision by a large number of regulatory bodies and other agencies. In addition to changes being pursued at a country level, changes are also being pursued globally through the actions of bodies such as the G-20, the FSB and Basel Committee, as well as regionally through the EU and similar. Key areas include the work of the FSB on global systemically important banks (G-SIBs), Basel Committees development of revised standardised approaches across a number of risk areas, and the FSB s development of requirements for total loss absorbing capacity.

In November 2014, as part of the too big to fail agenda, the FSB published proposals for total loss absorbing capacity (TLAC) for G-SIBs. The FSB proposals include a minimum TLAC requirement in the range of 16-20% of RWAs and a TLAC leverage ratio of at least twice the Basel III Tier 1 leverage ratio. The TLAC requirement is to be applied in accordance with individual resolution strategies, as determined by the G-SIB s crisis management group. A quantitative impact study (QIS) is currently underway, the results of which will inform finalised proposals. The QIS will inform the conformance period for the TLAC requirement, which is not expected to come into place before 1 January 2019. Once finalised, it is expected that any new TLAC standard should be met alongside the Basel III minimum capital requirements.

The draft proposals require G-SIBs to be subject to a minimum TLAC requirement with the precise requirement to be informed by the QIS. There are a number of requirements relating to the types of liabilities which can be used to meet the TLAC requirement, the composition of TLAC, and the location of liabilities within a banking group, in accordance with its resolution strategy. The TLAC proposals are expected to be finalised in 2015 and will then need to be implemented into national legislation.

Throughout 2014, the Basel Committee published proposals across all Pillar 1 risk types, to update standardised, non-modelled approaches for calculating capital requirements and to provide the basis for the application of capital floors.

In particular, in March 2014, the Basel Committee published finalised proposals for the standardised approach for calculating counterparty credit risk exposures, expected to come into effect on 1 January 2017.

In October 2014, the Basel Committee also consulted on proposals to revise the standardised approach for calculating operational risk. An implementation date is

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yet to be proposed. Also in October 2014, the Basel Committee finalised another aspect of the Basel III liquidity framework the Net Stable Funding Ratio (NSFR). The NSFR is a significant component of the Basel III reforms. It requires banks to maintain a stable funding profile in relation to their on- and off-balance sheet activities, thus reducing the likelihood that disruptions to a bank s regular sources of funding will erode its liquidity position in a way that could increase the risk of its failure and potentially lead to broader systemic stress. Further details on NSFR can be found on page 164.

In December 2014, the Basel Committee undertook a further consultation on its fundamental review of the trading book. This included revisions to the market risk framework that was published for consultation in October 2013. The Committee intends to carry out a further QIS in early 2015 to inform finalised proposals expected at the end of 2015.

In December 2014, the Basel Committee published a revised framework for securitisation risk, which will come into effect on 1 January 2018.

In December 2014, the Basel Committee also published a consultation paper on revisions to the Standardised Approach for credit risk and a consultation on the design of a capital floor framework, which will replace the Basel I floor. The Committee intends to publish final proposals including calibration and implementation timelines by the end of 2015.

All finalised Basel Committee proposals for standardised approaches for calculating risk requirements and introduction of a revised capital floor would need to be transposed into EU requirements before coming into effect.

Recovery and resolution

Globally there have been a number of developments relating to banking structural reform and the introduction of recovery and resolution regimes.

As recovery and resolution planning has developed, some regulators and national authorities have also required changes to the corporate structures of banks. These include requiring the local incorporation of banks or ring-fencing of certain businesses. In the UK, ring-fencing legislation has been enacted requiring the separation of retail and Small and Medium Size Enterprise (SME) deposits from trading activity. Similar requirements have been introduced or are in the process of being introduced in other jurisdictions.

The FSB has been designated by the G-20 as the body responsible for coordinating the delivery of a global reform programme following the financial crisis, a key element of which is that no firm should be too big or too complicated to fail, and that taxpayers should not bear the cost of resolution. HSBC has been classified by the FSB as a G-SIB and therefore subject to what the FSB refers to as a multi-pronged and integrated set of policies . These include proposals that would place an

additional capital and TLAC buffer on the Group and require enhanced reporting.

Following the financial crisis, G20 leaders requested the FSB to establish more effective arrangements for the recovery and resolution of 28 (now 30) designated Global Systemically Important Banks or Financial Institutions (G-SIB s or G-SIFI s) resulting in a series of policy recommendations in relation to recovery and resolution planning, cross border cooperation agreements and measures to mitigate obstacles to resolution.

In December 2013, the PRA set out rules for the recovery and resolution of UK banks and international banks operating in the UK. These rules were modified as part of the implementation of the EU Bank Recovery and Resolution Directive from January 2015.

We have been working with the Bank of England and the PRA together with the Group s other primary regulators that together form the Crisis Management Group (CMG) to develop and agree a resolution strategy for the HSBC Group. It is our view that a resolution strategy whereby the Group breaks up at a subsidiary bank level at the point of resolution (referred to as a Multiple Point of Entry strategy) rather than being kept together as a group at the point of resolution (referred to as Single Point of Entry strategy) is the optimal approach as it is aligned to the Group s existing legal and business structure.

In common with all G-SIBs, we are working with our regulators in the CMG to understand inter-dependencies between different businesses and subsidiary banking entities in the HSBC Group in order to enhance resolvability.

We have initiated plans to mitigate or remove critical inter-dependencies to further facilitate the resolution of the Group. In particular, in order to remove operational dependencies (where one subsidiary bank provides critical services to another), we have determined to transfer such critical services from the subsidiary banks to a separately incorporated group of service companies (ServCo Group). A significant portion of the ServCo group already exists and therefore this initiative involves transferring the remaining critical services still held by subsidiary banks into the ServCo Group. The services will then be provided to the subsidiary banks by the ServCo Group.

In accordance with guidance from the FSB and UK requirements, HSBC has produced a recovery plan for the Group, drawing together many of the actions contained in stress testing and scenario planning exercises conducted within the Group. The recovery plan identify a series of early warning signals indicative of developing financial stress and establishes triggers which, if breached, would precipitate pre-planned but urgent action from the Group. The plan also contains a series of recovery options to raise additional capital or funding for the Group or individual entities as appropriate. These options would be reviewed for applicability and feasibility once the cause and magnitude of the financial stress was evident. The Group recovery plan has been submitted to the PRA and the BoE in the UK.

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European regulation

Through the UK s membership of the EU, HSBC is both directly and indirectly subject to European financial services regulation.

CRD IV implemented Basel III in the EU and, in the UK, the PRA rulebook CRR Firms Instrument 2013 transposed the various national discretions under CRD IV into UK law. CRD IV and the PRA requirements came into force on 1 January 2014.

Additionally, the EU is implementing its Banking Union to increase integration in the Eurozone banking system. As part of this, in November 2014, the Single Supervisory Mechanism (SSM) established the ECB as the single supervisor for all banks in the Eurozone with direct supervisory responsibility for larger and systemically important banks, including HSBC France and HSBC Malta. A Single Resolution Mechanism (SRM) was also established to apply to all banks covered by the SSM. This is intended to ensure that bank resolution is managed effectively through a Single Resolution Board and a Single Resolution Fund, financed by the banking sector.

Non-Eurozone countries within the EU may opt to join the Banking Union, but the UK has indicated that it will not do so.

In January 2014, the European Commission published legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors, at their discretion, to require trading activities such as market-making, complex derivatives and securitisation operations to be undertaken in a separate subsidiary from deposit taking activities.

The ring-fenced deposit taking entity would be subject to separation from the trading entity including requirements for separate capital and management structures, issuance of own debt and arms-length transactions between entities.

The draft proposals contain a provision which would permit derogation by member states which have implemented their own structural reform legislation, subject to meeting certain conditions. This derogation may benefit the UK in view of the UK Financial Services (Banking Reform) Act 2013.

The proposals are currently subject to discussion in the European Parliament and the Council. The implementation date for any separation under the final rules would depend upon the date on which the final legislation is agreed.

In the EU, BRRD was finalised and published in June 2014. This came into effect from 1 January 2015, with

the option to delay implementation of bail-in provisions until 1 January 2016. Regardless of this, the UK introduced bail in powers from 1 January 2015. The UK transposition of the BRRD builds on the resolution framework already in place in the UK. In January 2015, the PRA published a policy statement containing updated requirements for recovery and resolution planning which revises PRA rules that have been in force since 1 January 2014. In addition, the European Banking Authority has produced a number of RTS, some of which are yet to be finalised, that will further inform the BRRD requirements.

The EU also continues to pursue the development of markets, and conduct-related EU regulations. This includes its work under e.g. the Short Selling Regulation and the European Markets Infrastructure Regulation, most or all parts of which have been or are now being implemented. A number of other EU market-related regulations are still in the legislative process. For example, in 2014 the Markets in Financial Instrument Regulation/Directive (MiFID II) and the Market Abuse Regulation texts were finalised and the EU legislative process is now focused on agreeing the supplementary technical standards and delegated acts ahead of implementation in 2016/2017. Amongst others, the EU s Framework for Benchmarks and Indices, Mortgage Credit Directive, Packaged Retail Investment and Insurance Products Regulation, Second Payment Services Directive, Money Markets Fund Regulation and Payment Accounts Directive are all expected to progress further towards implementation during 2015 and the Group continues to enhance and strengthen its governance and resourcing more generally around regulatory change management and the implementation of required measures, actively to address this ongoing and significant agenda of regulatory change.

Anti-money laundering and Sanctions regulation

HSBC places a high priority on its obligations to deter money laundering and terrorist financing and to enforce global sanctions. The European Commission has proposed a Fourth Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (known as the Fourth Money Laundering Directive). Political agreement between the European Council and European Parliament has been reached on the text of the Directive and it is due to go forward for further review and endorsement before being put to a vote in the European Parliament in 2015, meaning that the new regime is likely to come into force in 2016. HSBC policy requires that all Group companies must adhere to the letter and spirit of all applicable laws and regulations and we have policies, procedures and training intended to ensure that our employees know and understand our criteria for deciding when a client relationship or business should be evaluated as higher risk.

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Risk mitigation measures aimed at deterring money laundering, terrorist and proliferation (weapons) financing (collectively referred to as AML) and enforcing Sanctions have been focused in three key areas:

- managing risk;
- transitioning to a new operating and governance model; and
- meeting HSBC s regulatory obligations.

HSBC met all obligations due in 2014 under the Deferred Prosecution Agreement with the US Department of Justice. Furthermore, HSBC s Deferred Prosecution Agreement with the New York County District Attorney s Office expired on 11 December 2014.

To maximise information sharing across the Group, two key units were formed in 2014: the Financial Intelligence Unit (FIU) and AML Investigations (AMLi). The FIU has been built out with the global team and five regional hubs in place. Additionally, six country FIUs have also been implemented. An AMLi function has been trained in eight priority countries with further resources operating across another 53 countries. The next tranche of 11 countries will begin to adopt AMLi global standards in 2015.

Enhanced global AML and sanctions policies, incorporating risk appetite, were approved by the Board in January 2014. The policies adopt and enforce the highest or most effective standards globally, including a globally consistent approach to knowing our customers.

The Policies are being implemented in phases through the development and application of procedures required to embed those policies in our day to day business operations globally. The overriding policy objective is for every employee to engage in only the right kind of business, conducted in the right way .

Conducting customer due diligence (CDD) is one of the fundamental ways in which we know our customers and understand and manage financial crime risk. Enhanced minimum standards for CDD, including, as applicable, standards to determine beneficial ownership information, are continuing to be deployed across the four global businesses. In-country CDD deployment has been initiated in 32 countries, with deployment to the remaining 29 countries driven by a risk prioritisation framework.

The AML and sanctions programmes are being better aligned to the three lines of defence model (described on page 112) with roles and accountability across all three lines clearly set out and embedded through employee awareness initiatives.

As part of our continuing evaluation of AML and sanctions risk, we also monitor activities relating to the countries subject to US economic sanctions programmes administered by OFAC, as well as those subject to United Nations, UK and EU sanctions. HSBC Group Policy requires all Group companies to comply to the extent applicable with US law and regulation, including the country, territory and individual economic sanctions (US Sanctions). This means that not only must US subsidiaries and US nationals comply with US Sanctions, but that HSBC subsidiaries outside the US which are not

US persons must not participate in transactions within US jurisdictions (including most US dollar transactions) that would contravene the US Sanctions. We do not consider that our business activities with counterparties with whom transactions are restricted or prohibited under US Sanctions are material to our business, and such activities represented a very small part of the Group s total assets at 31 December 2014 and total revenues for the year ended 31 December 2014.

Other

HSBC Bank USA entered into a Consent Cease and Desist Order with the OCC, and HNAH entered into a Consent Cease and Desist Order with the Federal Reserve Board in October 2010. These Orders require improvement of our Compliance Risk Management Programme including AML controls across our US businesses. Steps continue to be taken to address the requirements of these Orders and to ensure that compliance and effective policies and procedures are maintained.

Disclosures pursuant to Section 13(r) of the Securities Exchange Act

Section 13(r) of the Securities Exchange Act, requires each issuer registered with the SEC to disclose in its annual or quarterly reports whether it or any of its affiliates have knowingly engaged in specified activities or transactions with persons or entities targeted by US Sanctions programmes relating to Iran, terrorism, or the proliferation of weapons of mass destruction, even if those activities are not prohibited by US law and are conducted outside the US by non-US affiliates in compliance with local laws and regulations.

In order to comply with this requirement, HSBC Holdings Plc (together with its affiliates, HSBC) has requested relevant information from its affiliates globally. The following activities are disclosed in response to Section 13(r).

Loans in repayment

Between 2001 and 2005, the Project and Export Finance (PEF) division of HSBC arranged or participated in a portfolio of loans to Iranian energy companies and banks. All of these loans were guaranteed by European and Asian export credit agencies, and they have varied maturity dates with final maturity in 2018. For those loans that remain outstanding, we continue to seek repayment in accordance with our obligations to the supporting export credit agencies and, in all cases, with appropriate regulatory approvals. Details of these loans follow.

At December 31, 2014, we had 11 loans outstanding to an Iranian petrochemical company. These loans are supported by the official Export Credit Agencies of the following countries: the United Kingdom, France, Germany, Spain, South Korea and Japan. We continue to seek repayments from the company under the existing loans in accordance with the original maturity profiles.

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All repayments made by the Iranian company have received a licence or an authorisation from relevant authorities. Two repayments were received under each loan in 2014.

Bank Melli and Bank Saderat acted as sub-participants in three of the aforementioned loans. The repayments due to these banks under the loan agreements were paid into frozen accounts under licences or authorisations from relevant European governments.

In 2002, we provided a loan to Bank Tejarat with a guarantee from the Government of Iran to fund the construction of a petrochemical plant undertaken by a UK contractor. This loan was supported by the UK Export Credit Agency and is administered under licence from the relevant European Government. This facility has now matured and the final claim for non-payment was processed by the supporting Export Credit Agency in 2014.

We also maintained sub-participations in four loans provided by other international banks to Bank Tejarat and Bank Mellat with guarantees from the Government of Iran. These sub-participations were supported by the Export Credit Agencies of Italy, The Netherlands and Spain.

With respect to Bank Mellat, we held two sub-participations in loans provided by another internal bank to Bank Mellat with a guarantee from the Government of Iran, supported by the Dutch and Spanish Export Credit Agencies. The facilities have matured and the final claims for non-payment were processed by the supporting export credit agency in 2014.

In relation to Bank Tejarat, we held two sub-participations in loans provided by another international bank to Bank Tejarat with a guarantee from the Government of Iran, supported by the Italian Export Credit Agency. Both facilities matured in 2014. The final claim for non-payment on one of the transactions was paid by the Italian Export Credit Agency in 2014 and the claim for the other transaction is currently being processed with the Italian Export Credit Agency. Licenses and relevant authorisations have been obtained from the competent authorities of the European Union with regard to the transactions.

Estimated gross revenue generated by these loans in repayment for 2014, which includes interest and fees, was approximately US$1.7m whilst net estimated profit was approximately US$1.1m. While we intend to continue to seek repayment under the existing loans, we do not intend to extend any new loans.

Legacy contractual obligations related to guarantees

Between 1996 and 2007, we provided guarantees to a number of its non-Iranian customers in Europe and the Middle East for various business activities in Iran. In a number of cases, we issued counter indemnities in support of guarantees issued by Iranian banks as the Iranian beneficiaries of the guarantees required that they be backed directly by Iranian banks. The Iranian

banks to which we provided counter indemnities included Bank Tejarat, Bank Melli, and the Bank of Industry and Mine.

We have worked with relevant regulatory authorities to obtain licences where required and ensure compliance with laws and regulations while seeking to cancel the guarantees and counter indemnities. None were cancelled during 2014 and approximately 20 remain outstanding.

There was no measurable gross revenue generated by this activity in 2014. We do not allocate direct costs to fees and commissions, and therefore, have not disclosed a separate net profit measure. We are seeking to cancel all relevant guarantees and do not intend to provide any new guarantees involving Iran.

Other relationships with Iranian banks

Activity related to US-sanctioned Iranian banks not covered elsewhere in this disclosure includes the following:

- We maintain a frozen account in the UK for an Iranian-owned, UK-regulated financial institution. In April 2007, the UK government issued a licence to allow us to handle certain transactions (operational payments and settlement of pre-sanction transactions) for this institution. In December 2013, the UK government issued a new licence allowing HSBC to deposit certain cheque payments. There was some licensed activity in 2014.

- We acted as the trustee and administrator for pension schemes involving four employees of a US-sanctioned Iranian bank in Hong Kong. Under the rules of these schemes, we accepted contributions from the Iranian bank each month and allocated the funds into the pension accounts of the four Iranian bank employees. We ran and operated these pension schemes in accordance with Hong Kong laws and regulations. During 2014, one of the two schemes was terminated and the only member and accrued benefits were transferred into the other scheme. Notices of resignation were received for two employees and accrued benefits were transferred into the former members personal accounts. We continue to act as trustee and administrator for the remaining pension scheme.

In 2010, we closed our representative office in Iran. We maintained a local account with an Iranian bank in Tehran in order to facilitate residual activity related to the closure. We were authorised by the US Government (and by relevant non-US regulators) to engage in such activity in connection with the liquidation and deregistration of the representative office in Tehran. During 2014, we initiated a payment of approximately US$55,000 into the account and paid fees in the amount of approximately US$90,500 from the account to settle tax assessments. Funds from this account were also used to pay outstanding and future accounting, legal and administrative related expenses associated with the closure. All debts have been satisfied and the account was closed with a zero balance in the fourth quarter of 2014.

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Estimated gross revenue in 2014 for all Iranian bank-related activity described in this section, which includes fees and/or commissions, was approximately US$585,370. We do not allocate direct costs to fees and commissions and therefore have not disclosed a separate net profit measure. We intend to continue to wind down this Iranian bank-related activity and not enter into any new such activity.

Activity related to US Executive Order 13224

We maintain a frozen personal account for an individual sanctioned under Executive Order 13224 and by the UK and the UN Security Council. Activity on this account in 2014 was permitted by a licence issued by the UK Government. There was no measurable gross revenue or net profit generated in 2014.

We undertook a review of an account held for a customer in the UK in the first quarter of 2014 and identified a domestic currency payment in the second quarter of 2013 from an entity designated under Executive Order 13224. We have exited this customer relationship.

Activity related to US Executive Order 13382

We held accounts for a customer in France that was sanctioned under Executive Order 13382 in the first quarter of 2014. We closed all accounts for the customer. There was no measurable gross revenue or net profits generated to HSBC in the first quarter of 2014. OFAC removed the designation placed on the customer in October 2014. We also maintain an account for a customer in the UK for whom we processed a payment received from the same sanctioned entity. The payment related to an invoice generated prior to designation.

We held an account for a customer in the Middle East who was sanctioned under Executive Order 13382 in the first quarter of 2014. We closed the account in the second quarter. There was no measurable gross revenue or net profit generated in the first and second quarters of 2014.

We held an account and an investment plan for a customer that was a wholly owned subsidiary of an entity sanctioned under Executive Order 13382. Sanctions were lifted from the parent entity in the third quarter of 2014. The account was closed in the fourth quarter of 2014 and the investment plan is active. The investment plan matures in 2015, and we intend to exit the customer relationship. The estimated gross revenue and the estimated net profits generated to HSBC were approximately US$2,000 in 2014.

Other activity

We hold a lease of branch premises in London which HSBC entered into in 2005 and is due to expire in 2020. The premises are owned by the Iranian government and the landlord is a specially designated national under US Sanctions programmes. We have exercised a break clause in the lease and are in the process of exiting the property. The relationship will be terminated in 2015 and we closed the branch in the third quarter of 2014. There was no gross revenue or net profit to HSBC in 2014.

We maintain an account for a customer in the US for whom we processed cheques involving the Iranian Interests Section of the Embassy of Pakistan in relation to intellectual property protection in Iran. The estimated gross revenue and estimated net profits generated to HSBC were approximately US$48 in 2014.

We maintain an account for a corporate customer in UAE for whom we processed a supplier payment to a hospital owned by the Government of Iran. There was no measurable gross revenue or net profit to HSBC in 2014.

Frozen accounts and transactions

We maintain several accounts that are frozen under relevant sanctions programmes and on which no activity, except as licensed or otherwise authorised, took place during 2014. In 2014, we also froze payments where required under relevant sanctions programmes. There was no gross revenue or net profit to HSBC.

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1 *Appendix to Risk risk policies and practices.*

2 *Unaudited.* 3 *Audited.* 4 *Audited where indicated.*

For details of HSBC s policies and practices regarding risk management and governance see the Appendix to Risk on page 204.

Risk profile

(Unaudited)

Managing our risk profile

A strong balance sheet remains core to our philosophy.

Our portfolios continue to be aligned to our risk appetite and strategy.

Our risk management framework is supported by strong forward-looking risk identification.

Maintaining capital strength and a strong liquidity position

Our transitional common equity tier 1 capital ratio remains strong at 10.9%.

We have sustained our strong liquidity position throughout 2014.

The ratio of customer advances to deposits remains significantly below 90%.

Strong governance

Robust risk governance and accountability is embedded across the Group.

The Board, advised by the Group Risk Committee, approves our risk appetite.

Our global risk operating model supports adherence to globally consistent standards and risk management policies across the Group.

Our top and emerging risks

Macroeconomic and geopolitical risk.

Macro-prudential, regulatory and legal risks to our business model.

Risks related to our business operations, governance and internal control systems.

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Risk factors

(Unaudited)

Macroeconomic and geopolitical risk

Current economic and market conditions may adversely affect our results

Our earnings are affected by global and local economic and market conditions. Economic growth in emerging markets remained weak in 2014, while concerns remained over the sustainability of economic growth in many developed markets. The significant decline in oil prices since the middle of 2014 as a result of increasing global demand-supply imbalances may lead to fiscal and financing challenges for energy exporters, and although it may bring benefits for oil importers, it also accentuates deflationary risks among some of these (particularly in the eurozone).

The uncertain economic conditions continue to create a challenging operating environment for financial services companies such as HSBC. In particular, we may face the following challenges to our operations and operating model in connection with these factors:

- the demand for borrowing from creditworthy customers may diminish if economic activity slows or remains subdued;

- as capital flows are increasingly disrupted, some emerging markets could be tempted to impose protectionist measures that could affect financial institutions and their clients;

- European banks may come under renewed stress as a result of the interdependencies between economic conditions and the sovereign financial situation in the eurozone;

- geopolitical risks, which remain elevated in many parts of the world, directly affect the economies of the countries in which we operate and present a clear risk of disruption to the global economy due to links to the global resources supply chain;

- a prolonged period of low, or negative, interest rates will constrain, for example, through margin compression and low returns on assets, the net interest income we earn from investing our excess deposits;

our ability to borrow from other financial institutions or to engage in funding transactions may be adversely affected by market disruption, for example, in the event of contagion from stress in the eurozone sovereign and financial sectors; and

market developments may depress consumer and business confidence beyond expected levels. If economic growth remains subdued, for example, asset prices and payment patterns may be adversely affected, leading to greater than expected increases in our delinquencies, default rates, write-offs and loan impairment charges.

The occurrence of any of these events or circumstances could have a material adverse effect on our business, our financial condition, our prospects, our customers and their operations and/or results of our operations.

We are subject to political and economic risks in the countries in which we operate, including the risk of government intervention

We operate through an international network of subsidiaries and affiliates in over 70 countries and territories around the world. Our results are, therefore, subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and changes in government policies on such matters as expropriation, authorisations, international ownership, interest-rate caps, limits on dividend flows and tax in the jurisdictions in which we operate.

For example, military escalation and/or civil war remain a possibility in Ukraine, while sanctions targeting the Russian government, institutions and individuals, together with falling oil prices, have had an adverse effect on the Russian economy. In the Middle East, the civil war in Syria has been complicated by the seizure of parts of Iraq and Syria by Islamic State, a terrorist group. Elsewhere in the region, chaos in Libya, ongoing tensions between Israel and Palestine and fraught negotiations over Iran s nuclear programme are combining to increase risks to stability. In East Asia, tensions over maritime sovereignty disputes involving mainland China and its neighbours may intensify, while tensions remain high over the line of control between India and Pakistan, raising concerns over a possible wider conflict between the two nuclear-armed neighbours. A break-up of the eurozone or continued social unrest triggered by the ongoing economic crisis and related austerity programmes may result in political or social disruption throughout Europe.

We may suffer adverse effects as a result of the renewed economic and sovereign debt tensions in the eurozone

Although in recent years the EU has introduced a series of legislative changes designed to better equip it to deal with a financial crisis and to reduce the risks of contagion in the event of an EU member country experiencing financial difficulties, the outcome of current negotiations on the terms of the Greek bail out is highly uncertain. The debt may be rescheduled or Greece may default on its debts; there is also the possibility that Greece may eventually exit the euro.

Any default on the sovereign debt of Greece or any eurozone nation and the resulting impact on other eurozone countries could have a material adverse effect on us, including (a) significant market dislocation, (b) heightened counterparty risk and (c) an adverse effect on the management of market risk.

Moreover, a significant number of financial institutions throughout Europe have substantial exposures to sovereign debt issued by eurozone nations that are under severe financial stress. Should any of those nations default on their debt, or experience a significant widening of credit spreads, major financial institutions and banking systems throughout Europe could be destabilised, resulting in, among other things, significant disruptions in financial activities.

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As a result, a default on the sovereign debt of any eurozone nation may have a material adverse effect on our operating results, financial condition and prospects.

Changes in foreign currency exchange rates may affect our results

We prepare our accounts in US dollars because the US dollar and currencies linked to it form the major currency bloc in which we transact and fund our business. A substantial portion of our assets, liabilities, assets under management, revenues and expenses are denominated in other currencies. Changes in foreign exchange rates, including those which may result from a currency becoming de-pegged from the US dollar, have an effect on our reported income, cash flows and shareholders equity and may have a material adverse effect on our business, prospects, financial condition and/or results of operations.

Macro-prudential, regulatory and legal risks to our business model

Failure to implement our obligations under the deferred prosecution agreements could have a material adverse effect on our results and operations

In December 2012, HSBC Holdings, HSBC North America Holdings, Inc (HNAH), and HSBC Bank USA N.A. (HSBC Bank USA) entered into agreements with US and UK government agencies regarding past inadequate compliance with the US Bank Secrecy Act (the BSA), anti-money laundering (AML) and sanctions laws. Among other agreements, HSBC Holdings and HSBC Bank USA entered into a five-year Deferred Prosecution Agreement with the US Department of Justice (DoJ), the US Attorney s Office for the Eastern District of New York, and the US Attorney s Office for the Northern District of West Virginia (US DPA); HSBC Holdings entered into a two-year deferred prosecution agreement with the New York County District Attorney (DANY DPA); and HSBC Holdings consented to a cease-and-desist order and HSBC Holdings and HNAH consented to a civil monetary penalty order with the Federal Reserve Board (FRB). In addition, HSBC Bank USA entered into a civil monetary penalty order with the Financial Crimes Enforcement Network and a separate civil monetary penalty order with the Office of the Comptroller of the Currency (OCC). HSBC Holdings entered into an agreement with the Office of Foreign Assets Control (OFAC) regarding historical transactions involving parties subject to OFAC sanctions and an undertaking with the FSA (now the FCA) to comply with certain forward-looking obligations with respect to AML and sanctions requirements (FCA Direction). HSBC Bank USA is also subject to an agreement entered into with the OCC, the Gramm-Leach-Bliley Act (GLBA) Agreement and other consent orders.

Under the agreements with the DoJ, FCA and FRB , an independent monitor (who is, for FCA purposes, a skilled person under Section 156 of the Financial Services and

Markets Act) is evaluating and regularly assessing the effectiveness of our AML and sanctions compliance function and our progress in implementing our remedial obligations under the agreements. The Monitor began his work on 22 July 2013.

HSBC has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two-year period of that agreement in December 2014.

Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA. Any such breach of the US DPA or the FCA Direction leading to further enforcement action, including the prosecution of HSBC, would have a material adverse effect on our business, financial condition, results of operations and prospects, including the potential significant loss of business and withdrawal of funding.

HSBC Bank USA, as clearer for all US dollar transactions for HSBC globally, manages a significant AML risk in the global correspondent banking area because of its breadth and scale, especially as it relates to transactions involving affiliates and global correspondent banks in high risk AML jurisdictions. A significant AML violation in this area or the utilisation of the global affiliate and correspondent banking network by terrorists or other perpetrators of financial crimes could have materially adverse consequences under the US DPA or our other consent agreements. The design and execution of AML and sanctions remediation plans is complex and requires major investments in people, systems and other infrastructure. This complexity creates significant execution risk, which could impact our ability to effectively manage financial crime risk and remedy AML and sanctions compliance deficiencies in a timely manner. This could, in turn, impact HSBC s ability to satisfy the Monitor or comply with the terms of the US DPA, the FCA Direction, or the FRB s cease and desist order and may require HSBC to take additional remedial measures.

Failure to comply with certain regulatory requirements would have a material adverse effect on our results and operations

As reflected in the agreement entered into with the OCC in December 2012 (the GLBA Agreement), the OCC has determined that HSBC Bank USA is not in compliance with the requirements that a national bank, and each depository institution affiliate of the national bank, must be both well capitalised and well managed in order to own or control a financial subsidiary. As a result, HSBC Bank USA and its parent holding companies, including HSBC Holdings, do not meet the qualification requirements for financial holding company status. If all of our affiliate depositary institutions are not in compliance with these requirements within the time periods specified in the GLBA Agreement, as they may be extended, HSBC could be required either to divest HSBC Bank USA or to divest or terminate any financial activities conducted in reliance on financial holding company status under the GLBA. Similar consequences could

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result for financial subsidiaries of HSBC Bank USA that engage in activities in reliance on expanded powers provided for in the GLBA. Any such divestiture or termination of activities would have a material adverse effect on our business, prospects, financial condition and results of operation.

Failure to meet the requirements of regulatory stress tests could have a material adverse effect on our capital position, operations, results and future prospects

We are subject to regulatory stress testing in many jurisdictions. These have increased both in frequency and in the granularity of information required by supervisors.

These exercises are designed to assess the resilience of banks to adverse economic or financial developments and ensure that they have robust, forward-looking capital planning processes that account for the risks associated with their business profile. Assessment by regulators is on both a quantitative and qualitative basis, the latter focusing on our data provision, stress testing capability and internal management processes and controls.

During 2014, we participated in the regulatory stress test programmes of the PRA, the FRB, the OCC, the ECB, the EBA and the HKMA, among others, which are described on page 125.

The PRA and the EBA disclosed the results of their stress test exercises on 16 December 2014 and 26 October 2014, respectively. HSBC s stressed CET1 ratio remained above the required minimum thresholds.

On 26 March 2014, the FRB informed HNAH that it did not object to HNAH s capital actions, including payment of dividends on outstanding preferred stock and trust preferred securities of HNAH and its subsidiaries. However, the FRB informed HNAH that it did object to the capital plan submitted for the 2014 Comprehensive Capital Analysis and Review (CCAR) programme due to weaknesses in its capital planning processes. The FRB does not permit bank holding companies to disclose confidential supervisory information, including the reason for an objection to a capital plan submitted for CCAR. HNAH made its CCAR 2015 submission, which also served as the required re-submission for CCAR 2014, on 5 January 2015. Disclosure by the FRB and HNAH of the results of the exercises will be made in March 2015.

Failure to meet quantitative or qualitative requirements of regulatory stress test programmes, or the failure by regulators to approve our stress results and capital plans, could have a material adverse effect on our operations, results and future prospects.

We are subject to a number of legal and regulatory actions and investigations, the outcomes of which are inherently difficult to predict, but unfavourable outcomes could have a material adverse effect on our operating results and brand

We face significant legal and regulatory risks in our business. The volume and amount of damages claimed in litigation, regulatory proceedings and other adversarial proceedings against financial institutions are increasing for many reasons, including a substantial increase in the number of regulatory changes taking place globally, increased media attention and higher expectations from regulators and the public. In addition, criminal prosecutions of financial institutions for, among other alleged conduct, breaches of AML and sanctions regulations, antitrust violations, market manipulation, aiding and abetting tax evasion, and providing unlicensed cross-border banking services, have become more commonplace and may increase in frequency due to increased media attention and higher expectations from prosecutors and the public. Any such prosecution of HSBC or one or more of its subsidiaries could have a material adverse effect on our business, could result in substantial fines, penalties and/or forfeitures and could have a material adverse effect on our business, financial condition, results of operations, prospects and reputation, including the potential loss of key licences, requirement to exit certain businesses and withdrawal of funding from depositors and other stakeholders.

Additionally, we continue to be subject to a number of material legal proceedings, regulatory actions and investigations (including criminal) as described in Note 40 on the Financial Statements. It is inherently difficult to predict the outcome of many of the legal, regulatory and other adversarial proceedings involving our businesses, particularly those cases in which the matters are brought on behalf of various classes of claimants, seek damages of unspecified or indeterminate amounts or involve novel legal claims. Moreover, we may face additional legal proceedings, investigations or regulatory actions in the future, including in other jurisdictions and/or with respect to matters similar to, or broader than, the existing legal proceedings, investigations or regulatory actions. An unfavourable result in one or more of these proceedings could have a material adverse effect on our business, prospects, financial condition, reputation and/or results of operations.

Unfavourable legislative or regulatory developments, or changes in the policy of regulators or governments, could have a material adverse effect on our operations, financial condition and prospects

Our businesses are subject to ongoing regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies, voluntary codes of practice and interpretations in the UK, the US, Hong Kong, the EU and the other markets in which we operate. This is particularly so in the current environment, where we expect government and regulatory intervention in the banking sector to continue to remain high for the foreseeable future. Additionally, many of these changes increasingly have an impact beyond the country in which they are effected as regulators either deliberately enact regulation with

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extra-territorial impact or our operations mean that the Group is obliged to give effect to local laws and regulations on a wider basis.

Since 2008, regulators and governments have focused on reforming both the prudential regulation of the financial services industry, to improve financial stability, and the ways in which business is conducted. Measures include enhanced capital, liquidity and funding requirements, the separation or prohibition of certain activities by banks, changes in the capital regime and the operation of capital markets activities, the introduction of tax levies and transaction taxes, changes in compensation practices and adjustments to how business is conducted. The US Government, the UK Government, our regulators in the UK, US, Hong Kong, the EU or elsewhere may intervene further in relation to areas of industry risk already identified, or in new areas, which could adversely affect us.

HSBC has been classified by the Financial Stability Board (FSB) as a global systemically important bank (G-SIB) and therefore is subject to what the FSB refers to as a multi-pronged and integrated set of policies . These include proposals that would place additional capital and Total Loss Absorbing Capacity (TLAC) buffers on the Group and require enhanced reporting.

Furthermore, the BRRD introduces requirements for banks to maintain at all times a sufficient aggregate amount of own funds and eligible liabilities (that is, liabilities that may be bailed in using the bail-in tool), known as the minimum requirements for eligible liabilities (MREL). The BoE is required to issue further secondary legislation to implement MREL requirements by 2016, which will take into account the regulatory technical standards to be developed by the EBA. The EBA has stated that these technical standards would be compatible with the proposed term sheet published by the FSB on TLAC requirements for G-SIBs, but the extent to which MREL and TLAC requirements may differ remains uncertain.

More stringent regulatory requirements, including enhanced capital, liquidity and funding requirements and those governing the development of parameters applied in, and controls around, models used for measuring risk can give rise to changes that may adversely affect our business, including increases in capital requirements.

Changes in laws, rules or regulations, or in their interpretation or enforcement, or in how new laws, rules or regulations are implemented may adversely affect our business, prospects, financial condition and/or results of operations. Further, uncertainty and lack of international regulatory coordination as enhanced supervisory standards are developed and implemented may adversely affect our ability to engage in effective business, capital and risk management planning.

We may fail to comply with all applicable regulations, particularly in areas where applicable regulations may be unclear or where regulators revise existing guidance or courts overturn previous rulings. Authorities in many jurisdictions have the power to bring administrative or

judicial proceedings against us which could result in, among other things, the suspension or revocation of our licenses, cease and desist orders, fines, civil penalties, criminal penalties or other disciplinary action which could have a material adverse effect on our business, prospects, financial condition, reputation and/or results of operations and seriously harm our reputation.

Areas where changes could have an adverse effect on our business, prospects, financial condition or results of operations include, but are not limited to:

- general changes in government, central bank or regulatory or competition policy, or changes in regulatory regimes that may influence investor decisions in particular markets in which we operate;

- the structural separation of banking and trading activities proposed or enacted in a number of jurisdictions (see below);

- requirements flowing from arrangements for the resolution strategy of the Group and its individual operating entities, which may have different effects in different countries;

- the implementation of extra-territorial laws, including the US Foreign Account Tax Compliance Act (FATCA) and other related initiatives to share tax information such as those being pursued by the OECD more generally;

- the implementation of CRD IV, notably the UK application of the capital buffer framework and its interaction with Pillar 2 and the PRA buffer;

- the implementation of the BRRD s minimum requirements for eligible liabilities by the BoE and its interaction with TLAC requirements for G-SIBs;

- the increasing focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets, promoting effective competition in the interests of consumers and ensuring the orderly and transparent operation of global financial markets;

- restrictions on the structure of remuneration imposed under CRD IV and UK regulations and increasing requirements to detail management accountability within the Group to meet the requirements of the Senior Managers Regime in the UK (including the continued focus in the UK on the progress being made in implementing wider recommendations made by the Parliamentary Commission on Banking Standards on matters relating to institutional culture , employee conduct and obligations more generally such as whistleblowing);

- the implementation of any measures as a result of regulators increased focus on conduct matters (including any measures resulting from the FCA s February 2015 announced plans to launch its first wholesale market study into investment and corporate banking to assess whether competition in the sector is working properly, as well as the FCA s ongoing retail banking market studies into whether

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competition is working effectively in the cash savings and consumer credit markets), which may include customer compensation and redress schemes or other, potentially significant, remedial work;

the proposals from the FSB which are subject to consultation and translation into national regulations but which would require G-SIBs to hold minimum levels of capital and TLAC;

external bodies applying or interpreting standards or laws differently to us;

further requirements relating to financial reporting, corporate governance and employee compensation; and

expropriation, nationalisation, confiscation of assets and changes in legislation or regulations relating to foreign ownership.

These developments, which are discussed in more detail on pages 110(b) to 110(n), are expected to continue to change the way in which we are regulated and supervised and could affect the manner in which we conduct our business activities, capital requirements, results of operations or how the Group is structured.

We and our UK subsidiaries may become subject to stabilisation provisions under the Bank Act 2009, as amended, in certain significant stress situations.

Under the Banking Act 2009, as amended (the Banking Act), substantial powers have been granted to HM Treasury, the BoE and the PRA and FCA (as successors to the FSA) (together, the Authorities) as part of the special resolution regime (SRR). These powers enable the Authorities to deal with and stabilise UK-incorporated institutions with permission to accept deposits pursuant to Part 4A of the FSMA that are failing or are likely to fail to satisfy the threshold conditions (within the meaning of section 55B of the FSMA). The SRR presently consists of three stabilisation options: (i) transfer of all or part of the business of the relevant entity or the shares of the relevant entity to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a bridge bank wholly-owned by the Bank of England; and (iii) temporary public ownership of the relevant entity. HM Treasury may also take a parent company of a relevant entity into temporary public ownership where certain conditions are met. The SRR also provides for two new insolvency and administration procedures for relevant entities. Certain ancillary powers include the power to modify certain contractual arrangements in certain circumstances.

In general, the Banking Act requires the Authorities to have regard to specified objectives in exercising the powers provided for by the Banking Act. One of the objectives (which is required to be balanced as appropriate with the other specified objectives) refers to the protection and enhancement of the stability of the financial system of the United Kingdom. The Banking Act

includes provisions related to compensation in respect of transfer instruments and orders made under it. The Authorities are also empowered by order to amend the law for the purpose of enabling the powers under the SRR to be used effectively. An order may make provision which has retrospective effect.

There is considerable uncertainty about the scope of the powers afforded to the Authorities under the Banking Act and how the Authorities may choose to exercise them or the powers that may be granted to the Authorities under future legislation. However, if we are at or approaching the point of non-viability such as to require regulatory intervention, any exercise of any resolution regime powers by the Authorities may result in holders of our ordinary shares losing all or a part of their shareholdings and/or in the rights of holders of our ordinary shares being adversely affected, including by the dilution of their percentage ownership of our share capital, and/or could have a material adverse effect on the market price of our ordinary shares.

Structural separation of banking and trading activities proposed or enacted in a number of jurisdictions could have a material adverse effect on our operations and operating results.

In December 2013, the UK Financial Services (Banking Reform) Act 2013 received Royal Assent. It implements the recommendations of the Independent Commission on Banking (ICB), which *inter alia* establish a framework for ring-fencing UK retail banking in separately incorporated banking entities (ring-fenced banks) from trading activities. Secondary legislation has also been finalised, and in October 2014 the PRA published a consultation on ring-fencing rules in relation to group structures, governance and arrangements to ensure continuity of services and facilities. Finalised rules are expected to be published in 2016, with the implementation of ring-fencing in 2019.

The proposed separation of retail and SME banking in the UK would be a material change to the structure of HSBC Bank plc. Considerable uncertainty remains over the likely cost of implementing structural separation at this time, although we expect it to be material.

In January 2014, the European Commission published legislative proposals on the structural reform of the European banking sector which would prohibit proprietary trading in financial instruments and commodities, and enable supervisors to require trading activities such as market-making, complex derivatives and securitisation operations to be undertaken in a separate subsidiary from deposit taking activities. The proposals are currently subject to discussion in the European Parliament and the Council. The implementation date for any separation under the final rules would depend upon the date on which the final legislation is agreed.

Structural separation of retail and investment banking and trading activities is discussed in more detail on page 119.

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We are subject to tax-related risks in the countries in which we operate which could have a material adverse effect on our operating results

HSBC is subject to the substance and interpretation of tax laws in all countries in which we operate and is subject to routine review and audit by tax authorities in relation thereto. We provide for potential tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities. The amounts ultimately paid may differ materially from the amounts provided depending on the ultimate resolution of such matters. Changes to tax law, tax rates and penalties for failure to comply could have a material adverse effect on our business, financial condition and/or results of operations.

Risks related to our business, business operations, governance and internal control systems

The delivery of our strategic priorities is subject to execution risk

The financial services industry is currently facing an unprecedented period of scrutiny. Regulatory requests, legal matters and business initiatives all require a significant amount of time and resources to implement. The magnitude and complexity of projects within HSBC required to meet these demands has resulted in heightened execution risk. Organisational change and external factors, including the challenging macroeconomic environment and the extent and pace of regulatory change also contribute to execution risk. These factors could adversely affect the successful delivery of our strategic priorities.

There also remains heightened risk around the execution of a number of disposals across the Group in line with our Strategy. The potential risks of disposals include regulatory breaches, industrial action, loss of key personnel and interruption to systems and processes during business transformation. They can have both financial and reputational implications and could also adversely affect the successful delivery of our strategic priorities.

We may not achieve all the expected benefits of our strategic initiatives

The Group s strategy (see page 11), is built around two trends, the continued growth of international trade and capital flows, and wealth creation, particularly in faster-growing markets. We have analysed those trends, and have developed criteria to help us better deploy capital in response. The development and implementation of our strategy requires difficult, subjective and complex judgements, including forecasts of economic conditions in various parts of the world. We may fail to correctly identify the trends we seek to exploit and the relevant factors in making decisions as to capital deployment and cost reduction.

Our ability to execute our strategy may also be limited by our operational capacity and the increasing complexity of the regulatory environment in which we operate. In

addition, factors beyond our control, including but not limited to, the economic and market conditions and other challenges discussed in detail above, could limit our ability to achieve all of the expected benefits of these initiatives.

We operate in markets that are highly competitive

We compete with other financial institutions in a highly competitive industry that is undergoing significant changes as a result of financial regulatory reform and increased public scrutiny stemming from the financial crisis and continued challenging economic conditions.

We target internationally mobile clients who need sophisticated global solutions and generally compete on the basis of the quality of our customer service, the wide variety of products and services that we can offer our customers and the ability of those products and services to satisfy our customers needs, the extensive distribution channels available for our customers, our innovation, and our reputation. Continued and increased competition in any one or all of these areas may negatively affect our market share and results of operations and/or cause us to increase our capital investment in our businesses in order to remain competitive. Additionally, if our products and services are not accepted by our targeted clients, this may have a material adverse effect on our business, financial condition and results of operations.

In many markets, there is increased competitive pressure to provide products and services at current or lower prices. Consequently, our ability to reposition or reprice our products and services from time to time may be limited and could be influenced significantly by the actions of our competitors who may or may not charge similar fees for their products and services. Any changes in the types of products and services that we offer our customers and/or the pricing for those products and services could result in a loss of customers and market share and could materially adversely affect our results of operations.

Further, new entrants to the market or new technologies could require us to spend more to modify or adapt our products to attract and retain customers. We may not respond effectively to these competitive threats from existing and new competitors and may be forced to increase our investment in our business to modify or adapt our existing products and services or develop new products and services to respond to our customers needs.

Our risk management measures may not be successful

The management of risk is an integral part of all our activities. Risk constitutes our exposure to uncertainty and the consequent variability of return. Specifically, risk equates to the adverse effect on profitability or financial condition arising from different sources of uncertainty including retail and wholesale credit risk, market risk, operational risk, non-traded

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market risk, insurance risk, concentration risk, liquidity and funding risk, litigation risk, reputational risk, strategic risk, pension obligation risk and regulatory risk. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, such techniques and the judgements that accompany their application cannot anticipate every unfavourable event or the specifics and timing of every outcome. Failure to manage risks appropriately could have a significant effect on our business prospects, financial condition and/or results of operations.

Operational risks are inherent in our business

We are exposed to many types of operational risk that are inherent in banking operations including fraudulent and other criminal activities (both internal and external), breakdowns in processes or procedures and systems failure or non-availability. These risks apply equally when we rely on outside suppliers or vendors to provide services to us and our customers. These operational risks could have a material adverse effect on our business, prospects, financial condition and results of operation.

Our operations are subject to the threat of fraudulent activity

Fraudsters may target any of our products, services and delivery channels including lending, internet banking, payments, bank accounts and cards. This may result in financial loss to the bank, an adverse customer experience, reputational damage and potential regulatory action depending on the circumstances of the event.

Our operations are subject to disruption from the external environment

HSBC operates in many geographical locations, which are subject to events that are outside our control. These events may be acts of God such as natural disasters and epidemics, geopolitical risks including acts of terrorism and social unrest, and infrastructure issues such as transport or power failure. These risk events may give rise to disruption to our services, result in physical damage and/or loss of life, and could have a material adverse effect on our business, prospects, financial condition and results of operation.

Our operations utilise third-party suppliers and service providers

HSBC places reliance on third-party firms for the supply of goods and services or outsourcing of certain activities. There has been increased scrutiny by global regulators of the use by financial institutions of third-party service providers, including how outsourcing decisions are made and how the key relationships are managed. Risks arising from the use of third-party service providers may be less transparent and therefore more challenging to manage or influence. The risk of inadequate management of risks associated with the use of significant third-party service providers could lead to a failure to meet our operational and business requirements which, in turn, may involve regulatory breaches, financial crime, loss of confidential

information, civil or monetary penalties or damage both to shareholder value and to our reputation/brand image.

Our operations are highly dependent on our information technology systems

The reliability and security of our information and technology infrastructure and our customer databases are crucial to maintaining the service availability of banking applications and processes and to protecting the HSBC brand. The proper functioning of our payment systems, financial control, risk management, credit analysis and reporting, accounting, customer service and other information technology systems, as well as the communication networks between our branches and main data processing centres, are critical to our operations.

Critical system failure, any prolonged loss of service availability or any material breach of data security, particularly involving confidential customer data, could cause serious damage to our ability to service our clients, could breach regulations under which we operate and could cause long-term damage to our business and brand that could have a material adverse effect on our business, prospects, financial condition, reputation and/or results of operations. This includes the operation of our key payments services.

HSBC remains susceptible to a wide range of cyber risks that impact and/or are facilitated by technology. The threat from cyber attacks is a concern for our organisation and failure to protect our operations from internet crime or cyber attacks may result in financial loss and/or loss of customer data or other sensitive information which could undermine our reputation and our ability to attract and keep customers. This could have a material adverse effect on our business, financial condition and/or results of our operations.

A cyber security breach in HSBC Turkey in November 2014 exposed the details of credit and debit card information for 2.7m customers. Although the exposure was not linked to fraudulent transactions and the breach was detected through internal security controls, customers and the local regulator were informed.

During 2014, we were subjected to 12 denial of service attacks on our external facing websites across the Group. A denial of service attack is the attempt to intentionally disrupt, paralyse and potentially extract data from a computer network by flooding it with data sent simultaneously from many individual computers.

Although most cyber attacks in 2014 had a negligible effect on our customers, services or firm, future cyber attacks could have a material adverse effect on our business, financial condition and/or results of operations and reputation.

We may not be able to meet regulatory requests for data

The volume, granularity, frequency and scale of regulatory and other reporting requirements necessitate a clear data strategy to enable consistent data aggregation, reporting and management. Inadequate

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management information systems or processes, including those relating to risk data aggregation and risk reporting, could lead to a failure to meet regulatory reporting requirements or other internal or external information demands. Financial institutions that fail to comply with the principles for effective risk data aggregation and risk reporting as set out by the Basel Committee on Banking Supervision by the required deadline may face supervisory measures.

Our operations have inherent reputational risk

Reputational risk is the risk of failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC, its employees or those with whom it is associated, that may cause stakeholders to form a negative view of HSBC. It could also arise from negative public opinion about the actual, or perceived, manner in which we conduct our business activities, our financial performance, as well as actual or perceived practices in banking and the financial services industry generally. Reputational risk could lead to adverse financial or non-financial consequences, including loss of confidence or adverse effects on our ability to retain and attract customers. Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk.

Modern technologies, in particular online social media channels and other broadcast tools which facilitate communication with large audiences in short time frames and with minimal costs, may significantly enhance and accelerate the impact of damaging information and allegations. Negative public opinion may adversely affect our ability to keep and attract customers and, in particular, corporate and retail depositors, and could have a material adverse effect on our business, prospects, financial condition, reputation and/or results of operations.

We may suffer losses due to employee misconduct

Our businesses are exposed to risk from potential non-compliance with policies, including the HSBC Values and related behaviours, and employee misconduct, such as fraud or negligence, all of which could result in regulatory sanctions or reputational or financial harm. In recent years, a number of multinational financial institutions have suffered material losses due to the actions of rogue traders or other employees. It is not always possible to deter employee misconduct and the precautions we take to prevent and detect this activity may not always be effective.

We rely on recruiting, retaining and developing appropriate senior management and skilled personnel

The demands being placed on the human capital of the Group are unprecedented. The cumulative workload arising from a regulatory reform programme that is often extra-territorial and still evolving is hugely consumptive of human resources, placing increasingly complex and

conflicting demands on a workforce where the required expert capabilities are in short supply and globally mobile.

Our continued success depends in part on the retention of key members of our management team and wider employee base. The ability to continue to attract, train, motivate and retain highly qualified professionals is a key element of our strategy. The successful implementation of our growth strategy depends on the availability of skilled management in each of our global businesses or global functions. If global businesses or global functions fail to staff their operations appropriately, or lose one or more of their key senior executives, and fail to replace them in a satisfactory and timely manner, or fail to implement successfully the organisational changes required to support the Group s strategy, our business prospects, financial condition and/or results of operations, including control and operational risks, may be materially adversely affected.

Our financial statements are based in part on judgements, estimates and assumptions which are subject to uncertainty

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, particularly those involving the use of complex models, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements, assumptions and models are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The accounting policies deemed critical to our results and financial position, based upon materiality and significant judgements and estimates, include impairment of loans and advances, goodwill impairment, valuation of financial instruments, deferred tax assets, provisions and interests in associates, which are discussed in detail in Critical accounting estimates and judgements on page 348.

The valuation of financial instruments measured at fair value can be subjective, in particular where models are used which include unobservable inputs. Given the uncertainty and subjectivity associated with valuing such instruments, future outcomes may differ materially from those assumed using information available at the reporting date. The effect of these differences on the future results of operations and the future financial position of the Group may be material. For further details, see Critical accounting estimates and judgements on page 348.

If the judgement, estimates and assumptions we use in preparing our consolidated financial statements are subsequently found to be materially different from those assumed using information available at the reporting

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date, this could affect our business, financial conditions, prospects, and/or results of operations and have a corresponding effect on our funding requirements and capital ratios.

HSBC could incur losses or be required to hold additional capital as a result of model limitations or failure

HSBC uses models for a range of purposes in managing its business, including regulatory and economic capital calculations, stress testing, granting credit, pricing and financial reporting, including the valuation of financial instruments measured at fair value, as explained above. HSBC could face adverse consequences as a result of decisions, which may lead to actions by management, based on models that are poorly developed, implemented or used, or as a result of the modelled outcome being misunderstood or the use of such information for purposes for which it was not designed. Risks arising from use of models could have a material adverse effect on our business, financial condition and/or results of operations, minimum capital requirements and reputation.

In addition, supervisory concerns over the internal models and assumptions used by banks in the calculation of regulatory capital have led to the imposition of risk weight and loss given default floors, which has the potential to increase our capital requirement.

Third parties may use us as a conduit for illegal activities without our knowledge, which could have a material adverse effect on us

We are required to comply with applicable anti-money laundering laws and regulations and have adopted various policies and procedures, including internal control and know your customer procedures, aimed at preventing use of HSBC products and services for the purpose of committing or concealing financial crime. A major focus of US and UK government policy relating to financial institutions in recent years has been combating money laundering and enforcing compliance with US and EU economic sanctions, and this prioritisation is evidenced by our agreements with US and UK authorities relating to various investigations regarding past inadequate compliance with anti-money laundering and sanctions laws. Certain US subsidiaries of HSBC Holdings have entered into a consent cease and desist order with the OCC and a similar consent order with the FRB which require the implementation of improvements to compliance procedures regarding obligations under the US Bank Secrecy Act (the BSA), FCA Direction and anti-money laundering (AML) rules. These consent orders do not preclude additional enforcement actions by bank regulatory, governmental or law enforcement agencies or private litigation.

A number of the remedial actions taken or being taken as a result of the matters to which the US DPA relates are intended to ensure that the Group s businesses are better protected in respect of these risks. However, there can be no assurance that the steps that continue to be taken to address the requirements of the US DPA

will be completely effective. Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC in relation to the matters which are the subject of the US DPA.

In relevant situations, and where permitted by regulation, we may rely upon certain counterparties to maintain and properly apply their own appropriate AML procedures. While permitted by regulation, such reliance may not be effective in preventing third parties from using us (and our relevant counterparties) as a conduit for money laundering including illegal cash operations without our knowledge (and that of our relevant counterparties). Becoming a party to money laundering, association with, or even accusations of being associated with money laundering will damage our reputation and could make us subject to fines, sanctions and/or legal enforcement (including being added to blacklists that would prohibit certain parties from engaging in transactions with us). Any one of these outcomes could have a material adverse effect on our business, prospects, financial condition and/or results of operations.

We have significant exposure to counterparty risk

We are exposed to counterparties that are involved in virtually all major industries, and we routinely execute transactions with counterparties in financial services, including brokers and dealers, central clearing counterparties, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default by our counterparty or client. Our ability to engage in routine transactions to fund our operations and manage our risks could be materially adversely affected by the actions and commercial soundness of other financial services institutions. Financial institutions are necessarily interdependent because of trading, clearing, counterparty or other relationships. As a consequence, a default by, or decline in market confidence in, individual institutions, or anxiety about the financial services industry generally, can lead to further individual and/or systemic difficulties, defaults and losses.

Mandatory central clearing of over the counter (OTC) derivatives, including under the Dodd-Frank Act and the EU s European Market Infrastructure Regulation (EMIR), brings new risks to HSBC. As a clearing member, we will be required to underwrite losses incurred at Central Counterparty (CCP) by the default of other clearing members and their clients. Hence central clearing brings with it a new element of interconnectedness between clearing members and clients which we believe may increase rather than reduce our exposure to systemic risk. At the same time, our ability to manage such risk ourselves will be reduced because control has been largely outsourced to CCPs and it is unclear at present how, at a time of stress, regulators and resolution authorities will intervene.

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Where bilateral counterparty risk has been mitigated by taking collateral, our credit risk may remain high if the collateral we hold cannot be realised or has to be liquidated at prices which are insufficient to recover the full amount of our loan or derivative exposure. There is a risk that collateral cannot be realised, including situations where this arises by change of law that may influence our ability to foreclose on collateral or otherwise enforce contractual rights.

The Group also has credit exposure arising from mitigants such as credit default swaps (CDS s), and other credit derivatives, each of which is carried at fair value. The risk of default by counterparties to CDSs and other credit derivatives used as mitigants affects the fair value of these instruments depending on the valuation and the perceived credit risk of the underlying instrument against which protection has been purchased. Any such adjustments or fair value changes may have a material adverse effect on our financial condition and results of operations.

Market fluctuations may reduce our income or the value of our portfolios

Our businesses are inherently subject to risks in financial markets and in the wider economy, including changes in, and increased volatility of, interest rates, inflation rates, credit spreads, foreign exchange rates, commodity, equity, bond and property prices and the risk that our customers act in a manner inconsistent with our business, pricing and hedging assumptions.

Market movements will continue to significantly affect us in a number of key areas. For example, banking and trading activities are subject to interest rate risk, foreign exchange risk, inflation risk and credit spread risk. Changes in interest rate levels, interbank spreads over official rates, yield curves and spreads affect the interest rate spread realised between lending and borrowing costs. The potential for future volatility and margin changes remains. Competitive pressures on fixed rates or product terms in existing loans and deposits sometimes restrict our ability to change interest rates applying to customers in response to changes in official and wholesale market rates. Our pension scheme assets include equity and debt securities, the cash flows of which change as equity prices and interest rates vary.

Our insurance businesses are exposed to the risk that market fluctuations will cause mismatches to occur between product liabilities and the investment assets which back them. Market risks can affect our insurance products in a number of ways depending upon the product and associated contract. For example, mismatches between assets and liability yields and maturities give rise to interest rate risk. Some of these risks are borne directly by the customer and some are borne by the insurance businesses, with their excess capital invested in the markets. Some insurance contracts involve guarantees and options that increase in value in adverse investment markets. There is a risk that the insurance businesses will bear some of the cost of such guarantees and options. The performance of the investment markets will thus have a direct effect upon the value embedded in the insurance and investment

contracts and our operating results, financial condition and prospects.

It is difficult to predict with any accuracy changes in market conditions, and such changes may have a material adverse effect on our business, operating results, financial condition and prospects.

Liquidity, or ready access to funds, is essential to our businesses

Our ability to borrow on a secured or unsecured basis and the cost of so doing can be affected by increases in interest rates or credit spreads, the availability of credit, regulatory requirements relating to liquidity or the market perceptions of risk relating to HSBC or the banking sector, including our perceived or actual creditworthiness.

Current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon preserving investor confidence in our capital strength and liquidity, and on comparable and transparent pricing. Although deposits have been, over time, a stable source of funding, this may not continue.

We also access wholesale markets in order to provide funding for entities that do not accept deposits, to align asset and liability maturities and currencies and to maintain a presence in local markets. In 2014, we issued the equivalent of US$20bn of debt securities in the public capital markets in a range of currencies and maturities from a number of Group entities, including US$9.1bn of subordinated securities issued by HSBC Holdings. An inability to obtain financing in the unsecured long-term or short-term debt capital markets, or to access the secured lending markets, could have a substantial adverse effect on our liquidity. Unfavourable macroeconomic developments, market disruptions or regulatory developments may increase our funding costs or challenge our ability to raise funds to support or expand our businesses, materially adversely affecting our business, prospects, financial condition and/or results of operations.

If we are unable to raise funds through deposits and/or in the capital markets, our liquidity position could be adversely affected and we might be unable to meet deposit withdrawals on demand or at their contractual maturity, to repay borrowings as they mature, to meet our obligations under committed financing facilities and insurance contracts, or to fund new loans, investments and businesses. We may need to liquidate unencumbered assets to meet our liabilities. In a time of reduced liquidity, we may be unable to sell some of our assets, or we may need to sell assets at depressed prices, which in either case could materially adversely affect our business, prospects, results of operations and/or financial condition.

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Any reduction in the credit rating assigned to HSBC Holdings, any subsidiaries of HSBC Holdings or any of their respective debt securities could increase the cost or decrease the availability of our funding and adversely affect our liquidity position and net interest margin

Credit ratings affect the cost and other terms upon which we are able to obtain market funding. Rating agencies regularly evaluate HSBC Holdings and certain of its subsidiaries, as well as their respective debt securities. Their ratings are based on a number of factors, including their assessment of the relative financial strength of HSBC or of the relevant entity, as well as conditions affecting the financial services industry generally. There can be no assurance that the rating agencies will maintain HSBC s or the relevant entity s current ratings or outlook, particularly given the rating agencies current review of their bank rating methodologies and the potential impact on HSBC s or its subsidiaries ratings.

As of the date hereof, HSBC Holdings long-term debt was rated AA-, A, Aa3 by Fitch, Standard & Poor s (S&P) and Moody s, respectively. Ratings outlook by Fitch and S&P were stable and Moody s rating outlook was negative. Among other factors, Moody s rating outlook reflects the potential removal of government support (in whole or in part) as a factor in our rating due to the European resolution framework, including BRRD and the UK bail-in power. S&P lowered our long-term debt rating in February 2015 to reflect their view that extraordinary government support is unlikely. Any reductions in these ratings and outlook could increase the cost of our funding, limit access to capital markets and require additional collateral to be placed and, consequently, materially adversely affect our interest margins and/or our liquidity position.

Under the terms of our current collateral obligations under derivative contracts, we could be required to post additional collateral as a result of a downgrade in HSBC s credit rating as described on page 173.

Risks concerning borrower credit quality are inherent in our businesses

Risks arising from changes in credit quality and the recoverability of loans and amounts due from borrowers and counterparties (e.g. reinsurers and counterparties in derivative transactions) are inherent in a wide range of our businesses. Adverse changes in the credit quality of our borrowers and counterparties arising from a general deterioration in economic conditions or systemic risks in the financial systems could reduce the recoverability and value of our assets and require an increase in our loan impairment charges.

We estimate and recognise impairment allowances for credit losses inherent in our credit exposure. This process, which is critical to our results and financial condition, requires difficult, subjective and complex judgements, including forecasts of how these economic conditions might impair the ability of our borrowers to repay their loans and the ability of other counterparties

to meet their obligations. As is the case with any such assessments, we may fail to estimate accurately the effect of factors that we identify or fail to identify relevant factors. Further, the information we use to assess the creditworthiness of our counterparties may be inaccurate or incorrect. Any failure by us to accurately estimate the ability of our counterparties to meet their obligations may have a material adverse effect on our business, prospects, financial conditions and/or results of operations.

Our insurance businesses are subject to risks relating to insurance claim rates and changes in insurance customer behaviour

We provide various insurance products for customers with whom we have a banking relationship, including several types of life insurance products. The cost of claims and benefits can be influenced by many factors, including mortality and morbidity rates, lapse and surrender rates and, if the policy has a savings element, the performance of assets to support the liabilities. Adverse developments in any of these factors may materially adversely affect our financial condition and results of operations.

HSBC Holdings is a holding company and as a result, is dependent on loan payments and dividends from its subsidiaries to meet its obligations, including obligations with respect to its debt securities, and to provide profits for payment of future dividends to shareholders

HSBC Holdings is a non-operating holding company and, as such, its principal source of income is from operating subsidiaries which hold the principal assets of HSBC. As a separate legal entity, HSBC Holdings relies on remittance of its subsidiaries loan interest payments and dividends in order to be able to pay obligations to debt holders as they fall due and to pay dividends to its shareholders. The ability of HSBC Holdings subsidiaries and affiliates to pay dividends could be restricted by changes in regulation, exchange controls and other requirements.

We may be required to make substantial contributions to our pension plans

We operate a number of pension plans throughout the world, including defined benefit plans. Pension scheme obligations fluctuate with changes in long-term interest rates, inflation, salary levels and the longevity of scheme members. The level of contributions we make to our pension plans has a direct effect on our cash flow. To the extent plan assets are insufficient to cover existing liabilities, higher levels of contributions will be required. As a result, deficits in those pension plans may have a material adverse effect on our business, prospects, financial condition and/or results of operations.

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Managing risk

(Unaudited)

As a provider of banking and financial services, we actively manage risk as a core part of our day-to-day activities.

Risk management framework

Our risk management framework, which is employed at all levels of the organisation, is set out on page 24. The key elements are discussed below.

The Group s Risk Appetite Statement is a key component in our management of risk and is described on page 24.

Risk governance framework

Robust risk governance and accountability are embedded throughout the Group through an established framework that ensures appropriate oversight of and accountability for the effective management of risk at all levels of the organisation and across all risk types. Adherence to consistent standards and risk management policies is required across HSBC by our Global Standards and our Global Risk operating model.

The Board has ultimate responsibility for approving HSBC s risk appetite and the effective management of risk.

The Group Risk Committee advises the Board on risk appetite and its alignment with strategy, risk governance and internal controls and high-level risk related matters.

The Financial System Vulnerabilities Committee reports to the Board on matters relating to financial crime and financial system abuse and provides a forward-looking perspective on financial crime risk.

The 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.

Executive accountability for the ongoing monitoring, assessment and management of the risk environment and the effectiveness of our risk management policies resides with the Risk Management Meeting of the GMB. Day-to-day risk management activities are the responsibility of senior managers of individual businesses, supported by global functions as described under Three lines of defence below.

The executive and non-executive risk governance structures and their interactions are set out on page 204, with similar arrangements in place for major operating subsidiaries.

The report of the Group Risk Committee is on page 280. The Report of the Financial System Vulnerabilities Committee is on page 282. The report of the Conduct & Values Committee is on page 286.

Three lines of defence

We use a three lines of defence model in the management of risk.

- First line every employee is responsible for the risks that form 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 Risk, Finance and Human Resources form the second line of defence. They are responsible for providing assurance, challenge and oversight 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 first and second lines of defence.

For details of our operational risk management framework, see page 186.

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 20).

Our risk culture is reinforced by our approach to remuneration. Individual awards, including those for executives, 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 300.

Independent Risk function

Global Risk, headed by the Group Chief Risk Officer, is responsible for enterprise-wide risk oversight including the establishment of global policy, the monitoring of risk profiles and forward-looking risk identification and management. Global Risk also has functional responsibility for risk management in support of HSBC s global businesses and regions through an integrated network of Risk sub-functions which are independent from the sales and trading functions of our businesses. This independence ensures the necessary balance in risk/return decisions.

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We run Global Risk like a business, ensuring that the function is dynamic and responsive to the needs of its stakeholders.

Risks faced by HSBC

All of our activities involve, to varying degrees, the analysis, evaluation, acceptance and management of risks or combinations of risks.

Risk factors

We have identified a comprehensive suite of risk factors which covers the broad range of risks our businesses are exposed to.

A number of the risk factors have the potential to affect the results of our operations or financial condition, but may not necessarily be deemed as top or emerging risks. However, they inform the ongoing assessment of our top and emerging risks which may result in our risk appetite being revised. The risk factors are:

Macroeconomic and geopolitical risk

Current economic and market conditions may adversely affect our results.

We are subject to political and economic risks in the countries in which we operate, including the risk of government intervention.

We may suffer adverse effects as a result of the renewed economic and sovereign debt tensions in the eurozone.

Changes in foreign currency exchange rates may affect our results.

Macro-prudential, regulatory and legal risks to our business model

Failure to implement our obligations under the deferred prosecution agreements could have a material adverse effect on our results and operations.

Failure to comply with certain regulatory requirements would have a material adverse effect on our results and operations.

Failure to meet the requirements of regulatory stress tests could have a material adverse effect on our capital position, operations, results and future prospects.

We are subject to a number of legal and regulatory actions and investigations, the outcomes of which are inherently difficult to predict, but unfavourable outcomes could have a material adverse effect on our operating results and brand.

Unfavourable legislative or regulatory developments, or changes in the policy of regulators or governments, could have a material adverse effect on our operations, financial condition and prospects.

HSBC Holdings and its UK subsidiaries may become subject to stabilisation provisions under the Bank Act 2009, as amended, in certain significant stress situations.

Structural separation of banking and trading activities proposed or enacted in a number of jurisdictions could have a material adverse effect on our operations and operating results.

We are subject to tax-related risks in the countries in which we operate which could have a material adverse effect on our operating results.

Risks related to our business, business operations, governance and internal control systems

The delivery of our strategic priorities is subject to execution risk.

We may not achieve all the expected benefits of our strategic initiatives.

We operate in markets that are highly competitive.

Our risk management measures may not be successful.

Operational risks are inherent in our business.

Our operations are subject to the threat of fraudulent activity.

Our operations are subject to disruption from the external environment.

Our operations utilise third-party suppliers and service providers.

Our operations are highly dependent on our information technology systems.

We may not be able to meet regulatory requests for data.

Our operations have inherent reputational risk.

We may suffer losses due to employee misconduct.

We rely on recruiting, retaining and developing appropriate senior management and skilled personnel.

Our financial statements are based in part on judgements, estimates and assumptions which are subject to uncertainty.

HSBC could incur losses or be required to hold additional capital as a result of model limitations or failure.

Third parties may use us as a conduit for illegal activities without our knowledge, which could have a material adverse effect on us.

We have significant exposure to counterparty risk.

Market fluctuations may reduce our income or the value of our portfolios.

Liquidity, or ready access to funds, is essential to our businesses.

Any reduction in the credit rating assigned to HSBC Holdings, any subsidiaries of HSBC Holdings or any of their respective debt securities could increase the cost or decrease the availability of our funding and adversely affect our liquidity position and interest margins.

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Risks concerning borrower credit quality are inherent in our businesses.

Our insurance business is subject to risks relating to insurance claim rates and changes in insurance customer behaviour.

HSBC Holdings is a holding company and, as a result, is dependent on loan payments and dividends from its subsidiaries to meet its obligations, including obligations with respect to its debt securities, and to provide profits for payment of future dividends to shareholders.

We may be required to make substantial contributions to our pension plans.

Risks managed by HSBC

The principal risks associated with our banking and insurance manufacturing operations are described in the tables below.

Description of risks   banking operations

Risks	Arising from	Measurement, monitoring and management of risk
Credit risk (page 127)		
The risk of financial loss if a customer or counterparty fails to meet an obligation under a contract.	Credit risk arises principally from direct lending, trade finance and leasing business, but also from certain other products such as guarantees and derivatives.	Credit risk is: **measured** as the amount which could be lost if a customer or counterparty fails to make repayments. In the case of derivatives, the measurement of exposure takes

		into account the current mark-to-market value to HSBC of the contract and the expected potential change in that value over time caused by movements in market rates; **monitored** within limits approved by individuals within a framework of delegated authorities. These limits represent the peak exposure or loss to which HSBC could be subjected should the customer or counterparty fail to perform its contractual obligations; and **managed** through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers.
Liquidity and funding risk (page 163)		
The risk that we do not have sufficient financial resources to meet our obligations as they fall due or that we can only do so at excessive cost.	Liquidity risk arises from mismatches in the timing of cash flows. Funding risk arises when the liquidity needed to fund illiquid asset positions cannot be obtained at the expected terms and when required.	Liquidity and funding risk is: **measured** using internal metrics including stressed operational cash flow projections, coverage ratios and advances to core funding ratios; **monitored** against the Group s liquidity and funding risk framework and overseen by regional Asset and Liability Management Committees (ALCO s), Group ALCO and the Risk Management Meeting; and **managed** on a stand-alone basis with no reliance on any Group entity (unless pre-committed) or central bank unless this represents routine established business as usual market practice.
Market risk (page 175)		
The risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce	Exposure to market risk is separated into two portfolios:	Market risk is:

our income or the value of our portfolios.	trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions.	**measured** in terms of value at risk, which is used to estimate potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence, augmented with stress testing to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables;
	non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from our insurance operations (page 198).	**monitored** using measures including the sensitivity of net interest income and the sensitivity of structural foreign exchange which are applied to the market risk positions within each risk type; and **managed** using risk limits approved by the GMB for HSBC Holdings and our various global businesses. These units are allocated across business lines and to the Group s legal entities.

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Risks	Arising from	Measurement, monitoring and management of risk
Operational risk (page 186)		
The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk (along with accounting, tax, security and fraud, people, systems, projects, operations and organisational change risk).	Operational risk arises from day to day operations or external events, and is relevant to every aspect of our business. Compliance risk and fiduciary risk are discussed below. Other operational risks are covered in the Appendix to Risk (page 204).	Operational risk is: **measured** using both the top risk analysis process and the risk and control assessment process, which assess the level of risk and effectiveness of controls; **monitored** using key indicators and other internal control activities; and **managed** primarily by global business and functional managers. They identify and assess risks, implement controls to manage them and monitor the effectiveness of these controls utilising the operational risk management framework. Global Operational Risk is responsible for the framework and for overseeing the management of operational risks within businesses and functions.
Compliance risk (page 189)		
The risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations	Compliance risk is part of operational risk, and arises from rules, regulations, other	Compliance risk is:

and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.	standards and Group policies, including those relating to anti-money laundering, anti-bribery and corruption, counter-terrorist and proliferation financing, sanctions compliance and conduct of business.	**measured** by reference to identified metrics, incident assessments (whether affecting HSBC or the wider industry), regulatory feedback and the judgement and assessment of the managers of our global businesses and functions;
	The DPA is discussed on page 120 and the Monitor on page 27.	**monitored** against our compliance risk assessments and metrics, the results of the monitoring and control activities of the second line of defence functions, including the Financial Crime Compliance and Regulatory Compliance functions, and the results of internal and external audits and regulatory inspections; and
		managed by establishing and communicating appropriate policies and procedures, training employees in them, and monitoring activity to assure their observance. Proactive risk control and/or remediation work is undertaken where required.
Other material risks		
Reputational risk (page 199)		
The risk that illegal, unethical or inappropriate behaviour by the Group itself, members of staff or clients or representatives of the Group will damage HSBC s reputation, leading potentially to a loss of business, fines or penalties.	Reputational risk is the risk of failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC itself, its employees or those with whom it is associated, that may cause stakeholders to form a negative view of HSBC.	Reputational risk is: **measured** by reference to our reputation as indicated by our dealings with all relevant stakeholders, including media, regulators, customers and employees; **monitored** through a reputational risk management framework, taking into account the results of the compliance risk monitoring activity outlined above; and

		managed by every member of staff and is covered by a number of policies and guidelines. There is a clear structure of committees and individuals charged with mitigating reputational risk, including the Group Reputational Risk Policy Committee and regional/business equivalents.
Fiduciary risk (page 200)		
The risk of breaching our fiduciary duties, defined as any duty where HSBC holds, manages, oversees or has responsibilities for assets for a third party that involves a legal and/or regulatory duty to act with the highest standard of care and with utmost good faith.	Fiduciary risk is part of operational risk, and arises from our business activities where we act in a fiduciary capacity (designated businesses) as Trustee, Investment Manager or as mandated by law or regulation.	Fiduciary risk is: **measured** by each designated business monitoring against their own risk appetite statements and by the operational risk and control assessment process, which assesses the level of risk and the effectiveness of the key controls; **monitored** through a combination of testing, key indicators and other metrics such as client and regulatory feedback; and **managed** within the designated businesses via established governance frameworks, and comprehensive policies, procedures and training programmes.

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Description of risks banking operations (continued)

Risks	Arising from	Measurement, monitoring and management of risk
Pension risk (page 236)		
The risk that contributions from Group companies and members fail to generate sufficient funds to meet the cost of accruing benefits for the future service of active members, and the risk that the performance of assets held in pension funds is insufficient to cover existing pension liabilities.	Pension risk arises from investments delivering an inadequate return, economic conditions leading to corporate failures, adverse changes in interest rates or inflation, or members living longer than expected (longevity risk). Pension risk includes operational risks listed above.	Pension risk is: **measured** in terms of the schemes ability to generate sufficient funds to meet the cost of their accrued benefits; **monitored** through the specific risk appetite that has been developed at both Group and regional levels; and **managed** locally through the appropriate pension risk governance structure and globally through the Risk Management Meeting.
Sustainability risk (page 237)		
The risk that the environmental and social effects of providing financial services outweigh the economic benefits.	Sustainability risk arises from the provision of financial services to companies or projects which run counter to the needs of sustainable development.	Sustainability risk is: **measured** by assessing the potential sustainability effect of a customer s activities and assigning a

		Sustainability Risk Rating to all high risk transactions; **monitored** quarterly by the Risk Management Meeting and monthly by Group Sustainability Risk management; and **managed** using sustainability risk policies covering project finance lending and sector-based sustainability polices for sectors with high environmental or social impacts.

Our insurance manufacturing subsidiaries are separately regulated from our banking operations. Risks in the insurance entities are managed using methodologies and processes appropriate to insurance activities, but remain subject to oversight at Group level. Our insurance

operations are also subject to the operational risks and the other material risks presented above in relation to the banking operations, and these are covered by the Group s risk management processes.

Description of risks insurance manufacturing operations

Risks	Arising from	Measurement, monitoring and management of risk
Financial risks (page 194)		
Our ability to effectively match the liabilities arising under insurance contracts with the asset portfolios that back them are contingent on the management of financial risks such as market, credit and liquidity risks, and the extent to which these risks are borne by the policyholders.	Exposure to financial risks arises from: market risk of changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, foreign exchange rates and equity prices;	Financial risks are: **measured** separately for each type of risk: market risk is measured in terms of exposure to fluctuations in key financial variables;

Liabilities to policyholders under unit-linked contracts move in line with the value of the underlying assets, and as such the policyholder bears the majority of the financial risks.	credit risk and the potential for financial loss following the default of third parties in meeting their obligations; and	credit risk is measured as the amount which could be lost if a customer or counterparty fails to make repayments; and liquidity risk is measured using internal metrics including stressed operational cash flow projections.
Contracts with DPF share the performance of the underlying assets between policyholders and the shareholder in line with the type of contract and the specific contract terms.	liquidity risk of entities not being able to make payments to policyholders as they fall due as there are insufficient assets that can be realised as cash.	**monitored** within limits approved by individuals within a framework of delegated authorities; and **managed** through a robust risk control framework which outlines clear and consistent policies, principles and guidance for risk managers. Subsidiaries manufacturing products with guarantees are usually exposed to falls in market interest rates and equity prices to the extent that the market exposure cannot be managed by utilising any discretionary participation (or bonus) features within the policy contracts they issue.

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Risks	Arising from	Measurement, monitoring and management of risk
Insurance risk (page 198)		
The risk that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income.	The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.	Insurance risk is: **measured** in terms of life insurance liabilities; **monitored** by the RBWM Risk Management Committee, which checks the risk profile of the insurance operations against a risk appetite for insurance business agreed by the GMB; and **managed** both centrally and locally using product design, underwriting, reinsurance and claims-handling procedures.

Risk management processes and procedures

In addition to risk appetite, the following processes are integral to risk management at HSBC:

- risk identification through our top and emerging risk process;
- 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.

Our current top and emerging risks are discussed below.

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 map process, which describes our risk profile by risk type in the different regions and global businesses.

In addition to our principal banking and insurance risks, the risk map 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.

Stress testing

We conduct stress testing scenarios across the Group on both an enterprise-wide basis and at a major subsidiary level, reflecting our business strategy and its resultant risk exposures. Our stress testing and scenario analysis programme examines the sensitivities of our capital plans and unplanned demand for regulatory capital under a number of scenarios and ensures that top and emerging risks are appropriately considered. These scenarios include, but are not limited to, adverse macroeconomic events, failures at country, sector and counterparty levels, geopolitical occurrences and a variety of projected major operational risk events.

The Stress Testing Management Board, which is chaired by the Group Finance Director, is responsible for stress testing strategy and stewardship. Stress testing models are approved through the Group s Model Oversight Committee framework. Updates on stress testing are provided at each meeting of the Risk Management Meeting of the GMB. The Group Risk Committee is informed and consulted, and approves, as appropriate.

The development of macroeconomic scenarios is a critical part of the process. Potential scenarios are defined and generated by an expert panel comprising economic experts from various global teams including Risk and Finance. Variables and assumptions underpinning the scenarios, including economic indicators such as yield curves, exchange rates and volatilities, are expanded and enriched by internal and external teams. Once approved by the governing committee, they are circulated to the regional and global business stress testing teams along with instructions for the exercise.

Scenarios are translated into financial impacts, such as on our forecast profitability and RWAs, using a suite of stress testing models and methodologies. Models are subject to independent model review and go through a process of validation and approval. Model overlays may be considered where necessary.

Stress testing results are subject to a review and challenge process at regional and Group levels and action plans are developed to mitigate identified risks. The extent to which these action plans would be implemented in the event of particular scenarios occurring depends on senior management s evaluation of the risks and their potential consequences, taking into account HSBC s risk appetite.

In addition to the Group-wide risk scenarios, each major HSBC subsidiary conducts regular macroeconomic and event-driven scenario analyses specific to their region. They may also participate in local regulatory stress testing programmes.

Stress testing is applied to risks such as market risk, liquidity and funding risk and credit risk to evaluate the potential effect of stress scenarios on portfolio values, structural long-term funding positions, income or capital.

Reverse stress testing is run annually on both Group and subsidiary entity bases. This stress test is conducted by assuming the business model is non-viable and working backwards to identify a range of occurrences that could

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bring that event about. Non-viability might occur before the bank s capital is depleted, and could result from a variety of events. These include idiosyncratic or systemic events or combinations thereof, and/or could imply failure of the Group s holding company or one of its major subsidiaries. They would not necessarily mean the simultaneous failure of all the major subsidiaries. Reverse stress testing is used to strengthen our resilience by helping to inform early-warning triggers, management actions and contingency plans designed to mitigate the potential stresses and vulnerabilities which the Group might face.

HSBC participated in regulatory stress testing programmes in a number of jurisdictions during 2014, as outlined on page 125.

Top and emerging risks

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(Unaudited)

Our approach to identifying and monitoring top and emerging risks is described on page 22.

During 2014, senior management paid particular attention to a number of top and emerging risks. Our current top and emerging risks are as follows:

Macroeconomic and geopolitical risks

Economic outlook and government intervention
Increased geopolitical risk

Economic outlook and government intervention

Economic growth in both developed and emerging market countries remained weak in 2014.

Oil and commodity prices have declined significantly since the middle of 2014 as a result of increasing global demand-supply imbalances. The precipitous fall in energy prices over such a short span of time changes both the nature and the distribution of risks. It sharpens fiscal and financing challenges for energy exporters, and although it brings benefits for oil importers, it also accentuates deflationary risks among some of these (particularly in the eurozone). In addition, the prospect of low oil prices for a prolonged period may reduce investment in exploration and thus poses the danger of significantly reduced future supply.

The economic recovery in the eurozone is still at risk. Deflationary pressures persist as a result of low oil prices and despite much looser monetary policy. Acceleration in the structural reform agenda could also accentuate deflationary pressures in the short-term. The eurozone is discussed further in Areas of special interest on page 126. Japan fell into a technical recession in the third quarter of 2014 and policy responses may not be sufficient to support a recovery in economic activity. Resilience in US economic activity represents an upside to the world economy.

Emerging markets, particularly those with domestic vulnerabilities, remain exposed to monetary policy normalisation in the US and to greater risk aversion. While high by international standards, mainland China s GDP growth in 2014 was the lowest in over two decades and recent forecasts indicate a lower trajectory than in recent years. Years of excessive investment, notably in the property market, has stoked potential financial bubbles, requiring the implementation of a new economic growth model.

Potential impact on HSBC

- HSBC s results could be adversely affected by a prolonged period of low or negative interest rates, low inflation levels or deflation and/or low oil prices.

- We earn a significant proportion of our profits from our operations in emerging markets. Our results could be adversely affected by a prolonged slowdown in emerging market growth.

- Global trade and capital flows may contract as a result of weaker economic growth, the introduction of protectionist measures, the emergence of geopolitical risks or increasing redenomination risk. This may curtail our profitability.

Mitigating actions

- We closely monitor economic developments in key markets and sectors with the aim of ensuring trends are identified, the implications for specific customers, customer segments or portfolios are assessed and appropriate mitigating action, which may include revising key risk appetite metrics and limits, is taken as circumstances evolve.

- We use stress testing, both internal and regulatory programmes, to assess the effect of changes in economic conditions on our operations. Regulatory stress tests are discussed on page 124.

Increased geopolitical risk

Our operations are exposed to risks arising from political instability and civil unrest in many parts of the world, which may have a wider effect on regional stability and regional and global economies.

Geopolitical risk increased during 2014. Military escalation and/or civil war remain a possibility in Ukraine, while sanctions targeting the Russian government, institutions and individuals, together with falling oil prices, have had an adverse effect on the Russian economy.

In the Middle East, the civil war in Syria has been complicated by the seizure of parts of Iraq and Syria by Islamic State, a terrorist group. Elsewhere in the region, chaos in Libya, ongoing tensions between Israel and Palestine and fraught negotiations over Iran s nuclear programme are combining to increase risks to stability. In Asia, there was no easing in the maritime sovereignty disputes involving mainland China and its neighbours, while tensions remain high over the line of control between India and Pakistan, raising concerns over a possible wider conflict between the two nuclear-armed neighbours.

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Civil unrest and demonstrations in a number of countries during 2014, including Turkey and Hong Kong, have also contributed to geopolitical risk as governments took measures to contain them.

A number of emerging and developed markets will hold elections in 2015, which could lead to further market volatility. In addition, a sustained period of low oil prices may affect stability in countries that rely heavily on oil production as a significant source of revenue.

Potential impact on HSBC

Our results are subject to the risk of loss from unfavourable political developments, currency fluctuations, social instability and changes in government policies on matters such as expropriation, authorisations, international ownership, interest-rate caps, foreign exchange transferability and tax in the jurisdictions in which we operate.

Actual conflict could expose our staff to physical risk and/or result in physical damage to our assets.

Mitigating actions

We continuously monitor the geopolitical outlook, in particular in countries where we have material exposures and/or a physical presence.

Our internal credit risk rating of sovereign counterparties takes these factors into account and drives our appetite for conducting business in those countries. Where necessary, we adjust our country limits and exposures to reflect our risk appetite and mitigate risks as appropriate.

Macro-prudential, regulatory and legal risks to our business model

- Regulatory developments affecting our business model and Group profitability
- Regulatory investigations, fines, sanctions, commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand
- Dispute risk

Financial service providers face increasingly stringent and costly regulatory and supervisory requirements, often involving the provision of large amounts of data, particularly in the areas of capital and liquidity management, conduct of business, operational structures and the integrity of financial services delivery. Increased government intervention and control over financial institutions both on a sector-wide basis and individually, together with measures to reduce systemic risk, may significantly alter the competitive landscape locally, regionally and/or globally for some or all of the Group s businesses. These measures may be introduced as formal requirements in a supra-equivalent manner and to differing timetables by different regulatory regimes.

Regulatory developments affecting our business model and Group profitability

Regulatory changes affect our activities, both of the Group as a whole and of some or all of our principal subsidiaries. These changes include:

- the UK s Financial Services (Banking Reform) Act 2013 which requires the ring-fencing of our UK retail banking activities from wholesale banking, together with the structural separation of other activities as envisaged in the legislation and rules adopted in the US (including the Volcker Rule adopted in December 2013 under the Dodd-Frank Act), measures adopted in France restricting certain trading activities and potential further changes under European Commission proposals for structural measures for larger EU banks;

- the implementation of extra-territorial laws, including the US Foreign Account Tax Compliance Act (FATCA) and other related initiatives to share tax information such as those being pursued by the OECD more generally;

- changes in the regime for the operation of capital markets, notably mandatory central clearing of over the counter (OTC) derivatives, including under the Dodd-Frank Act and the EU s European Market Infrastructure Regulation (EMIR);

- changes arising from the increasing focus by regulators on how institutions conduct business, particularly with regard to the delivery of fair outcomes for customers and orderly/transparent markets, promoting effective competition in the interests of consumers (including the outcome of the current investigation by the UK Competition and Markets Authority on the personal current account and SME banking market in the UK and recent indications of further FCA focus on UK wholesale markets);

- the outcome of the Fair and Effective Financial Markets Review being undertaken by the Bank of England which will consider changes in the operation of wholesale financial markets in the UK;

- restrictions on the structure of remuneration imposed under CRD IV and UK regulations and increasing requirements to detail management accountability within the Group to meet the requirements of the Senior Managers Regime in the UK (including the continued focus in the UK on the progress being made in implementing wider recommendations made by the Parliamentary Commission on Banking Standards on matters relating to institutional culture , employee conduct and obligations more generally such as whistleblowing etc.);

- the implementation of CRD IV, notably the UK application of the capital buffer framework and its interaction with Pillar 2;

- the effect of proposals for the UK Financial Policy Committee to be given more powers to impose leverage constraints on UK banks;

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the proposals from the Financial Stability Board which are subject to consultation and translation into national regulations but which would require G-SIB s to hold minimum levels of capital and subordinated debt as total loss absorbing capacity (TLAC);

requirements flowing from arrangements for the resolution strategy of the Group and its individual operating entities, which may have different effects in different countries;

the continuing stress tests by supervisory authorities and the implication for capital requirements and capital transfers within the Group;

the tightening by regulators in a number of countries of credit controls on mortgage lending and unsecured portfolios; and

the continued risk of further changes to regulation relating to taxes affecting financial service providers, including financial transaction taxes.

Potential impact on HSBC

Proposed changes in and/or the implementation of regulations including mandatory central clearing of OTC derivatives, EMIR, ring-fencing and similar requirements, the Volcker Rule, recovery and resolution plans, FATCA and findings from competition orientated enquiries and investigations may affect the manner in which we conduct our activities and how the Group is structured.

Requirements for higher levels of capital or TLAC may increase the funding costs for the Group and reduce our return on equity.

Mandatory central clearing of OTC derivatives also brings new risks to HSBC in our role as a clearing member, as we will be required to underwrite losses incurred by central clearing counterparties from the default of other clearing members and their clients. Hence central clearing brings with it a new element of interconnectedness between clearing members and clients which we believe may increase rather than reduce our exposure to systemic risk.

Increased regulatory scrutiny of conduct of business (including incentive structures, remuneration, product governance and sales processes) and management accountability may affect the industry in areas such as employee recruitment and retention, product pricing and profitability in both retail and wholesale markets. HSBC s businesses may be affected by these developments.

These measures have the potential to increase our cost of doing business and curtail the types of business we can carry out, with the consequent risk of decreased profitability.

Mitigating actions

We are engaged closely with governments and regulators in the countries in which we operate to help ensure that the new requirements are considered properly and can be implemented in an effective manner.

We have developed and are implementing a global approach to the management of conduct and have established a Conduct & Values Committee as a sub-committee of the Board to oversee the management of conduct across the Group.

We have enhanced our governance around central clearing counterparties and appointed specialists to manage the associated liquidity and collateral risks.

We continue to enhance and strengthen governance and resourcing more generally around regulatory change management and the implementation of required measures to actively address this ongoing and significant agenda of regulatory change.

Regulatory investigations, fines, sanctions, commitments and consent orders and requirements relating to conduct of business and financial crime negatively affecting our results and brand

Financial service providers are at risk of regulatory sanctions or fines related to conduct of business and financial crime. The incidence of regulatory proceedings against financial service firms is increasing, with a consequent increase also in civil litigation arising from or relating to issues which are subject to regulatory investigation, sanction or fine. In addition, criminal prosecutions of financial institutions for, among other alleged conduct, breaches of AML and sanctions regulations, antitrust violations, market manipulation, aiding and abetting tax evasion, and providing unlicensed cross-border banking services, have become more commonplace and may increase in frequency due to increased media attention and higher expectations from prosecutors and the public. Moreover, financial service providers may face similar or broader legal proceedings, investigations or regulatory actions across many jurisdictions as a result of, among other things, increased media attention and higher expectations from regulators and the public. Any such prosecution or investigation of, or legal proceeding or regulatory action brought against, HSBC or one or more of its subsidiaries could result in substantial fines, penalties and/or forfeitures and could have a material adverse effect on our results, business, financial condition, prospects and reputation, including the potential loss of key licences, requirement to exit certain businesses and withdrawal of funding from depositors and other stakeholders.

Regulatory commitments and consent orders

In December 2012, HSBC Holdings, HSBC North America Holdings Inc. (HNAH) and HSBC Bank USA, N.A. (HSBC Bank USA) entered into agreements with US and UK authorities regarding past inadequate compliance with AML and sanctions laws. Among these agreements, HSBC Holdings and HSBC Bank USA entered into a five-year deferred prosecution agreement (US DPA) with the US Department of Justice (DoJ) and HSBC Holdings entered

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into a two-year DPA with the New York County District Attorney (the DANY DPA). HSBC Holdings also entered into an undertaking with the FSA (the FCA Direction) to comply with certain forward-looking obligations with respect to AML and sanctions requirements. In addition, HSBC Holdings entered into a cease and desist order with the US FRB with respect to compliance with US AML and sanctions requirements.

The agreements with the DoJ and the FRB and the FCA Direction require us to retain an independent monitor to evaluate our progress in fully implementing our obligations and produce regular assessments of the effectiveness of our Financial Crime Compliance function. The Monitor is discussed on page 27.

HSBC has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two-year period of that agreement in December 2014.

While we still have significant work to do to build and improve our AML and sanctions compliance programme, and our DPA with the DoJ and other settlement agreements remain in place, the expiration of the DANY DPA is an important milestone.

HSBC Bank USA is also subject to an agreement entered into with the Office of the Comptroller of the Currency (OCC) in December 2012, the Gramm-Leach-Bliley Act (GLBA) Agreement and other consent orders.

Potential impact on HSBC

It is difficult to predict the outcome of the regulatory proceedings involving our businesses. Unfavourable outcomes may have a material adverse effect on our reputation, brand and results, including loss of business and withdrawal of funding.

Our significant involvement in facilitating international capital flows and trade exposes the Group to the risk of financial crime or inadvertently breaching restrictions and sanctions imposed by the US Office of Foreign Assets Control and other regulators.

Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA.

The design and execution of AML and sanctions remediation plans is complex and requires major investments in people, systems and other infrastructure. This complexity creates significant execution risk, which could impact our ability to effectively manage financial crime risk and remedy AML and sanctions compliance deficiencies in a timely manner. This could, in turn, impact HSBC s ability to satisfy the Monitor or comply with the terms of the US DPA, the FCA Direction, or the FRB Cease and Desist Order, and may require HSBC to take additional remedial measures in the future.

Failure to comply with the requirements of consent orders or the GLBA Agreement within the time periods specified in them or otherwise as may be extended, could result in supervisory action. Any such action could have a material adverse effect on the consolidated results and operation of HSBC.

Mitigating actions

Steps to address many of the requirements of the US DPA, the FCA Direction and the GLBA Agreement have either already been taken or are under way in consultation with the relevant regulatory agencies. These include simplifying the Group s control structure, strengthening the governance structure with new leadership appointments, revising key policies and implementing Global Standards to detect, deter and protect against financial crime (see page 26). In addition, we have substantially increased spending and staffing in the Financial Crime Compliance and Regulatory Compliance functions in the past few years.

During 2014, we approved a new global strategy for transaction monitoring. Globally standardised AML investigations processes have been developed and are being implemented, starting in priority countries.

Conduct of business

Regulators in the UK and other countries have continued to increase their focus on conduct matters relating to fair outcomes for customers and orderly/transparent markets including, for example, attention to sales processes and incentives, product and investment suitability, product governance, employee activities and accountabilities as well as the risks of market abuse in relation to benchmark, index, other rate setting processes, wider trading activities and more general conduct of business concerns.

In the UK, the FCA is making increasing use of existing and new powers of intervention and enforcement, including powers to consider past business undertaken and implement customer compensation and redress schemes or other, potentially significant, remedial work. The FCA is also now regulating areas of activity not previously regulated by them, such as consumer credit, and considering competition issues in the markets they regulate. Additionally, the FCA and other regulators increasingly take actions in response to customer complaints or where they see poor customer outcomes and/or market abuses, either specific to an institution or more generally in relation to a particular product. There have been examples of this approach by regulators in the context of the possible mis-selling of PPI, of interest rate hedging products for SMEs and of wealth management products.

The Group also remains subject to a number of other regulatory proceedings including investigations and reviews by various national regulatory, competition and enforcement authorities relating to certain past submissions made by panel banks and the process for making submissions in connection with the setting of Libor and other interbank offered and benchmark

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interest rates. There are also ongoing investigations into foreign exchange, precious metals and credit default swap related activities. Details of these investigations can be found in Note 40 on the Financial Statements.

Potential impact on HSBC

HSBC may face regulatory censure or sanctions including fines and/or be exposed to legal proceedings and litigation.

Regulators in the UK and other countries may identify future industry-wide mis-selling, market conduct or other issues that could affect the Group. This may lead from time to time to significant direct costs or liabilities and/or changes in the practices of such businesses. Also, decisions taken by the Financial Ombudsman Service in the UK (or similar overseas bodies) could, if applied to a wider class or grouping of customers, have a material adverse effect on the operating results, financial condition and prospects of the Group.

Mitigating actions

Programmes to enhance the management of conduct of business are progressing in all global businesses and functions.

Performance management arrangements for managers and staff are being reviewed, focusing on reward linked to values-based behaviour and good conduct.

Enhancements to surveillance capabilities and benchmark rate setting processes are ongoing and HSBC Holdings and its subsidiaries are cooperating fully with all regulatory investigations and reviews.

Dispute risk

HSBC is party to legal proceedings and regulatory matters in a number of jurisdictions arising out of its normal business operations. Further details are provided in Note 40 on the Financial Statements.

Potential impact on HSBC

Dispute risk gives rise to potential financial loss and significant reputational damage which could adversely affect customer and investor confidence.

Mitigating actions

We continue to focus on identifying emerging regulatory and judicial trends in order to limit exposure to litigation or regulatory enforcement action in the future.

We are enhancing our financial crime and regulatory compliance controls and resources.

Risks related to our business operations, governance and internal control systems

Heightened execution risk
People risk
Internet crime and fraud
Information security risk
Data management
Model risk
Third party risk management

Heightened execution risk

The financial services industry is currently facing an unprecedented period of scrutiny. Regulatory requests, legal matters and business initiatives all require a significant amount of time and resources to implement. The magnitude and complexity of projects within HSBC required to meet these demands has resulted in heightened execution risk. There also remains heightened risk around the execution of a number of disposals across the Group in line with our strategy.

Potential impact on HSBC

These factors may affect the successful delivery of our strategic priorities.

The potential risks of disposals include regulatory breaches, industrial action, loss of key personnel and interruption to systems and processes during business transformation. They can have both financial and reputational implications.

Mitigating actions

We have strengthened our prioritisation and governance processes for significant projects and have invested in our project implementation and IT capabilities.

Risks related to disposals are carefully assessed and monitored and are subject to close management oversight.

People risk

The demands being placed on the human capital of the Group are unprecedented. The cumulative workload arising from a regulatory reform programme that is often extra-territorial and still evolving is hugely consumptive of human resources, placing increasingly complex and conflicting demands on a workforce where the expertise is in short supply and globally mobile.

Potential impact on HSBC

Changes in remuneration policy and practice resulting from the new regulations under CRD IV 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 (based on qualitative and quantitative criteria issued by the

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EBA). This presents significant challenges for HSBC because a significant number of our material risk takers are based outside the EU.

The policy statement issued by the PRA extends the Remuneration Code to require all PRA-authorised firms to apply clawback to vested/paid variable remuneration on a Group-wide basis for any material risk takers receiving variable pay from 1 January 2015.

The introduction by the PRA and FCA in the UK of the Senior Managers and Certification regimes and of the related Rules of Conduct (the detail of which is currently subject to consultation) are intended to set clearer expectations of the accountabilities and behaviour of both senior and more junior employees. However, there are a number of uncertainties around the precise impact of these regimes at present (including on more senior employees, on non-UK based employees and on non-executive directors).

Organisational changes to support the Group s strategy and/or implement regulatory reform programmes have the potential to lead to increased staff turnover.

Mitigating actions

The changes in remuneration under the new CRD IV regulations 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.

Risks related to organisational change and disposals are subject to close management oversight.

We continue to increase the level of specialist resources within Financial Crime Compliance, Regulatory Compliance and stress testing and to engage with our regulators as they finalise new regulations.

Internet crime and fraud

HSBC is increasingly exposed to fraudulent and criminal activities as a result of increased usage of internet and mobile services by customers. We also face the risk of breakdowns in processes or procedures and systems failure or unavailability, and our business is subject to disruption from events that are wholly or partially beyond our control, such as internet crime and acts of terrorism.

Potential impact on HSBC

Internet crime could result in financial loss and/or customer data and sensitive information being compromised. They may also give rise to losses in service to customers. The same threats apply equally when we rely on external suppliers or vendors for services provided to us and our customers.

Mitigating actions

We continually assess these threats as they evolve and adapt our controls to mitigate them.

We have increased our defences through enhanced monitoring and have implemented additional controls, such as two-factor authentication, to reduce the possibility of losses from fraud.

Information security risk

The security of our information and technology infrastructure is crucial for maintaining our banking applications and processes while protecting our customers and the HSBC brand. HSBC and other multinational organisations continue to be the targets of cyber-attacks which may disrupt services including the availability of our external facing websites, compromise organisational and customer information or expose security weaknesses.

Potential impact on HSBC

Information security risk gives rise to potential financial loss and reputational damage which could adversely affect customer and investor confidence. Loss of customer data would also trigger regulatory breaches which could result in fines and penalties being incurred.

Mitigating actions

We have invested significantly in addressing this risk through increased training to raise staff awareness of the requirements, enhanced multi-layered controls protecting our information and technical infrastructure, heightened monitoring and management of potential cyber-attacks and continued vulnerability assessment.

Data management

HSBC must have a clear data strategy to meet the volume, granularity, frequency and scale of regulatory and other reporting requirements. As a G-SIB, HSBC is also required to comply with the principles for effective risk data aggregation and risk reporting as set out by the Basel Committee on Banking Supervision (the Basel Committee) in its paper.

Potential impact on HSBC

Ineffective data management could adversely affect our ability to aggregate and report complete, accurate and consistent data to regulators, investors and senior management on a timely basis.

Financial institutions that fail to meet their Basel Committee data obligations by the required deadline may face supervisory measures.

Mitigating actions

Since the Data Strategy Board was established in 2012, we have set a data strategy for the Group and defined Group-level principles, standards and policies to enable consistent data aggregation, reporting and management.

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A number of key initiatives and projects to implement our data strategy and work towards meeting our Basel Committee data obligations are in progress.

Model risk

HSBC uses models for a range of purposes in managing its business, including regulatory and economic capital calculations, stress testing, granting credit, pricing and financial reporting. Model risk is the potential for adverse consequences as a result of decisions based on incorrect model outputs and reports or the use of such information for purposes for which it was not designed. Model risk could arise from models that are poorly developed, implemented or used, or from the modelled outcome being misunderstood and acted upon inappropriately by management. The regulatory environment and supervisory concerns over banks use of internal models to determine regulatory capital further contribute to model risk.

Potential impact on HSBC

HSBC could incur losses or be required to hold additional capital as a result of model limitations or failure.

Supervisory concerns over the internal models and assumptions used by banks in the calculation of regulatory capital have led to the imposition of risk weight and loss given default floors. Such changes have the potential to increase our capital requirement and/or make it more volatile.

Mitigating actions

We aim to mitigate model risk through appropriate governance over model development, usage and validation, together with independent review, monitoring and feedback.

Third-party risk management

We have increased our risk management focus on our use of third-party service providers, in part in response to increased scrutiny by global regulators. This includes how outsourcing decisions are made, how the key relationships are managed and the consistency of risk management across the range of third parties used. Risks arising from the use of third-party service providers may be less transparent and therefore more challenging to manage or influence.

Potential impact on HSBC

Any deficiency in the management of third-party service providers could lead to a variety of risks including business disruption, regulatory failings, loss of confidential information and financial crime.

Mitigating actions

We are enhancing our third-party risk management capability in line with guidance issued by the OCC and FRB, strengthening controls over third-party use and increasing the monitoring and assurance over these controls.

Areas of special interest

(Unaudited)

During 2014, we considered a number of particular areas because of the effect they may have on the Group. Whilst these areas may already have been identified in top and emerging risks, further details of the actions taken during the year are provided below.

Financial crime compliance and regulatory compliance

In recent years, we have experienced increasing levels of compliance risk as regulators and other agencies pursued investigations into historical activities, and we continued to work with them in relation to existing issues. This has included the matters giving rise to the DPAs reached with US authorities in relation to investigations regarding inadequate compliance with anti-money laundering and sanctions law, and the related undertaking with the FSA (the FCA Direction). The work of the Monitor, who has been appointed to assess our progress against our various obligations is discussed on page 27.

We continue to respond to a number of investigations by the FCA into the possible mis-selling in the UK of certain products, including sales of PPI, of interest rate hedging products for SMEs and of wealth management products. In addition, we also remain subject to a number of other regulatory proceedings including investigations and reviews by various national regulatory, competition and enforcement authorities relating to certain past submissions made by panel banks and the process for making submissions in connection with the setting of Libor and other interbank offered and benchmark interest rates. There are also investigations in progress into activities related to foreign exchange, precious metals and credit default swaps. Details of these investigations and legal proceedings can be found in Note 40 on the Financial Statements.

It is clear from both our own and wider industry experience that the level of activity among regulators and law enforcement agencies in investigating possible breaches of regulations has increased, and that the direct and indirect costs of such breaches can be significant. Coupled with a substantial rise in the volume of new regulation, much of which has some element of extra-territorial reach, and the geographical spread of our businesses, we believe that the level of inherent compliance risk that we face as a Group will continue to remain high for the foreseeable future.

Further information about the Group s compliance risk management may be found on page 189.

Private Bank

Past practices at our Swiss private bank and the financial affairs of some of our Swiss private banking clients have been subject to recent media coverage. The media focus has been on historical events that show the standards to which we operate today were not universally in place in our Swiss operations eight years ago.

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Since then, we have fundamentally changed the way HSBC is run and have established much tighter central control around who are our customers. We have put in place tough, world-class financial crime, regulatory compliance and tax transparency standards, enforced by a team of over 7,000 compliance staff.

GPB, and in particular its Swiss private bank, has undergone a radical transformation. We have taken significant steps over the past several years to implement reforms and exit clients who did not meet strict new HSBC standards, including those where we had concerns in relation to tax compliance. As a result of this repositioning, HSBC s Swiss private bank has reduced its client base by almost 70% since 2007.

We are fully committed to the exchange of information with relevant authorities and are actively pursuing measures that ensure clients are tax transparent, even in advance of a regulatory or legal requirement to do so. We are also cooperating with relevant authorities investigating these matters.

Regulatory stress tests

Stress testing is an important tool for regulators to assess vulnerabilities in the banking sector and in individual banks, the results of which could have a significant effect on minimum capital requirements, risk and capital management practices and planned capital actions, including the payment of dividends, going forward.

We are subject to regulatory stress testing in many jurisdictions. These have increased both in frequency and in the granularity of information required by supervisors. They include the programmes of the PRA, the FRB, the EBA, the ECB, the Hong Kong Monetary Authority (HKMA) and other regulators. Assessment by regulators is on both quantitative and qualitative bases, the latter focusing on portfolio quality, data provision, stress testing capability, forward-looking capital management processes and internal management processes.

In 2014, the Group took part in the first PRA concurrent stress test exercise involving major UK banks. The exercise was run on an enterprise-wide basis and comprised the EBA base scenario and a stress scenario that predominantly followed the EBA stress scenario with an additional overlay of variables reflecting the vulnerabilities facing the UK banking system, including significant declines in the value of sterling, residential and commercial property prices and bond and equity prices, along with a downturn in economic activity and rising unemployment. HSBC s submission was made to the PRA at the end of June 2014. The Group also participated in the complementary programme of regular data provision to the Bank of England under its Firm Data Submission Framework.

The PRA disclosed the results of the 2014 Concurrent Stress Test on 16 December 2014. The stressed CET1

capital ratio of HSBC was deemed by the PRA to fall to a minimum of 8.7%, taking into account approved management mitigating actions. This was above the target minimum of 4.5%.

The EBA conducted a Europe-wide stress test in the first half of 2014, administered via the PRA for UK banks. The base scenario covered a wide range of risks including credit, market, securitisation, sovereign and funding risks. The adverse macroeconomic scenario included country-specific shocks to sovereign bond spreads, short-term interest rates and residential property prices, together with a decline in world trade, currency depreciation in Central and Eastern

Europe and slow-downs or contractions in GDP growth around the world.

The EBA disclosed results of the stress test exercise on 26 October 2014. Our stressed CET1 capital ratio was projected to fall to a low point of 8.7% at the end of 2015, above the EBA minimum threshold of 5.5%. Our fully-loaded stressed CET1 ratio was projected to be 9.3% at the end of 2016, which compared favourably with other major European banks.

The PRA and EBA results demonstrate HSBC s continued capital strength.

The ECB conducted its comprehensive assessment in the first half of 2014, which comprised an Asset Quality Review and the ECB s stress testing process, the latter using the EBA scenarios. HSBC France and HSBC Malta fell within scope and both passed the exercise, the results of which were also published in October 2014. The CET1 ratio for HSBC France was projected to fall from 12.9% in 2013 to 6.6% by the end of 2016, remaining above the regulatory minimum. The fall reflected the impact of stress on HSBC France s business model, which includes the Group s euro Rates trading business, and the effect of ECB credit loss benchmarks on the loan portfolio.

HNAH participates in the Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Stress Testing (DFAST) programmes of the FRB and HSBC Bank USA in the OCC s DFAST programme. Both made their first submissions under these programmes on 6 January 2014. On 26 March 2014, the FRB informed HNAH that it objected to the submitted capital plan on qualitative grounds and a resubmission of its capital plan was required by 5 January 2015, together with improvements to its stress testing processes. However, the FRB approved the capital actions included in HNAH s CCAR submission and HNAH was allowed to proceed with the payment of dividends on the outstanding preferred shares and trust preferred securities of HNAH and its subsidiaries. HNAH s stressed CET1 capital ratio was forecast by the FRB to fall to a minimum of 9.4% under the supervisory severely adverse scenario, above the regulatory minimum ratio of 4.5%. HNAH made its CCAR 2015 submission, which also served as the required re-submission for the CCAR 2014, and HSBC Bank USA made its DFAST 2015 submission, on 5 January 2015. Disclosure by the FRB and HNAH and HSBC Bank USA of the results of the exercises, based on the supervisory scenarios published in November 2014, will be made in

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March 2015. In addition, the FRB will also provide its non-objection or objection to HNAH s capital plan and the capital actions included within its 2015 CCAR submission.

The Hongkong and Shanghai Banking Corporation participated in the HKMA stress test exercise in the first half of 2014. The HKMA stress scenario envisaged a significant deceleration of growth in mainland China and a sharper contraction in Hong Kong.

Oil and gas prices

Oil and commodity prices have declined significantly since the middle of 2014 as a result of increasing global demand and supply imbalances and changes in market sentiment. There is considerable uncertainty regarding the future price levels during 2015 and beyond. Prolonged depressed oil prices will affect countries, industries and individual companies differently:

- Country level: net oil importers are likely to benefit from reduced oil prices. In advanced economies, this is likely to increase consumer disposable income while in emerging market countries it is more likely to benefit the governments fiscal position. The impact on oil exporting countries will depend on the importance of the oil receipts to fiscal revenues, the extraction costs and the amount of fiscal reserves that the countries are able to draw upon.

- Industry level: the oil and gas industry and supporting services will be affected, though this will vary depending on the relevant sub-sector. Large integrated producers are likely to remain resilient. Within the pure producers sector, the higher cost pure producers, such as shale and oil sands producers, are likely to experience higher levels of stress. Similarly, infrastructure and services providers are likely to come under stress as producers curtail capital expenditure. Industries where oil and gas represent major costs, such as haulage, transport and shipping, are likely to benefit if prices remain depressed.

The oil and gas sector has been considered a higher risk sector for some time and has been under enhanced monitoring and controls with risk appetite and new money lending under increased scrutiny.

HSBC has a diversified lending profile to the oil and gas sector. Lending in GB&M is concentrated predominately in upstream activities and with large investment-grade global integrated producers. CMB mainly focuses on lending to service companies and pure producers. The exposures are diversified across a number of countries.

The overall portfolio has drawn risk exposures amounting to about US$34bn, with just over 47% consisting of exposures to oil service companies and non-integrated producers. In-depth client reviews have been conducted on larger clients considered to be potentially vulnerable to depressed oil prices for a period of one to two years, particularly, but not exclusively, focusing on oil service companies, and producers (and their suppliers) reliant on expensive extraction methods such as shale or oil sands.

Following these reviews, about US$0.5bn of exposures have been identified as being of sufficient concern to require close management. Whilst weakening credit is evident in this population, no new customers were identified as being impaired at this stage.

Russia

During 2014, tensions have risen between the Russian Federation (Russia) and western countries (the West) in respect of Ukraine. The West s response to date has been to impose sanctions on a selected list of Russian individuals, banks and corporates during the course of 2014. Monitoring and action in response to the sanctions requirements is ongoing and will impose some restrictions on HSBC s business in Russia, although the effect on the Group is not expected to be significant. Our exposures to counterparties incorporated or domiciled in Ukraine are not considered material.

The fourth quarter of 2014 saw significant falls in the value of the Russian rouble and the price of crude oil, and multiple interest rate rises implemented by Russia s central bank. The impact of these developments is being monitored by management and, combined with the sanctions, means the outlook for Russia remains highly uncertain with the economy expected to contract in 2015.

Our exposures to Russia mainly consist of loans and advances. At 31 December 2014 these amounted to US$4bn.

In addition to the above, a number of our multinational clients have indirect exposure to Russia through majority or minority stakes in Russia-based entities, via dependency of supply or from reliance on exports. The operations and businesses of such clients may be negatively affected should the scope and nature of sanctions and other actions be widened or the Russian economy deteriorate. Also, we run operations in neighbouring countries where the financial system has strong links to the Russian economy. Management is monitoring the quantum and potential severity of such risks.

Eurozone

In recent years the EU has introduced a series of legislative changes designed to better equip it to deal with a financial crisis and to reduce the risks of contagion in the event of an EU member country experiencing financial difficulties. The outcome of current negotiations on the terms of the Greek bail out is highly uncertain. The debt may be rescheduled or Greece may default on its debts; there is also the possibility that Greece may eventually exit the euro. Our exposures to Greece mainly consist of loans and advances and reverse repos. At 31 December 2014 these amounted to US$4bn and US$2bn respectively. Included in loans and advances are US$2bn related to the shipping industry, denominated in US dollars and booked in the UK. We believe the shipping industry is less sensitive to the Greek economy as it is mainly dependent on international trade.

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Credit risk

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Report of the Directors: Financial Review (continued)

1 *Appendix to Risk risk policies and practices.*

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Credit risk

(Unaudited)

Credit risk is the risk of financial loss if a customer or counterparty fails to meet an obligation under a contract. It arises principally from direct lending, trade finance and leasing business, but also from other products such as guarantees and credit derivatives and from holding assets in the form of debt securities.

There were no material changes to our policies and practices for the management of credit risk in 2014.

A summary of our current policies and practices regarding credit risk is provided in the Appendix to Risk on page 204.

Our maximum exposure to credit risk is presented on page 131 and credit quality on page 133. While credit risk arises across most of our balance sheet, losses have typically been incurred on loans and advances and securitisation exposures and other structured products. As a result, our disclosures focus primarily on these two areas.

This year we have redesigned the Credit risk section in order to enhance clarity and reduce duplication. It now begins with a summary of credit risk followed by an overview of our gross exposures. We describe various measures of credit quality such as past due status, impaired loans and renegotiated loans before analysing impairment allowances. There are specific sections on wholesale lending and personal lending where additional detail is provided and we cover areas of particular focus such as our exposure to commercial real estate in wholesale lending and our Consumer and Mortgage Lending (CML) portfolio in personal lending. This is followed by a section describing our securitisation exposures and other structured products. Information on our exposures to oil and gas, Russia and Greece is provided in Areas of special interest on page 126.

Following the change in balance sheet presentation explained on page 347, non-trading reverse repos are shown separately on the balance sheet and are no longer included in Loans and advances to customers and Loans and advances to banks . Comparative data have been re-presented accordingly. As a result, any analysis that references loans and advances to customers or banks excludes non-trading reverse repos. The amount of the non-trading reverse repos to customers and banks is set out on page 151.

Loan impairment charges, loan impairment allowances and impaired loans all reduced compared with 2013.

Gross loans and advances decreased by US$28bn which included adverse foreign exchange movements of US$51bn; excluding these movements customer lending grew in 2014.

The commentary that follows is on a constant currency basis, whilst tables are presented on a reported basis.

Summary of credit risk

(Unaudited)

	2014 US$bn	2013 US$bn	Page
At year-end			
Maximum exposure to credit risk	**3,133**	3,112	131
Gross loans and advances[1]			
personal lending	**393**	411	132
wholesale lending	**706**	716	132
Total	**1,099**	1,127	132
Impaired loans			
personal lending	**15**	19	137
wholesale lending	**14**	18	137
Total	**29**	37	137
Impaired loans as a % of gross loans and advances			
personal lending	**3.9%**	4.6%	
wholesale lending	**2.0%**	2.5%	
total	**2.7%**	3.3%	
	US$bn	US$bn	
Impairment allowances			
personal lending	**4.6**	6.6	143
wholesale lending	**7.8**	8.6	143
Total	**12.4**	15.2	143
Loans and advances net of impairment allowances[1]	**1,087**	1,112	
For year ended 31 December			
Loan impairment charge			
personal lending	**1.8**	3.1	141
wholesale lending	**2.3**	2.9	141
Total	**4.1**	6.0	141

For footnotes, see page 202.

See page 158 for further details in respect of the constant currency reconciliation. For an analysis of loans and advances by country see page 160.

Wholesale gross loans and advances increased by US$21bn. Asia grew by US$16bn and North America by US$10bn with more modest levels of growth in the Middle East and North Africa and Latin America. This was offset by a decrease of US$15bn in Europe. Loan impairment charges were lower in 2014 as we continued to benefit from the improvement in various economies and the low interest rate environment.

Personal lending balances, excluding the planned US CML portfolio run off, grew by US$7.7bn. This was primarily driven by increased mortgage and other lending in Asia and growth in the mortgage portfolio in both North America and Latin America. The growth was partially offset by lower lending balances in Europe due to repayments on the mortgage and credit card portfolio in the UK. The CML portfolio declined by a further US$5.7bn during the year. Loan impairment charges were down as a result of improvements in the US housing market and the continued run-off of the CML portfolio.

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Gross loans to customers and banks over five years[1] *(US$bn)*

(Unaudited)

Loan impairment charge over five years (US$bn)

(Unaudited)

Loan impairment charges by geographical region (US$bn)

(Unaudited)

Loan impairment charges by industry (US$bn)

(Unaudited)

Loan impairment allowances over five years

(Unaudited)

For footnote, see page 202.

Credit exposure

Maximum exposure to credit risk

(Audited)

The table on page 131 provides information on balance sheet items, offsets and loan and other credit-related commitments. Commentary on balance sheet movements is provided on page 58. The offset on derivatives increased in line with the increase in maximum exposure amounts.

The offset on corporate and commercial loans to customers decreased by US$31bn. This reduction was in the UK where a small number of clients benefit from the use of net interest arrangements across their overdraft and deposit positions. During the year, as we aligned our approach in our Payments and Cash Management business to be more globally consistent, many of these clients increased the frequency with which they settled these balances thereby reducing the amount of offset available.

Maximum exposure to credit risk table (page 131)

The table presents our maximum exposure to credit risk from balance sheet and off-balance sheet financial instruments before taking account of any collateral held or other credit enhancements (unless such enhancements meet accounting offsetting requirements). For financial assets recognised on the balance sheet, the maximum exposure to credit risk equals their carrying amount; for financial guarantees and similar contracts granted, it is the maximum amount that we would have to pay if the guarantees were called upon. For loan commitments and other credit-related commitments, it is generally the full amount of the committed facilities.

The offset in the table relates to amounts where there is a legally enforceable right of offset in the event of counterparty default and where, as a result, there is a net exposure for credit risk purposes. However, as there is no intention to settle these balances on a net basis under normal circumstances, they do not qualify for net presentation for accounting purposes.

In the case of derivatives the offset column also includes collateral received in cash and other financial assets.

Other credit risk mitigants

While not disclosed as an offset in the Maximum exposure to credit risk table, other arrangements are in place which reduce our maximum exposure to credit risk. These include a charge over collateral over borrowers specific assets such as residential properties. Other credit risk mitigants include short positions in securities and financial assets held as part of linked insurance/investment contracts where the risk is predominantly borne by the policyholder. In addition, we hold collateral in the form of financial instruments that are not recognised on the balance sheet.

See Note 32 and from page 147 and page 156 respectively on the Financial Statements for further details on collateral in respect of certain loans and advances and derivatives.

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Maximum exposure to credit risk

(Audited)

	2014 Maximum exposure US$m	2014 Offset US$m	2014 Net US$m	2013 Maximum exposure US$m	2013 Offset US$m	2013 Net US$m
Cash and balances at central banks	**129,957**		**129,957**	166,599		166,599
Items in the course of collection from other banks	**4,927**		**4,927**	6,021		6,021
Hong Kong Government certificates of indebtedness	**27,674**		**27,674**	25,220		25,220
Trading assets	**228,944**		**228,944**	239,301	(1,777)	237,524
Treasury and other eligible bills	**16,170**		**16,170**	21,584		21,584
debt securities	**141,532**		**141,532**	141,644		141,644
loans and advances to banks	**27,581**		**27,581**	27,885		27,885
loans and advances to customers	**43,661**		**43,661**	48,188	(1,777)	46,411
Financial assets designated at fair value	**9,031**		**9,031**	12,719		12,719
Treasury and other eligible bills	**56**		**56**	50		50
debt securities	**8,891**		**8,891**	12,589		12,589
loans and advances to banks	**84**		**84**	76		76
loans and advances to customers				4		4
Derivatives	**345,008**	**(313,300)**	**31,708**	282,265	(252,344)	29,921
Loans and advances to customers held at amortised cost[1]	**974,660**	**(67,094)**	**907,566**	992,089	(96,726)	895,363
personal	**388,954**	**(4,412)**	**384,542**	404,126	(1,348)	402,778
corporate and commercial	**535,184**	**(59,197)**	**475,987**	537,922	(90,215)	447,707
financial (non-bank financial institutions)	**50,522**	**(3,485)**	**47,037**	50,041	(5,163)	44,878
Loans and advances to banks held at amortised cost[1]	**112,149**	**(258)**	**111,891**	120,046	(587)	119,459
	161,713	**(5,750)**	**155,963**	179,690	(22,267)	157,423

Reverse repurchase agreements non-trading						
Financial investments	**404,773**		**404,773**	416,785		416,785
Treasury and other similar bills	**81,517**		**81,517**	78,111		78,111
debt securities	**323,256**		**323,256**	338,674		338,674
Other assets	**35,264**		**35,264**	37,324	(22)	37,302
assets held for sale	**1,375**		**1,375**	3,306	(22)	3,284
endorsements and acceptances	**10,775**		**10,775**	11,624		11,624
other	**23,114**		**23,114**	22,394		22,394
Financial guarantees and similar contracts[2]	**47,078**		**47,078**	46,300		46,300
Loan and other credit-related commitments[3]	**651,380**		**651,380**	587,603		587,603
At 31 December	**3,132,558**	**(386,402)**	**2,746,156**	3,111,962	(373,723)	2,738,239

For footnotes, see page 202.

Loan and other credit-related commitments[3]

(Unaudited)

	Europe US$m	**Asia[4] US$m**	**MENA US$m**	**North America US$m**	**Latin America US$m**	**Total US$m**
Personal	**86,247**	**96,497**	**2,995**	**15,636**	**11,679**	**213,054**
Corporate and commercial	**98,045**	**138,366**	**20,141**	**102,911**	**17,540**	**377,003**
Financial[5]	**26,605**	**9,355**	**711**	**23,559**	**1,093**	**61,323**
At 31 December 2014	**210,897**	**244,218**	**23,847**	**142,106**	**30,312**	**651,380**
Personal	92,148	74,445	2,940	15,647	9,774	194,954
Corporate and commercial	91,895	120,084	19,045	92,837	21,956	345,817
Financial[5]	18,930	8,477	705	17,478	1,242	46,832
At 31 December 2013	202,973	203,006	22,690	125,962	32,972	587,603

For footnotes, see page 202.

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Report of the Directors: Financial Review (continued)

Concentration of exposure

(Unaudited)

Concentrations of credit risk are described in the Appendix to Risk on page 206.

The geographical diversification of our lending portfolio and our broad range of global businesses and products ensured that we did not overly depend on a few markets to generate growth in 2014. This diversification also supported our strategy for growth in faster-growing markets and those with international connectivity.

Financial investments

Our holdings of available-for-sale government and government agency debt securities, corporate debt securities, ABSs and other securities were spread across a wide range of issuers and geographical regions in 2014, with 15% invested in securities issued by banks and other financial institutions and 72% in government or government agency debt securities. We also held assets backing insurance and investment contracts.

For an analysis of financial investments, see Note 18 on the Financial Statements.

Trading assets

Trading securities remained the largest concentration within trading assets at 77% compared with 75% in 2013. The largest concentration within the trading securities

portfolio was in government and government agency debt securities. We had significant exposures to US Treasury and government agency debt securities (US$26bn) and UK (US$9.3bn) and Hong Kong (US$6.9bn) government debt securities.

For an analysis of debt and equity securities held for trading, see Note 12 on the Financial Statements.

Derivatives

Derivative assets were US$345bn at 31 December 2014 (2013: US$282bn). Details of derivative amounts cleared through an exchange, central counterparty and non-central counterparty are shown on page 150.

For an analysis of derivatives, see page 150 and Note 16 on the Financial Statements.

Loans and advances to customers

The following tables analyse loans and advances to customers by industry sector and by the location of the principal operations of the lending subsidiary or, in the case of the operations of The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East Limited (HSBC Bank Middle East) and HSBC Bank USA, by the location of the lending branch. The distribution of loans across geographical regions and industries remained similar to last year.

For an analysis of loans and advances by country see page 160.

Gross loans and advances to customers by industry sector and by geographical region

(Audited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m	As a % of total gross loans
Personal	**178,531**	**129,515**	**6,571**	**65,400**	**13,537**	**393,554**	**39.9**
first lien residential mortgages[6]	131,000	93,147	2,647	55,577	4,153	286,524	29.0
other personal[7]	47,531	36,368	3,924	9,823	9,384	107,030	10.9
Corporate and commercial	**210,585**	**220,799**	**20,588**	**57,862**	**30,722**	**540,556**	**54.8**
manufacturing	39,456	37,767	2,413	15,299	12,051	106,986	10.9
international trade and services	76,629	72,814	9,675	13,484	8,189	180,791	18.3
commercial real estate	28,187	35,678	579	6,558	2,291	73,293	7.4
other property-related	7,126	34,379	1,667	8,934	281	52,387	5.3
government	2,264	1,195	1,552	164	968	6,143	0.6
other commercial[8]	56,923	38,966	4,702	13,423	6,942	120,956	12.3
Financial	**23,103**	**13,997**	**3,291**	**9,034**	**1,393**	**50,818**	**5.1**
non-bank financial institutions	21,867	13,410	3,289	9,034	1,199	48,799	4.9
settlement accounts	1,236	587	2		194	2,019	0.2
Asset-backed securities reclassified	**1,938**			**131**		**2,069**	**0.2**
Total gross loans and	**414,157**	**364,311**	**30,450**	**132,427**	**45,652**	**986,997**	**100.0**

advances to customers at 31 December 2014 (A)							
Percentage of A by geographical region	**42.0%**	**36.9%**	**3.1%**	**13.4%**	**4.6%**	**100.0%**	

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Report of the Directors: Financial Review (continued)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m	As a % of total gross loans
Personal	192,107	124,529	6,484	72,690	14,918	410,728	40.8
first lien residential mortgages[6]	140,474	92,047	2,451	60,955	3,948	299,875	29.8
other personal[7]	51,633	32,482	4,033	11,735	10,970	110,853	11.0
Corporate and commercial	239,116	203,894	19,760	50,307	30,188	543,265	53.9
manufacturing	55,920	30,758	3,180	11,778	12,214	113,850	11.3
international trade and services	76,700	79,368	8,629	11,676	8,295	184,668	18.3
commercial real estate	31,326	34,560	639	5,900	2,421	74,846	7.4
other property-related	7,308	27,147	1,333	8,716	328	44,832	4.5
government	3,340	1,021	1,443	499	974	7,277	0.7
other commercial[8]	64,522	31,040	4,536	11,738	5,956	117,792	11.7
Financial	27,872	9,688	2,532	9,055	1,376	50,523	5.0
non-bank financial institutions	26,314	9,359	2,532	9,055	1,277	48,537	4.8
settlement accounts	1,558	329			99	1,986	0.2
Asset-backed securities reclassified	2,578			138		2,716	0.3
Total gross loans and advances to customers at 31 December 2013 (B)	461,673	338,111	28,776	132,190	46,482	1,007,232	100.0
Percentage of B by geographical region	45.8%	33.6%	2.9%	13.1%	4.6%	100.0%	

For footnotes, see page 202.

Credit quality of financial instruments

(Audited)

A summary of our current policies and practices regarding the credit quality of financial instruments is provided in the Appendix to Risk on page 207.

We assess credit quality on all financial instruments which are subject to credit risk.

The five classifications describing the credit quality of our lending, debt securities portfolios and derivatives are defined on page 207 (unaudited). Additional credit quality information in respect of our consolidated holdings of ABSs is provided on page 162.

For the purpose of the following disclosure, retail loans which are past due up to 90 days and are not otherwise classified as impaired in accordance with our disclosure convention are not disclosed within the expected loss (EL) grade to which they relate, but are separately classified as past due but not impaired.

The overall credit quality of assets remained stable with Strong and Good categories making up 84% of the portfolio, Satisfactory 13%, Sub-standard and Past due but not impaired 2% and Impaired 1%.

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Report of the Directors: Financial Review (continued)

Distribution of financial instruments by credit quality

(Audited)

	Neither past due nor impaired							
	Strong US$m	Good US$m	Satisfactory US$m	Sub-standard US$m	Past due but not impaired US$m	Impaired US$m	Total gross amount US$m	Impairment allowances[9] US$m
s	127,971	1,438	195	353			129,957	
	4,515	46	365	1			4,927	
of s	27,674						27,674	
	168,521	35,042	24,740	641			228,944	
nd e	13,938	1,641	559	32			16,170	
	111,138	17,786	12,305	303			141,532	
	17,492	4,961	5,016	112			27,581	
s	25,953	10,654	6,860	194			43,661	
t	3,017	4,476	1,207	331			9,031	
nd e	5			51			56	

	3,011	**4,476**	**1,124**	**280**			**8,891**	
	1		**83**				**84**	
s								
0	**269,490**	**58,596**	**15,962**	**960**			**345,008**	
	487,734	**239,136**	**196,685**	**20,802**	**13,357**	**29,283**	**986,997**	**(12,337)**
	320,678	**32,601**	**15,109**	**1,130**	**8,876**	**15,160**	**393,554**	**(4,600)**
and								
	141,375	**192,799**	**171,748**	**18,986**	**3,922**	**13,795**	**542,625**	**(7,441)**
	25,681	**13,736**	**9,828**	**686**	**559**	**328**	**50,818**	**(296)**
t								
ost	**83,766**	**19,525**	**7,945**	**914**	**1**	**47**	**112,198**	**(49)**
	98,470	**28,367**	**33,283**	**1,593**			**161,713**	
	347,218	**27,373**	**22,600**	**5,304**		**2,278**	**404,773**	
nd								
'	**68,966**	**6,294**	**4,431**	**1,826**			**81,517**	
	278,252	**21,079**	**18,169**	**3,478**		**2,278**	**323,256**	
	13,015	**7,564**	**12,976**	**631**	**210**	**884**	**35,280**	**(16)**
d								
	802	**43**	**79**		**2**	**465**	**1,391**	**(16)**
ents								
	1,507	**4,644**	**4,281**	**298**	**34**	**11**	**10,775**	
	10,706	**2,877**	**8,616**	**333**	**174**	**408**	**23,114**	
er	**1,631,391**	**421,563**	**315,958**	**31,530**	**13,568**	**32,492**	**2,446,502**	**(12,402)**

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Report of the Directors: Financial Review (continued)

	Neither past due nor impaired				Past due		Total	
				Sub-	but not		gross	Impairment
	Strong US$m	Good US$m	Satisfactory US$m	standard US$m	impaired US$m	Impaired US$m	amount US$m	allowances[9] US$m
nt nks ne	162,017	2,877	265	1,440			166,599	
r	5,590	66	286	79			6,021	
ng ent s of ess	25,220						25,220	
	163,444	39,475	34,868	1,514			239,301	
and ble	17,235	3,585	758	6			21,584	
	107,831	16,498	16,167	1,148			141,644	
nd	15,804	5,546	6,342	193			27,885	
ers	22,574	13,846	11,601	167			48,188	
d at 10	6,608	5,183	671	257			12,719	
and ble	50						50	
	6,490	5,179	664	256			12,589	
nd	68		7	1			76	
ers		4					4	

es[10]	220,711	47,004	13,425	1,125			282,265		
l to s									
	488,504	243,077	199,821	23,942	15,460	36,428	1,007,232	(15,143)	
l	326,269	39,024	14,882	1,580	10,175	18,798	410,728	(6,602)	
te and al	132,943	194,966	174,905	21,281	5,009	16,877	545,981	(8,059)	
al k s)	29,292	9,087	10,034	1,081	276	753	50,523	(482)	
l to d at cost	91,498	21,131	6,266	1,123	11	75	120,104	(58)	
e ts ng	111,543	37,878	28,265	2,004			179,690		
nts	362,799	27,833	17,556	6,089		2,508	416,785		
and lar	69,364	5,595	1,856	1,296			78,111		
	293,435	22,238	15,700	4,793		2,508	338,674		
ets	12,501	8,028	14,848	1,159	307	592	37,435	(111)	
eld	1,129	642	1,050	351	89	156	3,417	(111)	
ments es	1,976	4,824	4,562	225	19	18	11,624		
nd	9,396	2,562	9,236	583	199	418	22,394		
nber	1,650,435	432,552	316,271	38,732	15,778	39,603	2,493,371	(15,312)	2,

For footnotes, see page 202.

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Report of the Directors: Financial Review (continued)

Past due but not impaired gross financial instruments

(Audited)

Past due but not impaired gross financial instruments are those loans where, although customers have failed to make payments in accordance with the contractual terms

of their facilities, they have not met the impaired loan criteria described on page 137.

Overall, past due but not impaired balances decreased by US$2.2bn, mainly due to continued run-off and loan sales in the CML portfolio.

Past due but not impaired gross financial instruments by geographical region

(Audited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Loans and advances to customers held at amortised cost	**2,409**	**4,260**	**704**	**4,634**	**1,350**	**13,357**
personal	**1,159**	**2,880**	**182**	**3,759**	**896**	**8,876**
corporate and commercial	**1,244**	**1,102**	**508**	**623**	**445**	**3,922**
financial (non-bank financial institutions)	**6**	**278**	**14**	**252**	**9**	**559**
Other financial instruments	**6**	**52**	**31**	**97**	**25**	**211**
At 31 December 2014	**2,415**	**4,312**	**735**	**4,731**	**1,375**	**13,568**
Loans and advances to customers held at amortised cost	2,399	4,211	757	6,453	1,640	15,460
personal	1,287	2,764	174	4,817	1,133	10,175
corporate and commercial	1,092	1,197	580	1,635	505	5,009
financial (non-bank financial institutions)	20	250	3	1	2	276
Other financial instruments	45	49	50	101	73	318
At 31 December 2013	2,444	4,260	807	6,554	1,713	15,778

For footnote, see page 202.

Ageing analysis of days for past due but not impaired gross financial instruments

(Audited)

	Up to 29 days US$m	30-59 days US$m	60-89 days US$m	90-179 days US$m	180 days and over US$m	Total US$m
Loans and advances to customers held at amortised cost	**10,427**	**2,057**	**801**	**54**	**18**	**13,357**
personal	**6,477**	**1,717**	**676**	**5**	**1**	**8,876**
corporate and commercial	**3,417**	**328**	**114**	**48**	**15**	**3,922**
financial (non-bank financial institutions)	**533**	**12**	**11**	**1**	**2**	**559**
Other financial instruments	**130**	**33**	**18**	**12**	**18**	**211**
At 31 December 2014	**10,557**	**2,090**	**819**	**66**	**36**	**13,568**
Loans and advances to customers held at amortised cost	11,689	2,587	1,057	76	51	15,460
personal	7,170	2,124	865	16		10,175
corporate and commercial	4,290	418	190	60	51	5,009
financial (non-bank financial institutions)	229	45	2			276
Other financial instruments	214	55	26	12	11	318
At 31 December 2013	11,903	2,642	1,083	88	62	15,778

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Report of the Directors: Financial Review (continued)

Impaired loans

(Audited)

Impaired loans and advances are those that meet any of the following criteria:

- wholesale loans and advances classified as Customer Risk Rating (CRR) 9 or CRR 10. These grades are assigned when the bank considers that either the customer is unlikely to pay their credit obligations in full, without recourse to security, or when the customer is more than 90 days past due on any material credit obligation to HSBC.

- retail loans and advances classified as Expected Loss (EL) 9 or EL 10. These grades are typically assigned to retail loans and advances more than 90 days past due unless individually they have been assessed as not impaired.

- renegotiated loans and advances that have been subject to a change in contractual cash flows as a result of a concession which the lender would not otherwise consider, and where it is probable that without the concession the borrower would be unable to meet the contractual payment obligations in full, unless the concession is insignificant and there are no other indicators of impairment. Renegotiated loans remain classified as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment.

For loans that are assessed for impairment on a collective basis, the evidence to support reclassification as no longer impaired typically comprises a history of payment performance against the original or revised terms, depending on the nature and volume of renegotiation and the credit risk characteristics surrounding the renegotiation. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

For further details of the CRR and the EL scales see page 207.

Movement in impaired loans by geographical region

(Unaudited)

	Europe	Asia[4]	MENA	North America	Latin	Total

	US$m	US$m	US$m	US$m	America US$m	US$m
Impaired loans at 1 January 2014	13,228	1,623	2,285	15,123	4,244	36,503
personal	2,938	526	317	13,669	1,348	18,798
corporate and commercial	9,714	1,082	1,765	1,427	2,889	16,877
financial[1]	576	15	203	27	7	828
Classified as impaired during the year	3,367	1,970	346	4,724	3,342	13,749
personal	1,168	857	193	4,360	1,958	8,536
corporate and commercial	2,166	1,113	153	354	1,383	5,169
financial[1]	33			10	1	44
Transferred from impaired to unimpaired during the year	(1,661)	(230)	(320)	(2,609)	(730)	(5,550)
personal	(282)	(184)	(178)	(2,551)	(364)	(3,559)
corporate and commercial	(1,319)	(46)	(53)	(57)	(366)	(1,841)
financial[1]	(60)		(89)	(1)		(150)
Amounts written off	(2,037)	(617)	(111)	(1,369)	(2,048)	(6,182)
personal	(631)	(470)	(77)	(1,007)	(1,371)	(3,556)
corporate and commercial	(1,201)	(147)	(29)	(356)	(673)	(2,406)
financial[1]	(205)		(5)	(6)	(4)	(220)
Net repayments and other	(2,655)	(698)	(219)	(4,175)	(1,443)	(9,190)
personal	(649)	(238)	(13)	(3,645)	(514)	(5,059)
corporate and commercial	(1,975)	(457)	(140)	(506)	(926)	(4,004)
financial[1]	(31)	(3)	(66)	(24)	(3)	(127)
Impaired loans at 31 December 2014	**10,242**	**2,048**	**1,981**	**11,694**	**3,365**	**29,330**
personal	**2,544**	**491**	**242**	**10,826**	**1,057**	**15,160**
corporate and	**7,385**	**1,545**	**1,696**	**862**	**2,307**	**13,795**

commercial financial[5]	**313**	**12**	**43**	**6**	**1**	**375**
Impaired loans as a percentage of gross loans	**2.3%**	**0.5%**	**4.8%**	**8.4%**	**6.1%**	**2.7%**
personal	**1.4%**	**0.4%**	**3.7%**	**16.6%**	**7.8%**	**3.9%**
corporate and commercial	**3.5%**	**0.7%**	**8.2%**	**1.5%**	**7.5%**	**2.5%**
financial[5]	**0.7%**	**0.0%**	**0.3%**	**0.0%**	**0.0%**	**0.2%**

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Report of the Directors: Financial Review (continued)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Impaired loans at 1 January 2013	11,145	1,624	2,474	20,345	3,188	38,776
personal	2,466	611	368	18,726	1,580	23,751
corporate and commercial	8,058	967	1,872	1,592	1,604	14,093
financial[5]	621	46	234	27	4	932
Classified as impaired during the year	4,952	1,424	419	6,168	4,333	17,296
personal	1,176	798	107	5,319	1,872	9,272
corporate and commercial	3,726	623	306	837	2,453	7,945
financial[5]	50	3	6	12	8	79
Transferred from impaired to unimpaired during the year	(1,215)	(145)	(166)	(3,198)	(642)	(5,366)
personal	(265)	(137)	(68)	(3,172)	(266)	(3,908)
corporate and commercial	(804)	(8)	(85)	(24)	(375)	(1,296)
financial[5]	(146)		(13)	(2)	(1)	(162)
Amounts written off	(1,411)	(538)	(165)	(1,706)	(1,957)	(5,777)
personal	(423)	(444)	(79)	(1,433)	(1,456)	(3,835)
corporate and commercial	(927)	(91)	(75)	(270)	(499)	(1,862)
financial[5]	(61)	(3)	(11)	(3)	(2)	(80)

Net repayments and other	(243)	(742)	(277)	(6,486)	(678)	(8,426)
personal	(16)	(302)	(11)	(5,771)	(382)	(6,482)
corporate and commercial	(339)	(409)	(253)	(708)	(294)	(2,003)
financial[1]	112	(31)	(13)	(7)	(2)	59
Impaired loans at 31 December 2013	13,228	1,623	2,285	15,123	4,244	36,503
personal	2,938	526	317	13,669	1,348	18,798
corporate and commercial	9,714	1,082	1,765	1,427	2,889	16,877
financial[1]	576	15	203	27	7	828
Impaired loans as a percentage of gross loans	2.7%	0.4%	6.5%	10.9%	7.5%	3.2%
personal	1.5%	0.4%	4.9%	18.8%	9.0%	4.6%
corporate and commercial	4.0%	0.5%	8.9%	2.8%	9.6%	3.1%
financial[1]	1.1%	0.0%	2.3%	0.2%	0.1%	0.5%

For footnotes, see page 202.

Impaired loans decreased by US$7.2bn during the year. Personal impaired loans declined mainly due to the continued run off and loan sales in the CML portfolio in North America. In personal lending, Net repayments and other includes US$2.9bn of CML portfolio assets that were reclassified as held for sale and also sold during the year.

Impaired loans in wholesale lending declined mainly in Europe and, to a lesser extent, in North America and Latin America due to repayments and a reduction in new impaired loans which reflected improvements in the economic conditions in these markets. These decreases were offset by an increase in Asia.

Renegotiated loans and forbearance

(Audited)

Current policies and procedures regarding renegotiated loans and forbearance are described in the Appendix to Risk on page 208.

The contractual terms of a loan may be modified for a number of reasons, including changes in market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer. Forbearance describes concessions made on the contractual terms of a loan in response to an obligor s financial difficulties. We classify and report loans on which concessions have been granted under conditions of credit distress as renegotiated loans

when their contractual payment terms have been modified, because we have significant concerns about the borrowers ability to meet contractual payments when due. On renegotiation, where the existing agreement is cancelled and a new agreement is made on substantially different terms, or if the terms of an existing agreement are modified such that the renegotiated loan is substantially a different financial instrument, the loan would be derecognised and recognised as a new loan for accounting purposes. However, the newly recognised financial asset will retain the renegotiated loan classification. Concessions on loans made to customers which do not affect the payment structure or basis of repayment, such as waivers of financial or security covenants, do not directly provide concessionary relief to customers in terms of their ability to service obligations as they fall due and are therefore not included in this classification.

The most significant portfolio of renegotiated loans remained in North America, substantially all of which were retail loans held by HSBC Finance.

The following tables show the gross carrying amounts of the Group s holdings of renegotiated loans and advances to customers by industry sector, geography and credit quality classification.

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Renegotiated loans and advances to customers by geographical region

(Audited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
First lien residential mortgages	**1,605**	**94**	**58**	**13,540**	**60**	**15,357**
neither past due nor impaired	**529**	**63**	**19**	**3,695**	**32**	**4,338**
past due but not impaired	**221**	**8**	**1**	**1,894**	**5**	**2,129**
impaired	**855**	**23**	**38**	**7,951**	**23**	**8,890**
Other personal lending[7]	**324**	**292**	**27**	**1,267**	**326**	**2,236**
neither past due nor impaired	**184**	**173**	**16**	**453**	**14**	**840**
past due but not impaired	**40**	**22**	**5**	**214**	**1**	**282**
impaired	**100**	**97**	**6**	**600**	**311**	**1,114**
Corporate and commercial	**5,469**	**501**	**1,439**	**427**	**1,324**	**9,160**
neither past due nor impaired	**1,383**	**102**	**483**	**36**	**303**	**2,307**
past due but not impaired	**68**		**31**	**1**	**1**	**101**
impaired	**4,018**	**399**	**925**	**390**	**1,020**	**6,752**
Financial[5]	**413**	**4**	**323**	**1**	**1**	**742**
neither past due nor impaired	**219**		**305**			**524**
past due but not impaired						
impaired	**194**	**4**	**18**	**1**	**1**	**218**

Renegotiated loans at 31 December 2014	**7,811**	**891**	**1,847**	**15,235**	**1,711**	**27,495**
neither past due nor impaired	**2,315**	**338**	**823**	**4,184**	**349**	**8,009**
past due but not impaired	**329**	**30**	**37**	**2,109**	**7**	**2,512**
impaired	**5,167**	**523**	**987**	**8,942**	**1,355**	**16,974**
Impairment allowances on renegotiated loans	**1,458**	**170**	**458**	**1,499**	**704**	**4,289**
renegotiated loans as % of total gross loans	**1.9%**	**0.2%**	**6.1%**	**11.5%**	**3.7%**	**2.8%**
First lien residential mortgages	1,820	117	91	16,853	76	18,957
neither past due nor impaired	392	78	47	4,332	32	4,881
past due but not impaired	517	11	3	2,684	4	3,219
impaired	911	28	41	9,837	40	10,857
Other personal lending[7]	431	318	58	1,277	531	2,615
neither past due nor impaired	253	207	33	503	18	1,014
past due but not impaired	39	24	17	284	2	366
impaired	139	87	8	490	511	1,235
Corporate and commercial	7,270	330	1,583	658	2,161	12,002
neither past due nor impaired	1,796	134	677	47	493	3,147
past due but not impaired	193	4	126	34	5	362
impaired	5,281	192	780	577	1,663	8,493
Financial[5]	235	2	362	1	1	601
neither past due nor	93		265			358

impaired						
past due but not impaired						
impaired	142	2	97	1	1	243
Renegotiated loans at 31 December 2013	9,756	767	2,094	18,789	2,769	34,175
neither past due nor impaired	2,534	419	1,022	4,882	543	9,400
past due but not impaired	749	39	146	3,002	11	3,947
impaired	6,473	309	926	10,905	2,215	20,828
Impairment allowances on renegotiated loans	1,867	101	460	2,285	1,014	5,727
renegotiated loans as % of total gross loans	2.1%	0.2%	7.3%	14.2%	6.0%	3.4%

For footnotes, see page 202.

The following table shows movements in renegotiated loans during the year. Renegotiated loans reduced by US$6.7bn to US$27bn in 2014. Renegotiated loans in personal lending reduced by US$4bn. Included within other movements is US$1.9bn of CML portfolio assets that were transferred to held for sale. New renegotiated

loans and write-offs reduced as a result of improvements in the US housing market and economic conditions.

Renegotiated loans in wholesale lending decreased by US$2.7bn. The reductions were mainly concentrated in Europe and Latin America and were the result of increased write-offs and repayments.

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Movement in renegotiated loans by geographical region

(Unaudited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Renegotiated loans at 1 January 2014	9,756	767	2,094	18,789	2,769	34,175
personal	2,251	435	149	18,130	607	21,572
corporate and commercial	7,270	330	1,583	658	2,161	12,002
financial	235	2	362	1	1	601
Loans renegotiated in the year without derecognition	1,543	371	296	862	725	3,797
personal	433	83	10	774	310	1,610
corporate and commercial	939	288	286	78	415	2,006
financial	171			10		181
Loans renegotiated in the year resulting in recognition of a new loan	500	5	79		92	676
personal	69	2			28	99
corporate and commercial	381		61		64	506
financial	50	3	18			71
Repayments	(2,416)	(246)	(562)	(1,518)	(1,036)	(5,778)
personal	(635)	(96)	(47)	(1,319)	(288)	(2,385)
corporate and commercial	(1,757)	(149)	(445)	(189)	(747)	(3,287)
financial	(24)	(1)	(70)	(10)	(1)	(106)
	(828)	(42)	(23)	(640)	(510)	(2,043)

Amounts written off						
personal	**(88)**	**(28)**	**(7)**	**(568)**	**(223)**	**(914)**
corporate and commercial	**(740)**	**(14)**	**(16)**	**(72)**	**(286)**	**(1,128)**
financial					**(1)**	**(1)**
Other	**(744)**	**36**	**(37)**	**(2,258)**	**(329)**	**(3,332)**
personal	**(101)**	**(10)**	**(20)**	**(2,210)**	**(48)**	**(2,389)**
corporate and commercial	**(624)**	**46**	**(30)**	**(48)**	**(283)**	**(939)**
financial	**(19)**		**13**		**2**	**(4)**
At 31 December 2014	**7,811**	**891**	**1,847**	**15,235**	**1,711**	**27,495**
personal	**1,929**	**386**	**85**	**14,807**	**386**	**17,593**
corporate and commercial	**5,469**	**501**	**1,439**	**427**	**1,324**	**9,160**
financial	**413**	**4**	**323**	**1**	**1**	**742**
Renegotiated loans at 1 January 2013	9,974	944	2,389	26,162	2,758	42,227
personal	2,817	493	190	25,474	781	29,755
corporate and commercial	6,829	447	1,859	685	1,975	11,795
financial	328	4	340	3	2	677
Loans renegotiated in the year without derecognition	2,807	49	101	1,727	1,311	5,995
personal	264	8	16	1,335	507	2,130
corporate and commercial	2,541	41	85	391	803	3,861
financial	2			1	1	4
Loans renegotiated in the year resulting in recognition of a new loan	105	113	14		62	294
personal	17	76	14		25	132
corporate and commercial	88	37			37	162

financial						
Repayments	(2,139)	(233)	(541)	(1,759)	(707)	(5,379)
personal	(489)	(111)	(64)	(1,387)	(353)	(2,404)
corporate and commercial	(1,574)	(121)	(477)	(370)	(354)	(2,896)
financial	(76)	(1)		(2)		(79)
Amounts written off	(426)	(25)	(38)	(1,035)	(409)	(1,933)
personal	(99)	(20)	(9)	(995)	(233)	(1,356)
corporate and commercial	(303)	(5)	(29)	(40)	(175)	(552)
financial	(24)				(1)	(25)
Other	(565)	(81)	169	(6,306)	(246)	(7,029)
personal	(259)	(11)	2	(6,297)	(120)	(6,685)
corporate and commercial	(311)	(69)	145	(8)	(125)	(368)
financial	5	(1)	22	(1)	(1)	24
At 31 December 2013	9,756	767	2,094	18,789	2,769	34,175
personal	2,251	435	149	18,130	607	21,572
corporate and commercial	7,270	330	1,583	658	2,161	12,002
financial	235	2	362	1	1	601

For footnote, see page 202.

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Report of the Directors: Financial Review (continued)

Impairment of loans and advances

(Audited)

A summary of our current policies and practices regarding impairment assessment is provided in the Appendix to Risk on page 212. For an analysis of loan impairment charges and other credit risk provisions by global business, see page 76.

The tables below analyse the impairment allowances recognised for impaired loans and advances that are either individually or collectively assessed, and collective impairment allowances on loans and advances that are classified as not impaired.

Loan impairment charge to the income statement by industry sector

(Unaudited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Personal	**245**	**321**	**25**	**117**	**1,095**	**1,803**
first lien residential mortgages	**(75)**	**6**	**(24)**	**26**	**15**	**(52)**
other personal[7]	**320**	**315**	**49**	**91**	**1,080**	**1,855**
Corporate and commercial	**790**	**327**	**6**	**196**	**937**	**2,256**
manufacturing and international trade and services	**520**	**197**	**36**	**116**	**382**	**1,251**
commercial real estate and other property-related	**78**	**29**	**(28)**	**27**	**176**	**282**
other commercial[8]	**192**	**101**	**(2)**	**53**	**379**	**723**
Financial[5]	**44**	**(4)**	**(32)**	**(13)**	**1**	**(4)**
	1,079	**644**	**(1)**	**300**	**2,033**	**4,055**

Total loan impairment charge for the year ended 31 December 2014						
Personal	320	345	46	963	1,522	3,196
first lien residential mortgages	(11)	(7)	(13)	647	11	627
other personal[7]	331	352	59	316	1,511	2,569
Corporate and commercial	1,467	152	(13)	253	1,115	2,974
manufacturing and international trade and services	800	134	37	125	594	1,690
commercial real estate and other property-related	432	(2)	(5)	79	322	826
other commercial[8]	235	20	(45)	49	199	458
Financial[5]	(55)	(14)	(77)	19	5	(122)
Total loan impairment charge for the year ended 31 December 2013	1,732	483	(44)	1,235	2,642	6,048

Loan impairment charge to the income statement by assessment type

(Unaudited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Individually assessed impairment allowances	**617**	**351**	**32**	**190**	**590**	**1,780**
new allowances	**1,112**	**542**	**134**	**298**	**738**	**2,824**
release of allowances no longer required	**(486)**	**(171)**	**(95)**	**(88)**	**(90)**	**(930)**
recoveries of amounts previously written off	**(9)**	**(20)**	**(7)**	**(20)**	**(58)**	**(114)**

Collectively assessed impairment allowances[12]	**462**	**293**	**(33)**	**110**	**1,443**	**2,275**
new allowances net of allowance releases	**757**	**426**	**2**	**205**	**1,726**	**3,116**
recoveries of amounts previously written off	**(295)**	**(133)**	**(35)**	**(95)**	**(283)**	**(841)**
Total loan impairment charge for the year ended 31 December 2014	**1,079**	**644**	**(1)**	**300**	**2,033**	**4,055**
Individually assessed impairment allowances	1,376	145	(86)	262	623	2,320
new allowances	1,828	316	196	398	702	3,440
release of allowances no longer required	(402)	(145)	(235)	(98)	(31)	(911)
recoveries of amounts previously written off	(50)	(26)	(47)	(38)	(48)	(209)
Collectively assessed impairment allowances[12]	356	338	42	973	2,019	3,728
new allowances net of allowance releases	943	479	82	1,058	2,253	4,815
recoveries of amounts previously written off	(587)	(141)	(40)	(85)	(234)	(1,087)
Total loan impairment charge for the year ended 31 December	1,732	483	(44)	1,235	2,642	6,048

2013

For footnotes, see page 202.

Total loan impairment charges of US$4.1bn were US$2.0bn lower than in 2013 reflecting reduced impairment charges in both the personal lending and

the corporate and commercial lending portfolios, primarily in North America, Europe and Latin America.

Report of the Directors: Financial Review (continued)

In North America, loan impairment charges relating to both first lien mortgages and other personal lending decreased, which reflected reduced levels of both delinquency and new impaired loans in the CML portfolio, and a fall in lending balances from continued run-off and loan sales. This was partly offset by lower favourable market value adjustments of underlying properties as improvements in housing market conditions were less pronounced in 2014 than in 2013.

In Europe, the reduction in loan impairment charges was primarily in corporate and commercial lending, as a result of lower individually assessed impairment allowances reflecting the improved quality of the portfolio and economic conditions. Loan impairment charges also decreased in personal lending, albeit to a lesser extent, due to lower delinquency levels in the improved economic environment and as customers continued to reduce outstanding credit card and loan balances. These factors

were partly offset by an increase in collectively assessed allowances in the corporate and commercial lending sector as we revised certain estimates in our collective corporate loan impairment calculation, and in the financial industry sector reflecting charges compared with releases in 2013.

In Latin America, the reduction in loan impairment charges in the other personal lending and the corporate and commercial portfolios primarily reflected the prior year adverse effect of changes to the impairment model and assumption revisions for restructured loan portfolios in Brazil. Individually assessed allowances were broadly stable. There were lower loan impairment charges in Mexico in the commercial real estate and other property related sector, in particular relating to certain homebuilders. In Brazil individually assessed allowances increased due to an impairment relating to a corporate customer in the other commercial sector.

Charge for impairment losses as a percentage of average gross loans and advances to customers by geographical region

(Unaudited)

	Europe %	Asia[4] %	MENA %	North America %	Latin America %	Total %
New allowances net of allowance releases	**0.37**	**0.22**	**0.14**	**0.32**	**5.00**	**0.53**
Recoveries	**(0.08)**	**(0.04)**	**(0.14)**	**(0.09)**	**(0.72)**	**(0.10)**
Total charge for impairment losses at 31 December 2014	**0.29**	**0.18**		**0.23**	**4.28**	**0.43**
	0.49	**0.13**	**0.58**	**0.97**	**3.59**	**0.58**

Amount written off net of recoveries						
New allowances net of allowance releases	0.65	0.20	0.15	1.00	5.93	0.81
Recoveries	(0.17)	(0.05)	(0.29)	(0.09)	(0.57)	(0.14)
Total charge for impairment losses at 31 December 2013	0.48	0.15	(0.14)	0.91	5.36	0.67
Amount written off net of recoveries	0.42	0.12	0.38	1.10	3.69	0.59

For footnote, see page 202.

Movement in impairment allowances by industry sector and by geographical region

(Unaudited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Impairment allowances at 1 January 2014	**5,598**	**1,214**	**1,583**	**4,242**	**2,564**	**15,201**
Amounts written off						
Personal	**(724)**	**(463)**	**(157)**	**(1,030)**	**(1,359)**	**(3,733)**
first lien residential mortgages	**(21)**	**(17)**	**(4)**	**(731)**	**(40)**	**(813)**
other personal[7]	**(703)**	**(446)**	**(153)**	**(299)**	**(1,319)**	**(2,920)**
Corporate and commercial	**(1,202)**	**(146)**	**(47)**	**(346)**	**(684)**	**(2,425)**
manufacturing and international trade and services	**(732)**	**(86)**	**(41)**	**(81)**	**(428)**	**(1,368)**
commercial real estate and other property-related	**(342)**	**(53)**	**(6)**	**(153)**	**(39)**	**(593)**
other commercial[8]	**(128)**	**(7)**		**(112)**	**(217)**	**(464)**
Financial[5]	**(203)**		**(8)**	**(6)**	**(4)**	**(221)**
Total amounts written off	**(2,129)**	**(609)**	**(212)**	**(1,382)**	**(2,047)**	**(6,379)**
Recoveries of amounts written off in previous years						
Personal	**271**	**143**	**35**	**86**	**283**	**818**
first lien residential mortgages	**3**	**3**		**40**	**33**	**79**
other personal[7]	**268**	**140**	**35**	**46**	**250**	**739**
Corporate and commercial	**29**	**9**	**7**	**25**	**58**	**128**
manufacturing and international trade and	**19**	**7**	**7**	**6**	**46**	**85**

services						
commercial real estate and other property-related	**11**			**3**	**1**	**15**
other commercial[8]	**(1)**	**2**		**16**	**11**	**28**
Financial[5]	**4**	**1**		**4**		**9**
Total recoveries of amounts written off in previous years	**304**	**153**	**42**	**115**	**341**	**955**
Charge to income statement	**1,079**	**644**	**(1)**	**300**	**2,033**	**4,055**
Exchange and other movements[13]	**(397)**	**(46)**	**(6)**	**(635)**	**(362)**	**(1,446)**
Impairment allowances at 31 December 2014	**4,455**	**1,356**	**1,406**	**2,640**	**2,529**	**12,386**

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	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Impairment allowances against banks:						
individually assessed	**31**		**18**			**49**
Impairment allowances against customers:						
individually assessed	**2,981**	**812**	**1,110**	**276**	**1,016**	**6,195**
collectively assessed[12]	**1,443**	**544**	**278**	**2,364**	**1,513**	**6,142**
Impairment allowances at 31 December 2014	**4,455**	**1,356**	**1,406**	**2,640**	**2,529**	**12,386**
Impairment allowances at 1 January 2013	5,361	1,219	1,811	5,616	2,162	16,169
Amounts written off						
Personal	(876)	(461)	(107)	(1,330)	(1,593)	(4,367)
first lien residential mortgages	(83)	(7)	(2)	(779)	(25)	(896)
other personal[7]	(793)	(454)	(105)	(551)	(1,568)	(3,471)
Corporate and commercial	(1,264)	(96)	(78)	(277)	(514)	(2,229)
manufacturing and international trade and services	(680)	(73)	(64)	(80)	(386)	(1,283)
commercial real estate and other property-related	(289)	(7)	(2)	(141)	(23)	(462)
other commercial[8]	(295)	(16)	(12)	(56)	(105)	(484)
Financial[5]	(40)	(3)	(10)	(3)	(3)	(59)
Total amounts written off	(2,180)	(560)	(195)	(1,610)	(2,110)	(6,655)
Recoveries of amounts written off in previous years						
Personal	584	153	41	82	237	1,097
first lien residential mortgages	25	4		67	23	119
other personal[7]	559	149	41	15	214	978

Corporate and commercial	52	14	46	41	45	198
manufacturing and international trade and services	19	7	2	6	27	61
commercial real estate and other property-related	6	4		18	1	29
other commercial[8]	27	3	44	17	17	108
Financial[5]	1					1
Total recoveries of amounts written off in previous years	637	167	87	123	282	1,296
Charge to income statement	1,732	483	(44)	1,235	2,642	6,048
Exchange and other movements[13]	48	(95)	(76)	(1,122)	(412)	(1,657)
Impairment allowances at 31 December 2013	5,598	1,214	1,583	4,242	2,564	15,201
Impairment allowances against banks:						
individually assessed	35		18	5		58
Impairment allowances against customers:						
individually assessed	4,019	634	1,131	410	878	7,072
collectively assessed[12]	1,544	580	434	3,827	1,686	8,071
Impairment allowances at 31 December 2013	5,598	1,214	1,583	4,242	2,564	15,201

For footnotes, see page 202.

Movement in impairment allowances on loans and advances to customers and banks

(Audited)

	Banks individually assessed US$m	Customers Individually assessed US$m	Customers Collectively assessed US$m	Total US$m
At 1 January 2014	58	7,072	8,071	15,201
Amounts written off	(6)	(2,313)	(4,060)	(6,379)
Recoveries of loans and advances previously written off		114	841	955
Charge to income statement	4	1,776	2,275	4,055
Exchange and other movements[13]	(7)	(454)	(985)	(1,446)
At 31 December 2014	**49**	**6,195**	**6,142**	**12,386**
Impairment allowances:				
on loans and advances to customers		6,195	6,142	12,337
personal		468	4,132	4,600

corporate and commercial		**5,532**	**1,909**	**7,441**
financial		**195**	**101**	**296**
as a percentage of loans and advances[1]	**0.04%**	**0.63%**	**0.62%**	**1.13%**

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	Banks individually assessed US$m	Customers Individually assessed US$m	Collectively assessed US$m	Total US$m
At 1 January 2013	57	6,572	9,540	16,169
Amounts written off	(4)	(1,937)	(4,714)	(6,655)
Recoveries of loans and advances previously written off		209	1,087	1,296
Charge to income statement	5	2,315	3,728	6,048
Exchange and other movements[13]		(87)	(1,570)	(1,657)
At 31 December 2013	58	7,072	8,071	15,201
Impairment allowances:				
on loans and advances to customers		7,072	8,071	15,143
personal		589	6,013	6,602
corporate and commercial		6,096	1,963	8,059
financial		387	95	482
as a percentage of loans and advances[1]	0.05%	0.70%	0.80%	1.35%

For footnotes, see page 202.

Wholesale lending

On a reported basis gross loans decreased by US$11bn, which included adverse foreign exchange movements of US$32bn, mainly in Europe.

The following commentary is on a constant currency basis.

Wholesale lending grew by US$21bn in the year. In Asia, balances grew by US$16bn as we continued to leverage our position in emerging markets. In North America, we also experienced strong growth of US$10bn as we executed our strategy of expanding our core offerings and proactively targeting companies with international

banking requirements in key growth markets. The fall in lending in Europe of US$15bn was mainly driven by a reduction in corporate overdraft balances. In the UK, a small number of clients benefited from the use of net interest arrangements across their overdraft and deposit positions. During the year, as we aligned our approach in our Payments and Cash Management business to be more globally consistent, many of these clients increased the frequency with which they settled these balances, reducing their overdraft and deposit balances, which fell by US$28bn. The Middle East and North Africa and Latin America grew by US$6bn and US$4bn, respectively.

Total wholesale lending

(Unaudited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Corporate and commercial (A)	**210,585**	**220,799**	**20,588**	**57,862**	**30,722**	**540,556**
manufacturing	**39,456**	**37,767**	**2,413**	**15,299**	**12,051**	**106,986**
international trade and services	**76,629**	**72,814**	**9,675**	**13,484**	**8,189**	**180,791**
commercial real estate	**28,187**	**35,678**	**579**	**6,558**	**2,291**	**73,293**
other property-related	**7,126**	**34,379**	**1,667**	**8,934**	**281**	**52,387**
government	**2,264**	**1,195**	**1,552**	**164**	**968**	**6,143**
other commercial[8]	**56,923**	**38,966**	**4,702**	**13,423**	**6,942**	**120,956**
Financial (non-bank financial institutions) (B)	**23,103**	**13,997**	**3,291**	**9,034**	**1,393**	**50,818**
Asset-backed securities reclassified	**1,938**			**131**		**2,069**
Loans and advances to banks (C)	**21,978**	**62,960**	**10,495**	**7,405**	**9,360**	**112,198**
Gross loans at 31 December 2014 (D)	**257,604**	**297,756**	**34,374**	**74,432**	**41,475**	**705,641**
Impairment allowances on wholesale lending						
Corporate and commercial (a)	**3,112**	**1,089**	**1,171**	**608**	**1,461**	**7,441**
manufacturing	**529**	**242**	**141**	**152**	**348**	**1,412**
international trade and services	**877**	**533**	**536**	**157**	**237**	**2,340**
commercial real estate	**909**	**44**	**147**	**101**	**476**	**1,677**
other property-related	**203**	**55**	**219**	**57**	**12**	**546**
government	**4**		**1**			**5**
other commercial	**590**	**215**	**127**	**141**	**388**	**1,461**
Financial (non-bank financial institutions) (b)	**221**	**13**	**21**	**39**	**2**	**296**

Loans and advances to banks (c)	**31**		**18**			**49**
Impairment allowances at 31 December 2014 (d)	**3,364**	**1,102**	**1,210**	**647**	**1,463**	**7,786**
(a) as a percentage of (A)	**1.48%**	**0.49%**	**5.69%**	**1.05%**	**4.76%**	**1.38%**
(b) as a percentage of (B)	**0.96%**	**0.09%**	**0.64%**	**0.43%**	**0.14%**	**0.58%**
(c) as a percentage of (C)	**0.14%**		**0.17%**			**0.04%**
(d) as a percentage of (D)	**1.31%**	**0.37%**	**3.52%**	**0.87%**	**3.53%**	**1.10%**

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	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Corporate and commercial (I)	239,116	203,894	19,760	50,307	30,188	543,265
manufacturing	55,920	30,758	3,180	11,778	12,214	113,850
international trade and services	76,700	79,368	8,629	11,676	8,295	184,668
commercial real estate	31,326	34,560	639	5,900	2,421	74,846
other property-related	7,308	27,147	1,333	8,716	328	44,832
government	3,340	1,021	1,443	499	974	7,277
other commercial[8]	64,522	31,040	4,536	11,738	5,956	117,792
Financial (non-bank financial institutions) (J)	27,872	9,688	2,532	9,055	1,376	50,523
Asset-backed securities reclassified	2,578			138		2,716
Loans and advances to banks (K)	24,273	72,814	6,419	6,420	10,178	120,104
Gross loans at 31 December 2013 (L)	293,839	286,396	28,711	65,920	41,742	716,608
Impairment allowances on wholesale lending						
Corporate and commercial (i)	3,821	918	1,212	769	1,339	8,059
manufacturing	618	246	182	89	384	1,519
international trade and services	1,216	428	502	188	349	2,683
commercial real estate	1,116	22	153	202	396	1,889
other property-related	269	102	236	93	8	708
government	3		10	1		14
other commercial	599	120	129	196	202	1,246
Financial (non-bank financial institutions) (j)	344	17	60	50	11	482
Loans and advances to banks (k)	35		18	5		58
Impairment allowances at 31 December 2013 (l)	4,200	935	1,290	824	1,350	8,599
(i) as a percentage of (I)	1.60%	0.45%	6.13%	1.53%	4.44%	1.48%
(j) as a percentage of (J)	1.23%	0.18%	2.37%	0.55%	0.80%	0.95%
(k) as a percentage of (K)	0.14%		0.28%	0.08%		0.05%

(l) as a percentage of (L)	1.43%	0.33%	4.49%	1.25%	3.23%	1.20%

For footnotes, see page 202.

Commercial real estate

Commercial real estate lending

(Unaudited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Neither past due nor impaired	**25,860**	**35,430**	**333**	**6,136**	**1,535**	**69,294**
Past due but not impaired	**18**	**170**	**47**	**100**	**28**	**363**
Impaired loans	**2,309**	**78**	**199**	**322**	**728**	**3,636**
Total gross loans and advances at 31 December 2014	**28,187**	**35,678**	**579**	**6,558**	**2,291**	**73,293**
Of which:						
renegotiated loans[14]	**1,954**	**19**	**183**	**191**	**377**	**2,724**
Impairment allowances	**909**	**44**	**147**	**101**	**476**	**1,677**
Neither past due nor impaired	28,044	34,433	402	5,400	2,249	70,528
Past due but not impaired	95	103	18	29	35	280
Impaired loans	3,187	24	219	471	137	4,038
Total gross loans and advances at 31 December 2013	31,326	34,560	639	5,900	2,421	74,846
Of which:						
renegotiated loans[14]	2,590	20	229	280	461	3,580
Impairment allowances	1,116	22	153	202	396	1,889

For footnotes, see page 202.

Commercial real estate lending includes the financing of corporate, institutional and high net worth individuals who are investing primarily in income producing assets and, to a lesser extent, in their construction and development. The business focuses mainly on traditional core asset classes such as retail, offices, light industrial and residential building projects. The portfolio is globally diversified with larger concentrations in Hong Kong, the UK, the US and Canada.

In more developed markets, our exposure mainly comprises the financing of investment assets, the

redevelopment of existing stock and the augmentation of both commercial and residential markets to support economic and population growth. In lesser developed commercial real estate markets our exposures comprise lending for development assets on relatively short tenors with a particular focus on supporting the larger, better capitalised developers involved in residential construction or in assets supporting economic expansion.

Many of these markets are beginning to move away from the rapid construction of recent years with an increasing focus on investment assets consistent with more

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developed markets. A significant amount of exposure is centred on cities which are key locations of economic, political or cultural importance.

Total commercial real estate was US$73bn at 31 December 2014, a reduction of US$1.6bn which included adverse foreign exchange movements of US$3.3bn, mainly in Europe.

Refinance risk in commercial real estate

Commercial real estate lending tends to require the repayment of a significant proportion of the principal at maturity. Typically, a customer will arrange repayment through the acquisition of a new loan to settle the existing debt. Refinance risk is the risk that a customer, being unable to repay the debt on maturity, fails to refinance it at commercial rates. Refinance risk is described in more detail on page 214. We monitor our commercial real estate portfolio closely, assessing those drivers that may indicate potential issues with refinancing. The principal driver is the vintage of the loan, when origination reflected previous market norms which do not apply in the current market. Examples might be higher LTV ratios and/or lower interest cover ratios. The range of refinancing sources in the local market is also an important consideration, with risk increasing when lenders are restricted to banks and when bank liquidity is limited. In addition, underlying fundamentals such as the reliability of tenants, the ability to let and the condition of the property are important, as they influence property values.

For the Group s commercial real estate portfolios as a whole, the behaviour of markets and the quality of assets did not cause undue concern in 2014. In the UK, which was subject to heightened concerns in recent years, the drivers described above are not currently causing sufficient concern to warrant enhanced management attention.

Further details on our UK portfolio are as follows: at 31 December 2014, we had US$20bn (2013: US$22bn) of commercial real estate loans of which US$5.9bn (2013: US$6.8bn) were due to be refinanced within the next 12 months. Of these balances, cases subject to close monitoring in our Loan Management Unit amounted to US$2.1bn (2013: US$2.4bn). US$1.3bn (2013: US$1.6bn) were disclosed as impaired with impairment allowances of US$0.6bn (2013: US$0.6bn). Where these loans are not considered impaired it is because there is sufficient evidence to indicate that the associated contractual cash flows will be recovered or that the loans will not need to be refinanced on terms we would consider below market norms.

Collateral on loans and advances

Details of the Group s practice regarding the use of collateral are provided in the Appendix to Risk on page 213.

Collateral held is analysed separately below for commercial real estate and for other corporate, commercial and financial (non-bank) lending. This reflects the greater correlation between collateral performance and principal repayment in the commercial

real estate sector than applies to other lending. In each case, the analysis includes off-balance sheet loan commitments, primarily undrawn credit lines.

The collateral measured in the tables below consists of fixed first charges on real estate and charges over cash and marketable financial instruments. The values in the tables represent the expected market value on an open market basis; no adjustment has been made to the collateral for any expected costs of recovery. Cash is valued at its nominal value and marketable securities at their fair value. The LTV ratios presented are calculated by directly associating loans and advances with the collateral that individually and uniquely supports each facility. When collateral assets are shared by multiple loans and advances, whether specifically or, more generally, by way of an all monies charge, the collateral value is pro-rated across the loans and advances protected by the collateral.

Other types of collateral which are commonly taken for corporate and commercial lending such as unsupported guarantees and floating charges over the assets of a customer s business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

For impaired loans the collateral values cannot be directly compared with impairment allowances recognised. The LTV tables below use open market values with no adjustments. Impairment allowances are calculated on a different basis, by considering other cash flows and adjusting collateral values for costs of realising collateral as explained further on page 212.

Commercial real estate loans and advances

The value of commercial real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Due to the complexity of valuing collateral for commercial real estate, local valuation policies determine the frequency of review on the basis of local market conditions. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase. Revaluations may also be sought where customers amend their banking requirements, resulting in the Group extending further funds or other significant rearrangements of exposure or collateral, which may change the customer risk profile. As a result, the real estate collateral values used for CRR1-7 might date back to the last point at which such considerations applied. For CRR 8 and 9-10 almost all collateral would have been revalued within the last three years.

In Hong Kong, market practice is typically for lending to major property companies to be either secured by guarantees or unsecured. In Europe, facilities of a working capital nature are generally not secured by a first fixed charge and are therefore disclosed as not collateralised.

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Commercial real estate loans and advances including loan commitments by level of collateral

(Audited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Rated CRR/EL 1 to 7						
Not collateralised	**5,351**	**16,132**	**361**	**87**	**1,719**	**23,650**
Fully collateralised	**25,873**	**26,323**	**23**	**9,093**	**556**	**61,868**
Partially collateralised (A)	**1,384**	**1,599**		**1,819**	**152**	**4,954**
collateral value on A	**1,032**	**901**		**1,199**	**47**	**3,179**
	32,608	**44,054**	**384**	**10,999**	**2,427**	**90,472**
Rated CRR/EL 8						
Not collateralised	**34**	**7**		**9**	**2**	**52**
Fully collateralised	**568**	**23**		**30**	**1**	**622**
LTV ratio:						
less than 50%	**64**			**16**	**1**	**81**
51% to 75%	**222**	**11**		**10**		**243**
76% to 90%	**132**	**9**		**4**		**145**
91% to 100%	**150**	**3**				**153**
Partially collateralised (B)	**365**			**7**		**372**
collateral value on B	**296**			**2**		**298**

	967	**30**		**46**	**3**	**1,046**
Rated CRR/EL 9 to 10						
Not collateralised	**369**	**48**	**6**	**1**	**499**	**923**
Fully collateralised	**992**	**15**	**7**	**166**	**178**	**1,358**
LTV ratio:						
less than 50%	**78**	**6**	**7**	**28**	**10**	**129**
51% to 75%	**593**	**2**		**91**	**43**	**729**
76% to 90%	**167**	**2**		**17**	**53**	**239**
91% to 100%	**154**	**5**		**30**	**72**	**261**
Partially collateralised (C)	**1,085**	**15**	**181**	**37**	**50**	**1,368**
collateral value on C	**664**	**5**	**89**	**30**	**13**	**801**
	2,446	**78**	**194**	**204**	**727**	**3,649**
At 31 December 2014	**36,021**	**44,162**	**578**	**11,249**	**3,157**	**95,167**
Rated CRR/EL 1 to 7						
Not collateralised	4,865	14,164	192	137	935	20,293
Fully collateralised	24,154	25,317	21	8,627	1,728	59,847
Partially collateralised (D)	2,664	2,377	139	704	484	6,368
collateral value on D	1,827	1,688	24	303	292	4,134
	31,683	41,858	352	9,468	3,147	86,508
Rated CRR/EL 8						
Not collateralised	109	10		1	3	123
Fully collateralised	793		72	68	1	934
LTV ratio:						
less than 50%	139			15		154
51% to 75%	367		72	49	1	489

76% to 90%	173			4		177
91% to 100%	114					114
Partially collateralised (E)	360	2		13		375
collateral value on E	281	1		11		293
	1,262	12	72	82	4	1,432
Rated CRR/EL 9 to 10						
Not collateralised	564		7	4	521	1,096
Fully collateralised	1,079	12	31	233	286	1,641
LTV ratio:						
less than 50%	275	2	7	39	32	355
51% to 75%	436	6	7	110	57	616
76% to 90%	209	3	17	62	62	353
91% to 100%	159	1		22	135	317
Partially collateralised (F)	1,815	5	181	240	56	2,297
collateral value on F	1,284	5	89	115	34	1,527
	3,458	17	219	477	863	5,034
At 31 December 2013	36,403	41,887	643	10,027	4,014	92,974

For footnote, see page 202.

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Other corporate, commercial and financial (non-bank loans) are analysed separately below. For financing activities in other corporate and commercial lending, collateral value is not strongly correlated to principal repayment performance. Collateral values are generally refreshed when an obligor s general credit performance deteriorates and we have to assess the

likely performance of secondary sources of repayment should it prove necessary to rely on them.

Accordingly, the table below reports values only for customers with CRR 8 to 10, recognising that these loans and advances generally have valuations which are comparatively recent.

Other corporate, commercial and financial (non-bank) loans and advances including loan commitments by level of collateral rated CRR/EL 8 to 10 only

(Audited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Rated CRR/EL 8						
Not collateralised	**2,051**	**237**	**15**	**320**	**227**	**2,850**
Fully collateralised	**629**	**56**	**72**	**331**	**11**	**1,099**
LTV ratio:		**13**				
less than 50%	**120**	**13**		**186**	**5**	**324**
51% to 75%	**293**			**72**	**6**	**371**
76% to 90%	**51**	**9**	**69**	**46**		**175**
91% to 100%	**165**	**34**	**3**	**27**		**229**
Partially collateralised (A)	**105**	**44**	**1**	**148**	**6**	**304**
collateral value on A	**46**	**17**	**1**	**68**	**4**	**136**
	2,785	**337**	**88**	**799**	**244**	**4,253**

Rated CRR/EL 9 to 10						
Not collateralised	**4,185**	**939**	**813**	**62**	**1,420**	**7,419**
Fully collateralised	**615**	**143**	**147**	**231**	**124**	**1,260**
LTV ratio:						
less than 50%	**169**	**68**	**25**	**48**	**48**	**358**
51% to 75%	**136**	**27**	**19**	**39**	**35**	**256**
76% to 90%	**168**	**16**	**6**	**35**	**26**	**251**
91% to 100%	**142**	**32**	**97**	**109**	**15**	**395**
Partially collateralised (B)	**624**	**364**	**547**	**251**	**140**	**1,926**
collateral value on B	**341**	**169**	**92**	**141**	**46**	**789**
	5,424	**1,446**	**1,507**	**544**	**1,684**	**10,605**
At 31 December 2014	**8,209**	**1,783**	**1,595**	**1,343**	**1,928**	**14,858**
Rated CRR/EL 8						
Not collateralised	2,411	185	37	328	456	3,417
Fully collateralised	259	51	1	227	70	608
LTV ratio:						
less than 50%	65	38	1	84	11	199
51% to 75%	103	4		47	10	164
76% to 90%	25	8		31	5	69
91% to 100%	66	1		65	44	176
Partially collateralised (C)	435	23	528	345	73	1,404
collateral value on C	17	5	398	89	18	527
	3,105	259	566	900	599	5,429
Rated CRR/EL 9 to 10						
Not collateralised	1,467	685	1,089	26	1,615	4,882
Fully collateralised	1,121	161	49	309	266	1,906

LTV ratio:						
less than 50%	124	57	2	24	159	366
51% to 75%	161	21	47	29	49	307
76% to 90%	156	53		46	43	298
91% to 100%	680	30		210	15	935
Partially collateralised (D)	1,192	304	770	359	290	2,915
collateral value on D	606	150	102	149	131	1,138
	3,780	1,150	1,908	694	2,171	9,703
At 31 December 2013	6,885	1,409	2,474	1,594	2,770	15,132

For footnote, see page 202.

Loans and advances to banks are typically unsecured. Collateral values held for customers rated CRR 9 to 10 (i.e. classified as impaired) are separately disclosed.

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Loans and advances to banks including loan commitments by level of collateral

(Audited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Rated CRR/EL 1 to 8						
Not collateralised	**22,405**	**64,210**	**10,472**	**7,985**	**9,406**	**114,478**
Fully collateralised	**104**	**1,587**				**1,691**
Partially collateralised (A)	**5**					**5**
collateral value on A	**3**					**3**
	22,514	**65,797**	**10,472**	**7,985**	**9,406**	**116,174**
Rated CRR/EL 9 to 10						
Not collateralised	**102**	**1**	**21**			**124**
At 31 December 2014	**22,616**	**65,798**	**10,493**	**7,985**	**9,406**	**116,298**
Rated CRR/EL 1 to 8						
Not collateralised	21,225	72,986	6,373	7,210	9,837	117,631
Fully collateralised	3,614	1,376			266	5,256
Partially collateralised	68	560				628

(B) collateral value on B	3	389				392
	24,907	74,922	6,373	7,210	10,103	123,515
Rated CRR/EL 9 to 10						
Not collateralised	153		312	14		479
At 31 December 2013	25,060	74,922	6,685	7,224	10,103	123,994

For footnote, see page 202.

Other credit risk exposures

In addition to collateralised lending, other credit enhancements are employed and methods used to mitigate credit risk arising from financial assets. These are described in more detail below:

- some securities issued by governments, banks and other financial institutions benefit from additional credit enhancement provided by government guarantees that cover the assets.

Details of government guarantees are included in Notes 12, 15 and 18 on the Financial Statements.

- debt securities issued by banks and financial institutions include ABSs and similar instruments which are supported by underlying pools of financial assets. Credit risk associated with ABSs is reduced through the purchase of credit default swap (CDS) protection.

Disclosure of the Group s holdings of ABSs and associated CDS protection is provided on page 162.

- trading assets include loans and advances held with trading intent. These mainly consist of cash collateral posted to satisfy margin requirements on derivatives, settlement accounts, reverse repos and stock borrowing. There is limited credit risk on cash collateral posted since in the event of default of the counterparty these would be set-off against the related liability. Reverse repos and stock borrowing are by their nature collateralised.

Collateral accepted as security that the Group is permitted to sell or repledge under these arrangements is described in Note 19 on the Financial Statements.

- the Group s maximum exposure to credit risk includes financial guarantees and similar contracts granted, as well as loan and other credit-related commitments. Depending on the terms of the arrangement, we may have recourse to additional credit mitigation in the event that a guarantee is called upon or a loan commitment is drawn and subsequently defaults. For further information on these arrangements, see Note 37 on the Financial Statements.

Derivatives

HSBC participates in transactions exposing us to counterparty credit risk. Counterparty credit risk is the risk of financial loss if the counterparty to a transaction defaults before satisfactorily settling it. It arises principally from OTC derivatives and securities financing transactions and is calculated in both the trading and non-trading books. Transactions vary in value by reference to a market factor such as interest rate, exchange rate or asset price.

The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment (CVA).

For an analysis of CVA, see Note 13 on the Financial Statements.

The table below reflects by risk type the fair values and gross notional contract amounts of derivatives cleared through an exchange, central counterparty and non-central counterparty.

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Notional contract amounts and fair values of derivatives by product type

(Unaudited)

	2014			2013		
	Notional amount	**Fair value**		Notional amount	Fair value	
		Assets	**Liabilities**		Assets	Liabilities
	US$m	**US$m**	**US$m**	US$m	US$m	US$m
Foreign exchange	**5,573,415**	**97,312**	**95,759**	5,291,003	80,914	75,798
exchange traded	**81,785**	**229**	**369**	41,384	121	93
central counterparty cleared OTC	**18,567**	**321**	**349**	16,869	415	622
non-central counterparty cleared OTC	**5,473,063**	**96,762**	**95,041**	5,232,750	80,378	75,083
Interest rate	**22,328,518**	**473,243**	**468,152**	27,347,918	458,576	452,531
exchange traded	**1,432,333**	**112**	**161**	857,562	335	225
central counterparty cleared OTC	**15,039,001**	**261,880**	**264,509**	18,753,836	285,390	285,375
non-central counterparty cleared OTC	**5,857,184**	**211,251**	**203,482**	7,736,520	172,851	166,931
Equity	**568,932**	**11,694**	**13,654**	589,903	18,389	22,573
exchange traded	**289,140**	**2,318**	**3,201**	274,880	8,403	2,949
non-central counterparty cleared OTC	**279,792**	**9,376**	**10,453**	315,023	9,986	19,624
Credit	**550,197**	**9,340**	**10,061**	678,256	9,092	8,926
central counterparty cleared OTC	**126,115**	**1,999**	**2,111**	104,532	1,346	1,409
non-central counterparty cleared OTC	**424,082**	**7,341**	**7,950**	573,724	7,746	7,517
Commodity and other	**77,565**	**3,884**	**3,508**	77,842	2,624	1,786
exchange traded	**7,015**	**80**	**23**	6,531	182	6
non-central counterparty cleared OTC	**70,550**	**3,804**	**3,485**	71,311	2,442	1,780

Total OTC derivatives	**27,288,354**	**592,735**	**587,379**	32,804,565	560,554	558,341
total OTC derivatives cleared by central counterparties	**15,183,683**	**264,200**	**266,968**	18,875,237	287,151	287,406
total OTC derivatives not cleared by central counterparties	**12,104,671**	**328,535**	**320,411**	13,929,328	273,403	270,935
Total exchange traded derivatives	**1,810,273**	**2,739**	**3,755**	1,180,357	9,041	3,273
Gross	**29,098,627**	**595,473**	**591,134**	33,984,922	569,595	561,614
Offset		**(250,465)**	**(250,465)**		(287,330)	(287,330)
Total at 31 December		**345,008**	**340,669**		282,265	274,284

The purposes for which HSBC uses derivatives are described in Note 16 on the Financial Statements.

The International Swaps and Derivatives Association (ISDA) Master Agreement is our preferred agreement for documenting derivatives activity. It provides the contractual framework within which dealing activity across a full range of OTC products is conducted, and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party defaults or another pre-agreed termination event occurs. It is common, and our preferred practice, for the parties to execute a Credit Support Annex (CSA) in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between the parties to mitigate the counterparty risk inherent in outstanding positions.

We manage the counterparty exposure arising from market risk on our OTC derivative contracts by using collateral agreements with counterparties and netting agreements. Currently, we do not actively manage our general OTC derivative counterparty exposure in the credit markets, although we may manage individual exposures in certain circumstances.

We have historically placed strict policy restrictions on collateral types and as a consequence the types of collateral received and pledged are, by value, highly liquid and of a strong quality, being predominantly cash.

Where a collateral type is required to be approved outside the collateral policy (which includes collateral that includes wrong way risks), a submission to one of three regional Documentation Approval Committees (DAC s) for approval is required. These DACs require the participation and sign-off of senior representatives from regional Global Markets Chief Operating Officers, Legal and Risk.

The majority of the counterparties with whom we have a collateral agreement are European. The majority of our CSAs are with financial institutional clients.

As a consequence of our policy, the type of agreement we enter into is predominately ISDA CSAs, the majority of which are written under English law. The table below provides a breakdown of OTC collateral agreements by agreement type:

OTC collateral agreements by type

(Unaudited)

	Number of agreements
ISDA CSA (English law)	**2,434**
ISDA CSA (New York law)	**1,628**
ISDA CSA (Japanese law)	**18**
French Master Agreement and CSA equivalent[15]	**227**
German Master Agreement and CSA equivalent[16]	**90**
Others	**205**
At 31 December 2014	**4,602**

For footnotes, see page 202.

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See page 130 and Note 32 on the Financial Statements for details regarding legally enforceable right of offset in the event of counterparty default and collateral received in respect of derivatives.

Reverse repos non-trading by geographical region

Following the change in balance sheet presentation explained on page 347, non-trading reverse repos are presented separately on the face of the balance sheet and are no longer included in Loans

and advances to customers and Loans and advances to banks .

Comparative data have been re-presented accordingly. As a result, any analysis in the Credit Risk section that references loans and advances to customers or banks excludes non-trading reverse repos to customers or banks, respectively. For reference, the amount of non-trading reverse repos to customers and banks is set out below.

Reverse repos non-trading by geographical region

(Audited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
With customers	**25,841**	**5,409**		**35,060**		**66,310**
With banks	**34,748**	**22,813**	**19**	**29,008**	**8,815**	**95,403**
At 31 December 2014	**60,589**	**28,222**	**19**	**64,068**	**8,815**	**161,713**
With customers	48,091	6,448		33,676		88,215
With banks	49,631	12,973	24	23,744	5,103	91,475
At 31 December 2013	97,722	19,421	24	57,420	5,103	179,690

For footnote, see page 202.

Personal lending

We provide a broad range of secured and unsecured personal lending products to meet customer needs. Personal lending includes advances to customers for asset purchases such as residential property where the loans are secured by the assets being acquired. We also offer loans secured on existing assets, such as first liens on residential property, and unsecured lending products such as overdrafts, credit cards and payroll loans.

Total personal lending

(Unaudited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
First lien residential mortgages (A)	**131,000**	**93,147**	**2,647**	**55,577**	**4,153**	**286,524**
Of which:						
interest only (including offset)	**44,163**	**956**		**276**		**45,395**
affordability including ARMs	**337**	**5,248**		**16,452**		**22,037**
Other personal lending (B)	**47,531**	**36,368**	**3,924**	**9,823**	**9,384**	**107,030**
other	**34,567**	**25,695**	**2,633**	**4,328**	**4,846**	**72,069**
credit cards	**12,959**	**10,289**	**897**	**1,050**	**3,322**	**28,517**
second lien residential mortgages		**56**	**2**	**4,433**		**4,491**
motor vehicle finance	**5**	**328**	**392**	**12**	**1,216**	**1,953**
Total gross loans at 31 December 2014 (C)	**178,531**	**129,515**	**6,571**	**65,400**	**13,537**	**393,554**
Impairment allowances on personal lending						
First lien residential mortgages (a)	**306**	**46**	**97**	**1,644**	**36**	**2,129**
Other personal lending (b)	**786**	**208**	**97**	**350**	**1,030**	**2,471**
other	**438**	**87**	**59**	**43**	**672**	**1,299**

credit cards	**347**	**119**	**33**	**36**	**298**	**833**
second lien residential mortgages				**271**		**271**
motor vehicle finance	**1**	**2**	**5**		**60**	**68**
Total impairment allowances at 31 December 2014 (c)	**1,092**	**254**	**194**	**1,994**	**1,066**	**4,600**
(a) as a percentage of A	**0.2%**		**3.7%**	**3.0%**	**0.9%**	**0.7%**
(b) as a percentage of B	**1.7%**	**0.6%**	**2.5%**	**3.6%**	**11.0%**	**2.3%**
(c) as a percentage of C	**0.6%**	**0.2%**	**3.0%**	**3.0%**	**7.9%**	**1.2%**

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	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
First lien residential mortgages (D)	140,474	92,047	2,451	60,955	3,948	299,875
Of which:						
interest only (including offset)	49,460	1,115		352		50,927
affordability including ARMs	508	5,593		16,274		22,375
Other personal lending (E)	51,633	32,482	4,033	11,735	10,970	110,853
other	37,126	21,636	2,728	5,309	5,651	72,450
credit cards	14,496	10,274	915	1,145	3,526	30,356
second lien residential mortgages		91	2	5,261		5,354
motor vehicle finance	11	481	388	20	1,793	2,693
Total gross loans at 31 December 2013 (F)	192,107	124,529	6,484	72,690	14,918	410,728
Impairment allowances on personal lending						
First lien residential mortgages (d)	439	57	124	2,886	32	3,538
	959	222	169	532	1,182	3,064

Other personal lending (e)						
other	553	93	104	59	881	1,690
credit cards	403	127	61	47	217	855
second lien residential mortgages				426		426
motor vehicle finance	3	2	4		84	93
Total impairment allowances at 31 December 2013 (f)	1,398	279	293	3,418	1,214	6,602
(d) as a percentage of D	0.3%	0.1%	5.1%	4.7%	0.8%	1.2%
(e) as a percentage of E	1.9%	0.7%	4.2%	4.5%	10.8%	2.8%
(f) as a percentage of F	0.7%	0.2%	4.5%	4.7%	8.1%	1.6%

For footnote, see page 202.

Total personal lending was US$394bn at 31 December 2014, down from US$411bn at the end of 2013 (US$392bn on a constant currency basis). We continued to run-off our CML portfolio in North America and the balance declined by a further US$5.7bn during the year.

Personal lending excluding the US CML run-off portfolio grew by US$7.7bn on a constant currency basis in 2014. This was mainly due to increased mortgage and other lending in Asia and growth in the mortgage portfolio in the US and Brazil. It was partially offset by a reduction in personal lending in UK.

Mortgage lending

(Unaudited)

We offer a wide range of mortgage products designed to meet customer needs, including capital repayment, interest-only, affordability and offset mortgages.

Group credit policy prescribes the range of acceptable residential property LTV thresholds with the maximum upper limit for new loans set at between 75% and 95%.

Specific LTV thresholds and debt-to-income ratios are managed at regional and country levels and, although the parameters must comply with Group policy, strategy and risk appetite, they differ in the various locations in which we operate to reflect the local economic and housing market conditions, regulations, portfolio performance, pricing and other product features.

The commentary that follows is on a constant currency basis

Personal lending excluding the US CML run-off portfolio, mortgage lending balances increased by US$3.9bn during the year. Mortgage lending in Asia, excluding the reclassification to Other Personal lending discussed on page 153, grew by US$4.8bn. The increases were primarily attributable to continued growth in Hong Kong (US$2.9bn) and, to a lesser extent, in Australia (US$0.5bn),

Malaysia (US$0.4bn), and Taiwan (US$0.3bn) as a result of strong demand and competitive customer offerings. The quality of our Asian mortgage book remained high with negligible defaults and impairment allowances. The average LTV ratio on new mortgage lending in Hong Kong was 47% compared with an estimated 29% for the overall portfolio.

In North America, our Canadian mortgage balances increased by US$0.5bn during the year as a result of a focused mortgage campaign and process improvements. The Premier mortgage portfolio in the US also increased by US$0.9bn during 2014 as we continued to focus on growth in our core portfolios. Our business in the US exhibited lower collectively assessed impairment charges due to continued improvement in the credit quality of the mortgage portfolio. The US CML portfolio declined by US$5.7bn in 2014.

Mortgage lending in Brazil increased by US$0.5bn as a result of improvements to both our process and products offered and overall growth in the mortgage market in the country during the year.

In Europe, there was a marginal decline of US$1.4bn or 1% due to decreased lending and effects of repayments, mainly in the UK mortgage portfolio.

Interest-only products made up US$44bn of total UK mortgage lending, including US$19bn of offset mortgages in First Direct. The LTV ratio on new lending was 60% compared with an average of 43.7% for the total mortgage portfolio. The credit quality of our UK mortgage portfolio remained high and both loan impairment charges and delinquency levels declined in 2014.

We grew our mortgage book in France by US$0.6bn in the year due to strong demand.

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Other personal lending

(Unaudited)

Other personal lending increased by US$3.7bn in 2014. This was driven by growth in personal loans and revolving credit facilities in Asia, mainly in Hong Kong (US$3.1bn). We also reclassified US$1.7bn of loans in mainland China from Residential mortgages to other personal lending as the supporting collateral over some of the properties either under construction or completed was yet to be fully registered. These increases were partially offset by a reduction in credit card lending of US$0.7bn in the UK and US$0.3bn in Turkey, due to repayments. Term lending in North America, primarily Canada, declined by US$0.7bn during the year. There was also a US$0.2bn reduction in the auto finance dealers run off portfolio in Brazil.

HSBC Finance US Consumer and Mortgage Lending residential mortgages[17]

(Unaudited)

	2014 US$m	2013 US$m
Residential mortgages:		
first lien	**21,915**	27,305
Other personal lending:		
second lien	**2,509**	3,014
Total (A) at 31 December	**24,424**	30,319
Impairment allowances	**1,679**	3,028
as a percentage of A	**6.9%**	10.0%

For footnote, see page 202.

HSBC Finance

Mortgage lending balances in HSBC Finance declined by US$5.7bn during 2014. In addition to the continued loan sales in the CML portfolio, we transferred a further US$2.9bn to assets held for sale during the year, and expect to sell these in multiple transactions over the next 12 months.

The decrease in impairment allowances reflected lower levels of both new impaired loans and loan balances outstanding as a result of continued liquidation of the portfolio. This included loan sales and loss estimates due

to lower delinquency and loss severity levels than in 2013.

Across the first and second lien residential mortgages in our CML portfolio, two months and over delinquent balances reduced by US$2.5bn to US$2.4bn during 2014 reflecting the continued portfolio run-off and loan sales.

HSBC Finance: foreclosed properties in the US

(Unaudited)

	2014 US$m	2013 US$m
Number of foreclosed properties at year-end	**2,139**	4,254
Number of properties added to foreclosed inventory in the period	**3,716**	9,752
Average (gain)/loss on sale of foreclosed properties[18]	**(1%)**	1%
Average total loss on foreclosed properties[19]	**51%**	51%
Average time to sell foreclosed properties (days)	**189**	154

For footnotes, see page 202.

The number of foreclosed properties at 31 December 2014 significantly decreased compared with the end of 2013 as during 2014 more properties were sold than were added to the foreclosed inventory. We added fewer properties to the inventory as many of them were sold prior to taking title as a result of the ongoing sale of receivables from the CML portfolio.

HSBC Bank USA

In HSBC Bank USA, mortgage balances grew by US$0.9bn during 2014 as we implemented our strategy to grow the HSBC Premier customer base. Credit quality improved further during 2014 and balances which were two months and over delinquent in our first lien residential mortgage portfolio declined by US$0.3bn to US$1.1bn at December 2014. We also continued to sell all agency eligible new originations in the secondary market as a means of managing our interest rate risk and improving structural liquidity.

Trends in two months and over contractual delinquency in the US

(Unaudited)

	2014 US$m	2013 US$m
In personal lending in the US		
First lien residential mortgages	**3,271**	5,931
Consumer and Mortgage Lending	**2,210**	4,595
other mortgage lending	**1,061**	1,336
Second lien residential mortgages	**216**	406
Consumer and Mortgage Lending	**154**	276
other mortgage lending	**62**	130
Credit card	**17**	25
Personal non-credit card	**7**	25
Total at 31 December	**3,511**	6,387
	%	%
As a percentage of the equivalent loans and receivables balances		
First lien residential mortgages	**8.6**	14.0
Second lien residential mortgages	**5.0**	8.1

Credit card	**2.4**	3.4
Personal non-credit card	**1.4**	4.9
Total at 31 December	**8.1**	13.1

Report of the Directors: Financial Review (continued)

Gross loan portfolio of HSBC Finance real estate secured balances

(Unaudited)

	Re-aged[20] US$m	Modified and re-aged US$m	Modified US$m	Total renegotiated loans US$m	Total non-renegotiated loans US$m	Total gross loans US$m	Total impairment allowances US$m	Impairment allowances/ gross loans %
At 31 December 2014	**6,637**	**6,581**	**587**	**13,805**	**10,619**	**24,424**	**1,679**	**7**
At 31 December 2013	8,167	8,213	768	17,148	13,171	30,319	3,028	10

For footnote, see page 202.

Number of renegotiated real estate secured accounts remaining in HSBC Finance s portfolio

(Unaudited)

	Number of renegotiated loans (000s)				Total number of loans
	Re-aged	Modified and re-aged	Modified	Total	(000s)
At 31 December 2014	**85**	**64**	**6**	**155**	**297**
At 31 December 2013	102	78	8	188	352

HSBC Finance loan modifications and re-age programmes

HSBC Finance maintains loan modification and re-age (loan renegotiation) programmes in order to manage customer relationships, improve collection opportunities and, if possible, avoid foreclosure.

Since 2006, HSBC Finance has implemented an extensive loan renegotiation programme, and a significant portion of its loan portfolio has been subject to renegotiation at some stage in the life of the customer relationship as a consequence of the economic conditions in the US and the characteristics of HSBC Finance s customer base.

The volume of loans that qualify for modification has reduced significantly in recent years and we expect this trend to continue. Volumes of new loan modifications are decreasing due to improvements in economic conditions, the cessation of new real estate secured and personal non-credit card receivables originations, and the continued run-off and loan sales in the CML portfolio.

Qualifying criteria

For an account to qualify for renegotiation it must meet certain criteria, and HSBC Finance retains the right to decline a renegotiation. The extent to which HSBC Finance renegotiates accounts that are eligible under its existing policies varies according to its view of prevailing economic conditions and other factors which may change from year to year. In addition, exceptions to policies and practices may be made in specific situations in response to legal or regulatory agreements or orders.

Renegotiated real estate secured are not eligible for a subsequent renegotiation for 12 months, with a maximum of five renegotiations permitted within a five-year period. Borrowers must be approved for a modification and, to activate it, must generally make

two minimum qualifying monthly payments within 60 days. In certain circumstances where the debt has been restructured in bankruptcy proceedings, fewer or no payments may be required. Real estate secured loans involving a bankruptcy and accounts whose borrowers are subject to a Chapter 13 plan filed with a bankruptcy court generally may be considered current upon receipt of one qualifying payment, while accounts whose borrowers have filed for Chapter 7 bankruptcy protection may be re-aged upon receipt of a signed reaffirmation agreement. In addition, some products accounts may be re-aged without receipt of a payment in certain special circumstances (e.g. in the event of a natural disaster or a hardship programme).

2014 compared with 2013

At 31 December 2014, renegotiated real estate secured accounts in HSBC Finance represented 91% (2013: 91%) of North America s total renegotiated loans. US$8.0bn of renegotiated real estate secured loans were classified as impaired (2013: US$10bn). During 2014, the aggregate number of renegotiated loans in HSBC Finance reduced, due to the run-off and loan sales in the CML portfolio, despite renegotiation activity continuing.

Within the constraints of our Group credit policy, HSBC Finance s policies allow for multiple renegotiations under certain circumstances. Consequently, a significant proportion of loans included in the table above have undergone multiple re-ages or modifications. In this regard, multiple modifications have remained consistent at 70% to 75% of total modifications.

The accounts that received second or subsequent renegotiations during the year do not appear in the statistics presented. These statistics treat a loan as an addition to the volume of renegotiated loans on its first renegotiation only.

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Types of loan renegotiation programmes in HSBC Finance

A temporary modification is a change to the contractual terms of a loan that results in HSBC Finance giving up a right to contractual cash flows over a pre-defined period. With a temporary modification the loan is expected to revert back to the original contractual terms, including the interest rate charged, after the modification period. An example is reduced interest payments.

A substantial number of HSBC Finance modifications involve interest rate reductions, which lower the amount of interest income HSBC Finance is contractually entitled to receive in future periods. Historically, modifications were granted for terms as low as six months, although, more recent modifications have a minimum term of two years.

Loans that have been re-aged are classified as impaired with the exception of first-time loan re-ages that were less than 60 days past due at the time of re-age. These remain classified as impaired until they have demonstrated a history of payment performance against their original contracted terms for at least 12 months.

A permanent modification is a change to the contractual terms of a loan that results in HSBC Finance giving up a right to contractual cash flows over the life of the loan. An example is a permanent reduction in the interest rate charged.

borrower s ability to pay, and the loan is disclosed as impaired. The loan remains disclosed as impaired from that date forward until the borrower has demonstrated a history of repayment performance for the period of time required for either modifications or re-ages, as described above.

Valuation of foreclosed properties in the US

We obtain real estate by foreclosing on the collateral pledged as security for residential mortgages. Prior to foreclosure, carrying amounts of the loans in excess of fair value less costs to sell are written down to the discounted cash flows expected to be recovered, including from the sale of the property.

Broker price opinions are obtained and updated every 180 days and real estate price trends are reviewed quarterly to reflect any improvement or additional deterioration. Our methodology is regularly validated by comparing the discounted cash flows expected to be recovered based on current market conditions (including estimated cash flows from the sale of the property) to the updated broker price opinion, adjusted for the estimated historical difference between interior and exterior appraisals. The fair values of foreclosed properties are initially determined on the basis of broker price opinions. Within 90 days of foreclosure, a more detailed property valuation is performed reflecting information obtained from a physical interior inspection of the property and additional allowances or write-downs are recorded as appropriate. Updates to the valuation are performed no less than once every 45 days until the property is sold, with declines or increases

Permanent or long-term modifications which are due to an underlying hardship event remain classified as impaired for their full life.

The term re-age describes a renegotiation by which the contractual delinquency status of a loan is reset to current after demonstrating payment performance. The overdue principal and/or interest is deferred and paid at a later date. Loan re-ageing enables customers who have been unable to make a small number of payments to have their loan delinquency status reset to current so that their credit score is not affected by the overdue balances.

Loans that have been re-aged remain classified as impaired until they have demonstrated a history of payment performance against the original contractual terms for at least 12 months.

A temporary or permanent modification may also lead to a re-ageing of a loan although a loan may be re-aged without any modification to its original terms and conditions.

Where loans have been granted multiple concessions, subject to the qualifying criteria discussed above, the concession is deemed to have been made due to concern regarding the

recognised through changes to allowances.

Second lien mortgages in the US

The majority of second lien residential mortgages were taken up by customers who held a first lien mortgage issued by a third party. Second lien residential mortgage loans have a risk profile characterised by higher LTV ratios, because in the majority of cases the loans were taken out to complete the refinancing of properties. Loss severity on default of second liens has typically approached 100% of the amount outstanding, as any equity in the property is consumed through the repayment of the first lien loan.

Impairment allowances for these loans were determined by applying a roll-rate migration analysis which captures the propensity of these loans to default based on past experience. Once we believe that a second lien residential mortgage loan is likely to progress to write-off, the loss severity assumed in establishing our impairment allowance is close to 100% in the CML portfolios, and more than 80% in HSBC Bank USA.

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Collateral and other credit enhancements held

(Audited)

Loans and advances held at amortised cost

Details of the Group s practice regarding the use of collateral are provided in the Appendix to Risk on page 213.

The tables below provide a quantification of the value of fixed charges we hold over specific assets where we have a history of enforcing, and are able to enforce,

collateral in satisfying a debt in the event of the borrower failing to meet its contractual obligations, and where the collateral is cash or can be realised by sale in an established market. The collateral valuation excludes any adjustments for obtaining and selling the collateral and, in particular, loans shown as not collateralised or partially collateralised may also benefit from other forms of credit mitigants.

Residential mortgage loans including loan commitments by level of collateral

(Audited)

	Europe US$m	Asia[4] US$m	MENA US$m	North America US$m	Latin America US$m	Total US$m
Non-impaired loans and advances						
Fully collateralised	**135,875**	**99,257**	**2,431**	**43,317**	**3,759**	**284,639**
LTV ratio:						
less than 50%	**66,075**	**60,315**	**1,324**	**14,003**	**1,454**	**143,171**
51% to 75%	**56,178**	**31,142**	**856**	**20,872**	**1,777**	**110,825**
76% to 90%	**11,856**	**6,906**	**212**	**5,994**	**480**	**25,448**
91% to 100%	**1,766**	**894**	**39**	**2,448**	**48**	**5,195**
Partially collateralised:						

greater than 100% LTV (A)	**537**	**99**	**60**	**2,209**	**167**	**3,072**
collateral value on A	**532**	**81**	**44**	**1,999**	**24**	**2,680**
	136,412	**99,356**	**2,491**	**45,526**	**3,926**	**287,711**
Impaired loans and advances						
Fully collateralised	**906**	**256**	**122**	**8,618**	**154**	**10,056**
LTV ratio:						
less than 50%	**232**	**130**	**53**	**1,291**	**103**	**1,809**
51% to 75%	**417**	**90**	**29**	**3,462**	**35**	**4,033**
76% to 90%	**163**	**32**	**19**	**2,471**	**10**	**2,695**
91% to 100%	**94**	**4**	**21**	**1,394**	**6**	**1,519**
Partially collateralised:						
greater than 100% LTV (B)	**55**	**7**	**31**	**1,395**	**2**	**1,490**
collateral value on B	**40**	**5**	**23**	**1,181**	**1**	**1,250**
	961	**263**	**153**	**10,013**	**156**	**11,546**
At 31 December 2014	**137,373**	**99,619**	**2,644**	**55,539**	**4,082**	**299,257**
Non-impaired loans and advances						
Fully collateralised	146,326	98,332	2,235	44,125	3,749	294,767
LTV ratio:						
less than 50%	55,028	55,479	749	13,172	1,337	125,765
51% to 75%	66,452	34,370	1,095	20,751	1,715	124,383
76% to 90%	21,603	6,836	348	6,933	606	36,326
91% to 100%	3,243	1,647	43	3,269	91	8,293
Partially collateralised:						
greater than 100% LTV (C)	1,410	362	42	4,150	59	6,023
collateral value on C	852	307	37	3,681	49	4,926

	147,736	98,694	2,277	48,275	3,808	300,790
Impaired loans and advances						
Fully collateralised	1,369	254	90	10,128	160	12,001
LTV ratio:						
less than 50%	244	100	15	1,393	97	1,849
51% to 75%	452	96	31	4,250	47	4,876
76% to 90%	320	49	34	2,809	13	3,225
91% to 100%	353	9	10	1,676	3	2,051
Partially collateralised:						
greater than 100% LTV (D)	104	17	6	2,548	8	2,683
collateral value on D	91	4	6	2,272	4	2,377
	1,473	271	96	12,676	168	14,684
At 31 December 2013	149,209	98,965	2,373	60,951	3,976	315,474

For footnote, see page 202.

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Supplementary information

Gross loans and advances by industry sector over five years

(Unaudited)

	2014 US$m	Currency translation adjustment US$m	Movement US$m	2013 US$m	2012 US$m	2011 US$m	2010 US$m
Personal	**393,554**	**(19,092)**	**1,918**	410,728	415,093	393,625	425,320
first lien residential mortgages[6]	**286,524**	**(12,372)**	**(979)**	299,875	301,862	278,963	268,681
other personal[7]	**107,030**	**(6,720)**	**2,897**	110,853	113,231	114,662	156,639
Corporate and commercial	**540,556**	**(24,729)**	**22,020**	543,265	513,229	472,784	445,505
manufacturing	**106,986**	**(5,856)**	**(1,008)**	113,850	112,149	96,054	91,121
international trade and services	**180,791**	**(8,232)**	**4,355**	184,668	169,389	152,709	146,567
commercial real estate	**73,293**	**(3,270)**	**1,717**	74,846	76,760	73,941	71,880
other property-related	**52,387**	**(922)**	**8,477**	44,832	40,532	39,539	34,838
government	**6,143**	**(395)**	**(739)**	7,277	10,785	11,079	8,594
other commercial[8]	**120,956**	**(6,054)**	**9,218**	117,792	103,614	99,462	92,505
Financial	**50,818**	**(2,303)**	**2,598**	50,523	46,871	44,832	41,213
non-bank financial institutions	**48,799**	**(2,180)**	**2,442**	48,537	45,430	43,888	39,651
settlement accounts	**2,019**	**(123)**	**156**	1,986	1,441	944	1,562
Asset-backed securities reclassified	**2,069**	**(147)**	**(500)**	2,716	3,891	5,280	5,892
Total gross loans and advances to customers (A)	**986,997**	**(46,271)**	**26,036**	1,007,232	979,084	916,521	917,930
Gross loans and advances to banks	**112,198**	**(4,925)**	**(2,981)**	120,104	117,142	139,203	142,027
Total gross loans and advances	**1,099,195**	**(51,196)**	**23,055**	1,127,336	1,096,226	1,055,724	1,059,957

Impaired loans and advances to customers	**29,283**	**(1,538)**	**(5,607)**	36,428	38,671	41,584	46,871
as a percentage of A	**3.0%**			3.6%	3.9%	4.5%	4.8%
Impairment allowances on loans and advances to customers	**12,337**	**(776)**	**(2,030)**	15,143	16,112	17,511	20,083
as a percentage of A	**1.2%**			1.5%	1.6%	1.9%	2.2%
Loan impairment charge	**4,055**	**(160)**	**(1,833)**	6,048	8,160	11,505	13,548
new allowances net of allowance releases	**5,010**	**(158)**	**(2,176)**	7,344	9,306	12,931	14,568
recoveries	**(955)**	**(2)**	**343**	(1,296)	(1,146)	(1,426)	(1,020)

For footnotes, see page 202.

The personal lending currency effect on gross loans and advances of US$19bn was made up as follows: Europe US$13bn, Asia US$2.6bn, Latin America US$1.8bn, North America US$1.8bn. The wholesale lending currency effect

on gross loans and advances of US$32bn was made up as follows: Europe US$21bn, Asia US$4.8bn, Latin America US$4.7bn, North America US$1.5bn and Middle East and North Africa US$0.3bn.

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Report of the Directors: Financial Review (continued)

Reconciliation of reported and constant currency impaired loans, allowances and charges by geographical region

(Unaudited)

	31 Dec 13 as reported US$m	Currency translation adjustment[21] US$m	31 Dec 13 at 31 Dec 14 exchange rates US$m	Movement constant currency basis US$m	**31 Dec 14 as reported US$m**	**Reported change[22] %**	**Constant currency change[22] %**
Impaired loans							
Europe	13,228	(1,011)	12,217	(1,975)	**10,242**	**(23)**	**(16)**
Asia[4]	1,623	(54)	1,569	479	**2,048**	**26**	**31**
Middle East and North Africa	2,285	(8)	2,277	(296)	**1,981**	**(13)**	**(13)**
North America	15,123	(42)	15,081	(3,387)	**11,694**	**(23)**	**(22)**
Latin America	4,244	(425)	3,819	(454)	**3,365**	**(21)**	**(12)**
	36,503	(1,540)	34,963	(5,633)	**29,330**	**(20)**	**(16)**
Impairment allowances							
Europe	5,598	(420)	5,178	(723)	**4,455**	**(20)**	**(14)**
Asia[4]	1,214	(32)	1,182	174	**1,356**	**12**	**15**
Middle East and North Africa	1,583	(4)	1,579	(173)	**1,406**	**(11)**	**(11)**
North America	4,242	(28)	4,214	(1,574)	**2,640**	**(38)**	**(37)**
Latin America	2,564	(294)	2,270	259	**2,529**	**(1)**	**11**
	15,201	(778)	14,423	(2,037)	**12,386**	**(19)**	**(14)**
Loan impairment charge							

Europe	1,732	62	1,794	(715)	**1,079**	**(38)**	**(40)**
Asia[4]	483	(17)	466	178	**644**	**33**	**38**
Middle East and North Africa	(44)		(44)	43	**(1)**	**98**	**98**
North America	1,235	(15)	1,220	(920)	**300**	**(76)**	**(75)**
Latin America	2,642	(190)	2,452	(419)	**2,033**	**(23)**	**(17)**
	6,048	(160)	5,888	(1,833)	**4,055**	**(33)**	**(31)**

For footnotes, see page 202.

Reconciliation of reported and constant currency loan impairment charges to the income statement

(Unaudited)

	31 Dec 13 as reported US$m	Currency translation adjustment[21] US$m	31 Dec 13 at 31 Dec 14 exchange rates US$m	Movement constant currency basis US$m	**31 Dec 14 as reported US$m**	**Reported change[22] %**	**Constant currency change[22] %**
Loan impairment charge							
Europe	1,732	62	1,794	(715)	**1,079**	**(38)**	**(40)**
new allowances	3,082	99	3,181	(736)	**2,445**	**(21)**	**(23)**
releases	(713)	(11)	(724)	(338)	**(1,062)**	**(49)**	**(47)**
recoveries	(637)	(26)	(663)	359	**(304)**	**52**	**54**
Asia[4]	483	(17)	466	178	**644**	**33**	**38**
new allowances	953	(31)	922	193	**1,115**	**17**	**21**
releases	(303)	8	(295)	(23)	**(318)**	**(5)**	**(8)**
recoveries	(167)	6	(161)	8	**(153)**	**8**	**5**
Middle East and North Africa	(44)		(44)	43	**(1)**	**98**	**98**
new allowances	408	(1)	407	(52)	**355**	**(13)**	**(13)**
releases	(365)	2	(363)	49	**(314)**	**14**	**13**
recoveries	(87)	(1)	(88)	46	**(42)**	**52**	**52**
North America	1,235	(15)	1,220	(920)	**300**	**(76)**	**(75)**
new allowances	1,640	(17)	1,623	(715)	**908**	**(45)**	**(44)**

releases	(282)	2	(280)	(213)	**(493)**	**(75)**	**(76)**
recoveries	(123)		(123)	8	**(115)**	**7**	**7**
Latin America	2,642	(190)	2,452	(419)	**2,033**	**(23)**	**(17)**
new allowances	3,262	(243)	3,019	(312)	**2,707**	**(17)**	**(10)**
releases	(338)	34	(304)	(29)	**(333)**	**1**	**(10)**
recoveries	(282)	19	(263)	(78)	**(341)**	**(21)**	**(30)**
Total	6,048	(160)	5,888	(1,833)	**4,055**	**(33)**	**(31)**
new allowances	9,345	(193)	9,152	(1,622)	**7,530**	**(19)**	**(18)**
releases	(2,001)	35	(1,966)	(554)	**(2,520)**	**(26)**	**(28)**
recoveries	(1,296)	(2)	(1,298)	343	**(955)**	**26**	**26**

For footnotes, see page 202.

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Report of the Directors: Financial Review (continued)

Loan impairment charges by industry sector over five years

(Unaudited)

	2014 US$m	2013 US$m	2012 US$m	2011 US$m	2010 US$m
Loan impairment charge/(release)					
Personal	**1,803**	3,196	5,362	9,318	11,187
Corporate and commercial	**2,256**	2,974	2,802	2,114	2,198
Financial[5]	**(4)**	(122)	(4)	73	163
Year ended 31 December	**4,055**	6,048	8,160	11,505	13,548

For footnotes, see page 202.

Charge for impairment losses as a percentage of average gross loans and advances to customers

(Unaudited)

	2014 %	2013 %	2012 %	2011 %	2010 %
New allowances net of allowance releases	**0.53**	0.81	1.00	1.34	1.65
Recoveries	**(0.10)**	(0.14)	(0.12)	(0.15)	(0.12)
Total charge for impairment losses	**0.43**	0.67	0.88	1.19	1.53
Amount written off net of recoveries	**0.58**	0.59	0.93	1.14	2.08

Movement in impairment allowances over five years

(Unaudited)

	2014 US$m	2013 US$m	2012 US$m	2011 US$m	2010 US$m
Impairment allowances at 1 January	**15,201**	16,169	17,636	20,241	25,649
Amounts written off	**(6,379)**	(6,655)	(9,812)	(12,480)	(19,300)
personal	**(3,733)**	(4,367)	(6,905)	(10,431)	(16,458)
corporate and commercial	**(2,425)**	(2,229)	(2,677)	(2,009)	(2,789)
financial[5]	**(221)**	(59)	(230)	(40)	(53)

Recoveries of amounts written off in previous years	**955**	1,296	1,146	1,426	1,020
personal	**818**	1,097	966	1,175	846
corporate and commercial	**128**	198	172	242	156
financial[5]	**9**	1	8	9	18
Loan impairment charge	**4,055**	6,048	8,160	11,505	13,548
Exchange and other movements[13]	**(1,446)**	(1,657)	(961)	(3,056)	(676)
Impairment allowances at 31 December	**12,386**	15,201	16,169	17,636	20,241
Impairment allowances					
individually assessed	**6,244**	7,130	6,629	6,662	6,615
collectively assessed	**6,142**	8,071	9,540	10,974	13,626
Impairment allowances at 31 December	**12,386**	15,201	16,169	17,636	20,241
Amount written off net of recoveries as a percentage of average gross loans and advances to customers	**0.6%**	0.6%	1.0%	1.2%	2.2%

For footnotes, see page 202.

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Report of the Directors: Financial Review (continued)

Gross loans and advances to customers by country

(Unaudited)

	First lien residential mortgages[6] US$m	Other personal[7] US$m	Property-related US$m	Commercial, international trade and other US$m	Total US$m
Europe	**131,000**	**47,531**	**35,313**	**200,313**	**414,157**
UK	**123,239**	**21,023**	**25,927**	**156,577**	**326,766**
France	**2,914**	**12,820**	**7,341**	**21,834**	**44,909**
Germany	**6**	**212**	**304**	**7,275**	**7,797**
Switzerland	**298**	**8,149**	**225**	**614**	**9,286**
Turkey	**645**	**3,389**	**297**	**4,244**	**8,575**
Other	**3,898**	**1,938**	**1,219**	**9,769**	**16,824**
Asia	**93,147**	**36,368**	**70,057**	**164,739**	**364,311**
Hong Kong	**56,656**	**22,891**	**52,208**	**82,362**	**214,117**
Australia	**9,154**	**815**	**2,130**	**6,360**	**18,459**
India	**1,235**	**285**	**613**	**5,099**	**7,232**
Indonesia	**64**	**469**	**202**	**5,476**	**6,211**
Mainland China	**4,238**	**1,981**	**6,606**	**24,875**	**37,700**
Malaysia	**5,201**	**1,750**	**1,988**	**5,217**	**14,156**
Singapore	**9,521**	**5,878**	**4,210**	**11,951**	**31,560**
Taiwan	**3,920**	**626**	**118**	**7,057**	**11,721**
Other	**3,158**	**1,673**	**1,982**	**16,342**	**23,155**
Middle East and North Africa (excluding Saudi Arabia)	**2,647**	**3,924**	**2,246**	**21,633**	**30,450**
Egypt	**1**	**510**	**98**	**2,272**	**2,881**
UAE	**2,263**	**1,782**	**1,545**	**13,814**	**19,404**
Other	**383**	**1,632**	**603**	**5,547**	**8,165**
North America	**55,577**	**9,823**	**15,492**	**51,535**	**132,427**
US	**37,937**	**5,482**	**11,461**	**38,632**	**93,512**
Canada	**16,236**	**4,085**	**3,708**	**11,825**	**35,854**
Other	**1,404**	**256**	**323**	**1,078**	**3,061**
Latin America	**4,153**	**9,384**	**2,572**	**29,543**	**45,652**

Argentina	**15**	**1,169**	**93**	**2,119**	**3,396**
Brazil	**2,067**	**5,531**	**1,077**	**16,814**	**25,489**
Mexico	**1,967**	**2,642**	**1,336**	**9,503**	**15,448**
Other	**104**	**42**	**66**	**1,107**	**1,319**
At 31 December 2014	**286,524**	**107,030**	**125,680**	**467,763**	**986,997**
Europe	140,474	51,633	38,634	230,932	461,673
UK	132,174	22,913	28,127	185,534	368,748
France	2,661	13,840	8,442	23,962	48,905
Germany	7	218	127	6,361	6,713
Switzerland	364	8,616	269	320	9,569
Turkey	833	4,002	305	4,059	9,199
Other	4,435	2,044	1,364	10,696	18,539
Asia	92,047	32,482	61,707	151,875	338,111
Hong Kong	53,762	19,794	44,904	75,547	194,007
Australia	9,468	1,236	2,511	7,138	20,353
India	1,080	297	425	4,231	6,033
Indonesia	69	447	78	5,361	5,955
Mainland China	4,880	300	5,808	22,149	33,137
Malaysia	5,140	1,994	1,997	5,420	14,551
Singapore	10,283	5,754	3,953	12,188	32,178
Taiwan	3,797	660	158	5,198	9,813
Other	3,568	2,000	1,873	14,643	22,084
Middle East and North Africa (excluding Saudi Arabia)	2,451	4,033	1,972	20,320	28,776
Egypt	1	477	146	2,232	2,856
UAE	2,082	1,842	1,331	12,344	17,599
Other	368	1,714	495	5,744	8,321
North America	60,955	11,735	14,616	44,884	132,190
US	42,317	6,257	10,174	30,952	89,700
Canada	17,036	5,116	3,912	13,079	39,143
Other	1,602	362	530	853	3,347
Latin America	3,948	10,970	2,749	28,815	46,482
Argentina	20	1,425	62	2,103	3,610
Brazil	1,811	6,466	1,268	17,132	26,677
Mexico	2,117	3,079	1,398	8,994	15,588
Other			21	586	607
At 31 December 2013	299,875	110,853	119,678	476,826	1,007,232

For footnotes, see page 202.

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The above tables analyse loans and advances by industry sector and by the location of the principal operations of the lending subsidiary or, in the case of the operations of The Hongkong and Shanghai Banking Corporation, HSBC Bank, HSBC Bank Middle East and HSBC Bank USA, by the location of the lending branch.

HSBC Holdings

(Audited)

Risk in HSBC Holdings is overseen by the HSBC Holdings Asset and Liability Management Committee (HALCO). The major risks faced by HSBC Holdings are credit risk, liquidity risk and market risk (in the form of interest rate risk and foreign exchange risk), of which the most significant is credit risk.

Credit risk in HSBC Holdings primarily arises from transactions with Group subsidiaries and from guarantees issued in support of obligations assumed

by certain Group operations in the normal conduct of their business. It is reviewed and managed within regulatory and internal limits for exposures by our Global Risk function, which provides high-level centralised oversight and management of credit risks worldwide.

HSBC Holdings maximum exposure to credit risk at 31 December 2014 is shown below. Its financial assets principally represent claims on Group subsidiaries in Europe and North America.

All the derivative transactions are with HSBC undertakings that are banking counterparties (2013: 100%) and for which HSBC Holdings has in place master netting arrangements. Since 2012, the credit risk exposure has been managed on a net basis and the remaining net exposure is specifically collateralised in the form of cash.

HSBC Holdings maximum exposure to credit risk

(Audited)

	2014			2013		
	Maximum exposure US$m	**Offset US$m**	**Exposure to credit risk (net) US$m**	Maximum exposure US$m	Offset US$m	Exposure to credit risk (net) US$m
Cash at bank and in hand:						
balances with HSBC undertakings	**249**		**249**	407		407
Derivatives	**2,771**	**(2,610)**	**161**	2,789	(2,755)	34

Loans and advances to HSBC undertakings	**43,910**		**43,910**	53,344		53,344
Financial investments in HSBC undertakings	**4,073**		**4,073**	1,210		1,210
Financial guarantees and similar contracts	**52,023**		**52,023**	52,836		52,836
Loan and other credit-related commitments	**16**		**16**	1,245		1,245
At 31 December	**103,042**	**(2,610)**	**100,432**	111,831	(2,755)	109,076

The credit quality of loans and advances and financial investments, both of which consist of intra-Group lending, is assessed as strong or good , with 100% of the exposure being neither past due nor impaired (2013: 100%).

Securitisation exposures and other structured products

(Audited)

This section contains information about our exposure to asset-backed securities (ABS s), some of which are held through consolidated structured entities and are summarised in the table below.

A summary of the nature of HSBC s exposures is provided in the Appendix to Risk on page 214.

Overall exposure of HSBC

(Audited)

	Carrying amount[23]	
	2014	2013
	US$bn	US$bn
Asset-backed securities	**48.9**	50.1
fair value through profit or loss	**3.6**	3.1
available for sale[24]	**29.7**	42.7
held to maturity[24]	**13.4**	1.1
loans and receivables	**2.2**	3.2
At 31 December	**48.9**	50.2

For footnotes, see page 202.

The following table summarises the carrying amount of our ABS exposure by categories of collateral and includes assets held in the GB&M legacy credit portfolio with a carrying value of US$23bn (2013: US$28bn).

At 31 December 2014, the available-for-sale reserve in respect of ABSs was a deficit of US$777m (2013: deficit of US$1,643m). For 2014, the impairment write-back in respect of ABSs was US$276m (2013: write-back of US$289m).

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Carrying amount of HSBC s consolidated holdings of ABSs[23]

(Audited)

	Trading US$m	Available for sale US$m	Held to maturity US$m	Designated at fair value through profit or loss US$m	Loans and receivables US$m	Total US$m	Of which held through consolidated SEs US$m
Mortgage-related assets:							
Sub-prime residential	**122**	**3,081**			**308**	**3,511**	**2,075**
US Alt-A residential	**96**	**3,022**	**11**		**110**	**3,239**	**2,411**
US Government agency and sponsored enterprises:							
MBSs	**82**	**10,401**	**13,436**			**23,919**	
Other residential	**928**	**1,220**			**330**	**2,478**	**652**
Commercial property	**654**	**3,627**			**516**	**4,797**	**2,854**
Leveraged finance-related assets	**172**	**3,660**			**218**	**4,050**	**2,526**
Student loan-related assets	**242**	**3,545**			**119**	**3,906**	**3,284**
Other assets	**1,264**	**1,114**		**19**	**646**	**3,043**	**758**
At 31 December 2014	**3,560**	**29,670**	**13,447**	**19**	**2,247**	**48,943**	**14,560**
Mortgage-related assets:							
Sub-prime residential	178	2,977			403	3,558	2,782
US Alt-A residential	101	3,538	18		134	3,791	2,926
US Government agency and sponsored enterprises:							
MBSs	178	18,661	1,110			19,949	
Other residential	618	1,925			399	2,942	1,513
Commercial property	133	5,667		104	669	6,573	5,146
Leveraged finance-related assets	294	5,011			251	5,556	4,310
Student loan-related assets	196	3,705			121	4,022	3,495
Other assets	1,271	1,265		34	1,186	3,756	989
At 31 December 2013	2,969	42,749	1,128	138	3,163	50,147	21,161

For footnote, see page 202.

Representations and warranties related to mortgage sales and securitisation activities

(Unaudited)

We have been involved in various activities related to the sale and securitisation of residential mortgages that are not recognised on our balance sheet. These activities include:

- the purchase of US$24bn of third-party originated mortgages by HSBC Bank USA and their securitisation by HSBC Securities (USA) Inc. (HSI) between 2005 and 2007;
- HSI acting as underwriter for the third-party issuance of private label mortgage-backed securities (MBS s) with an original issuance value of US$37bn, most of which were sub-prime; and
- the origination and sale by HSBC Bank USA of mortgage loans, primarily to government-sponsored entities.

In selling and securitising mortgage loans, various representations and warranties may be made to purchasers of the mortgage loans and MBSs. When purchasing and securitising mortgages originated by third parties and underwriting third-party MBSs, the obligation to repurchase loans in the event of a breach of loan level representations and warranties resides predominantly with the organisation that originated the loan.

Participants in the US mortgage securitisation market that purchased and repackaged whole loans, such as

servicers, originators, underwriters, trustees or sponsors of securitisations, have been the subject of lawsuits and governmental and regulatory investigations and inquiries.

At 31 December 2014, a liability of US$27m (2013: US$99m) was recognised in respect of various representations and warranties regarding the origination and sale by HSBC Bank USA of mortgage loans, primarily to government sponsored entities. These relate to, among other things, the ownership of the loans, the validity of the liens, the loan selection and origination process and compliance with the origination criteria established by the agencies. In the event of a breach of its representations and warranties, HSBC Bank USA may be obliged to repurchase the loans with identified defects or to indemnify the buyers. The estimated liability was based on the level of outstanding repurchase demands, the level of outstanding requests for loan files and the expected future repurchase demands in respect of mortgages sold to date which were either two or more payments delinquent or might become delinquent at an estimated conversion rate. Repurchase demands of US$3m were outstanding at 2014 (2013: US$44m).

For further information on legal proceedings and regulatory matters, see Note 40 on the Financial Statements.

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Report of the Directors: Financial Review (continued)

Upon receipt of a repurchase demand, we perform a detailed evaluation of the request. In many cases, we ultimately are not required to repurchase a loan as we are able to resolve the purported defect. From initial inquiry to ultimate resolution, a typical case takes roughly 12 months. Acceptance of a repurchase demand will involve either a) repurchase of the loan at the unpaid principal balance plus accrued interest or b) reimbursement for any realised loss on the sale of a property (make-whole payment).

To date, repurchase demands we have received primarily relate to prime loans sourced during 2004 through 2008 from the legacy broker channel which we exited from in late 2008.

The outstanding repurchase demands and movement in repurchase liabilities are as follows:

Outstanding repurchase demands received from GSEs and other third parties

	2014	2013
	US$m	US$m
GSEs	**2**	41
Others	**1**	3
At 31 December	**3**	44

Movement in repurchase liability for loans sold to GSEs and other third parties

	2014	2013
	US$m	US$m
At 1 January	**99**	219
Increase/(decrease) in liability recorded through earnings	**(41)**	21
Realised losses	**(31)**	(141)
At 31 December	**27**	99

Because the level of mortgage loan repurchase losses are dependent upon economic factors, investor demand strategies and other external risk factors such as housing market trends that may change, the estimate of the liability for a mortgage loan repurchase requires significant judgement. Because these estimates are influenced by factors outside our control, there is uncertainty inherent in them, making it reasonably possible that the estimates could change.

Risk elements in the loan portfolio

(Unaudited)

The disclosure of credit risk elements in this section reflects US accounting practice and classifications. The purpose of the disclosure is to present within the US disclosure framework those elements of the loan portfolios with a greater risk of loss. The three main classifications of credit risk elements presented are:

impaired loans;

unimpaired loans contractually more than 90 days past due as to interest or principal; and

troubled debt restructurings not included in the above.

Interest foregone on impaired and restructured loans

Interest income that would have been recognised under the original terms of impaired and restructured loans amounted to approximately US$2.2bn in 2014 (2013: US$2.5bn). The table below analyses this by geographic region.

	US$m	US$m
Europe	**218**	214
Asia	**113**	92
Middle East and North Africa	**135**	147
North America	**1,350**	1,667
Latin America	**411**	421
Year ended 31 December	**2,227**	2,541

Interest recognised on impaired and restructured loans

Interest income from such loans of approximately US$1.6bn was recorded in 2014 (2013: US$1.7bn). The table below analyses this by geographical region.

	2014 **US$m**	2013 US$m
Europe	**112**	97
Asia	**38**	42
Middle East and North Africa	**40**	28
North America	**995**	1,087
Latin America	**284**	410
Year ended 31 December	**1,469**	1,664

Impaired loans

In the following tables, we present information on our impaired loans and advances in accordance with the classification approach described on page 137 .

A loan is impaired, and an impairment allowance is recognised, when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated. In accordance with IFRSs, we recognise interest income on assets after they have been written down as a result of an impairment loss.

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The balance of impaired loans at 31 December 2014 was US$7.2bn lower than at 31 December 2013. This reduction occurred primarily in North America due to the continued run-off of the CML portfolio, partly offset by increases in individually assessed impaired balances in Asia.

Unimpaired loans more than 90 days past due

Examples of unimpaired loans more than 90 days past due include individually assessed mortgages that are in arrears more than 90 days where there are no other indicators of impairment, but where the value of collateral is sufficient to repay both the principal debt and all potential interest for at least one year; and short-term trade facilities past due more than 90 days for technical reasons such as delays in documentation, but where there is no concern over the creditworthiness of the counterparty.

The amount of unimpaired loans more than 90 days past due at 31 December 2014 was US$72m, US$55m lower than at 31 December 2013.

Troubled debt restructurings

Under US GAAP, a troubled debt restructuring (TDR) is a loan the terms of which have been modified for economic or legal reasons related to the borrower s financial difficulties to grant a concession to the borrower that the lender would not otherwise consider. A modification which results in a delay in payment that is considered insignificant is not regarded as a concession for the purposes of this disclosure. The SEC requires separate disclosure of any loans which meet the definition of a TDR that are not included in the previous two loan categories. These are classified as TDRs in the table on page 162(a). Loans that have been identified as a TDR under the US guidance retain this designation until maturity or derecognition.

The balance of TDRs not included as impaired loans at 31 December 2014 was US$253m lower than at 31 December 2013. The decrease was mainly in North America and reflects the continued run off and loan sales in the CML portfolio. This was partly offset by an increase in the Middle East and North Africa and Europe.

Potential problem loans

Potential problem loans are loans where information on possible credit problems among borrowers causes management to seriously doubt their ability to comply with the loan repayment terms. The following concentrations of credit risk have a higher risk of containing potential problem loans.

Total Personal lending on page 151 includes disclosure about certain homogeneous groups of loans, including interest-only mortgages and ARMs, which are collectively assessed for impairment. Collectively assessed loans and advances approach, as described on page 137, although typically not classified as impaired until more than 90 days past due, are assessed collectively for losses that have been incurred but have not yet been individually identified. This policy is further described on pages 212 and 351.

Renegotiated loans and forbearance on page 138 includes disclosure about the credit quality of loans whose contractual terms have been changed at some point in the life of the loan because of significant concerns about the borrower s ability to make contractual payments when due. Renegotiated loans are classified as impaired when:

- there has been a change in contractual cash flow as a result of a concession which the lender would otherwise not consider; and
- it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full.

This presentation applies unless the concession is insignificant and there are no other indicators of impairment. The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-repayment of future cash flows, and there are no other indicators of impairment. Refer to page 155 for further details on renegotiated loans within HSBC Finance.

Renegotiated loans that are not classified as impaired may have a higher risk of becoming delinquent in the future, and may therefore be potential problem loans. Further information regarding the credit quality classification of renegotiated loans can be found on page 209 .

Areas of special interest on page 126 includes information on Oil and Gas, Russia and Greece.

Refinancing risk in the commercial real estate sector is a separate area of focus and is covered on page 146.

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Analysis of risk elements in the loan portfolio by geographical region

(Unaudited)

	2014	2013	2012	2011	2010
	US$m	US$m	US$m	US$m	US$m
Impaired loans					
Europe	**10,242**	13,228	11,145	11,819	11,500
Asia	**2,048**	1,623	1,624	1,678	1,989
Middle East and North Africa	**1,981**	2,285	2,474	2,445	2,549
North America	**11,694**	15,123	20,345	22,758	27,902
Latin America	**3,365**	4,244	3,188	3,039	3,124
	29,330	36,503	38,776	41,739	47,064
Unimpaired loans contractually more than 90 days past due as to principal or interest					
Europe	**6**	25	33	41	65
Asia	**1**	33	14	24	47
Middle East and North Africa	**59**	56	108	214	263
North America	**3**	13	69	74	265
Latin America	**3**			10	3
	72	127	224	363	643
Troubled debt restructurings (not included in the classifications above)					
Europe	**1,652**	1,427	1,306	753	591
Asia	**267**	277	236	230	403
Middle East and North Africa	**778**	406	593	444	141
North America	**3,932**	4,643	3,813	2,300	1,970
Latin America	**353**	482	1,001	1,037	1,274
	6,982	7,235	6,949	4,764	4,379
Trading loans classified as in default					
North America	**4**	133	166	230	412
Risk elements on loans[61]					
Europe	**11,900**	14,680	12,484	12,613	12,157
Asia	**2,316**	1,933	1,874	1,932	2,439
Middle East and North Africa	**2,818**	2,747	3,175	3,103	2,953
North America	**15,633**	19,912	24,393	25,362	30,549
Latin America	**3,721**	4,726	4,189	4,086	4,401
	36,388	43,998	46,115	47,096	52,499

Assets held for resale[62]					
Europe	**29**	46	51	60	47
Asia	**14**	10	19	14	7
Middle East and North Africa					2
North America	**186**	370	319	359	1,084
Latin America	**16**	27	55	69	121
	245	453	444	502	1,261
Total risk elements					
Europe	**11,929**	14,726	12,535	12,673	12,204
Asia	**2,330**	1,943	1,893	1,946	2,446
Middle East and North Africa	**2,818**	2,747	3,175	3,103	2,955
North America	**15,819**	20,282	24,712	25,721	31,633
Latin America	**3,737**	4,753	4,244	4,155	4,522
At 31 December	**36,633**	44,451	46,559	47,598	53,760
	%	%	%	%	%
Loan impairment allowances as a percentage of risk elements on loans[63]	**34.0**	34.7	35.2	37.6	38.9

For footnotes, see page 202.

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Country distribution of outstandings and cross-border exposures

(Unaudited)

We control the risk associated with cross-border lending through a centralised structure of internal country limits. Exposures to individual countries and cross-border exposure in the aggregate are kept under continual review.

The following table summarises the aggregate of our in-country foreign currency and cross-border outstandings by type of borrower to countries which individually

represent in excess of 0.75% of our total assets. The classification is based on the country of residence of the borrower but also recognises the transfer of country risk in respect of third-party guarantees, eligible collateral held and residence of the head office when the borrower is a branch. In accordance with the Bank of England Country Exposure Report (Form CE) guidelines, outstandings comprise loans and advances (excluding settlement accounts), amounts receivable under finance leases, acceptances, commercial bills, certificates of deposit (CD s) and debt and equity securities (net of short positions), and exclude accrued interest and intra-HSBC exposures.

In-country foreign currency and cross-border amounts outstanding

(Unaudited)

	Banks US$bn	Government and official institutions US$bn	Other US$bn	Total US$bn
At 31 December 2014				
US	**6.8**	**30.3**	**32.4**	**69.5**
Mainland China	**26.5**	**5.7**	**28.5**	**60.7**
UK	**24.0**	**8.3**	**41.8**	**74.2**
Germany	**7.7**	**26.6**	**6.7**	**41.0**
Hong Kong	**8.1**	**0.4**	**29.0**	**37.5**
Japan[64]	**9.0**	**15.7**	**12.2**	**36.9**
France	**7.3**	**3.1**	**11.6**	**22.1**
At 31 December 2013				
US	10.0	2.3	42.5	54.8

UK	5.9	34.3	24.5	64.7
Mainland China	28.8	6.9	19.3	55.0
Germany	10.0	12.9	31.9	54.8
France	12.8	21.1	5.6	39.5
Hong Kong	10.9	0.7	26.5	38.1
Japan[64]	7.2	14.8	7.0	29.0
Ireland[64]	6.2	8.7	11.2	26.1
At 31 December 2012				
UK	5.9	37.9	14.7	58.5
US	18.0	2.8	34.7	55.5
Mainland China	23.4	3.3	16.0	42.7
Japan	11.6	15.9	10.2	37.7
France	12.8	11.3	13.2	37.3
Hong Kong	8.3	1.0	21.3	30.6
Germany	6.7	16.8	1.6	25.1
Ireland	0.8	0.1	19.5	20.4

For footnote, see page 202.

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Liquidity and funding

1 *Appendix to Risk risk policies and practices.*

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Liquidity and funding

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. The risk arises from mismatches in the timing of cash flows.

There were no material changes to our policies and practices for the management of liquidity and funding risks in 2014.

Following the change in balance sheet presentation explained on page 347, the advances to deposits ratio now excludes non-trading reverse repos and repos with customers. The change had no effect on the 31 December 2013 ratio as disclosed.

A summary of our current policies and practices regarding liquidity and funding is provided in the Appendix to Risk on page 215.

Our liquidity and funding risk management framework

The objective of our liquidity framework is to allow us to withstand very severe liquidity stresses. It is designed to be adaptable to changing business models, markets and regulations.

Our liquidity and funding risk management framework requires:

- liquidity to be managed by operating entities on a stand-alone basis with no implicit reliance on the Group or central banks;
- all operating entities to comply with their limits for the advances to core funding ratio; and

all operating entities to maintain a positive stressed cash flow position out to three months under prescribed Group stress scenarios.

Liquidity and funding in 2014

(Unaudited)

The liquidity position of the Group strengthened in 2014, and we continued to enjoy strong inflows of customer deposits and maintained good access to wholesale markets. Customer accounts increased by 4% (US$47bn) on a constant currency basis. On a reported basis, customer account balances decreased marginally by 1% (US$11bn). Loans and advances to customers increased by 3% (US$28bn) on a constant currency basis. On a reported basis, loans and advances to customers decreased by 2% (US$17bn). These changes resulted in a small decrease in our advances to deposits ratio to 72% (2013:73%)

HSBC UK recorded a decrease in its advances to core funding (ACF) ratio to 97% at 31 December 2014 (2013: 100%), mainly because core deposits increased more than advances, and due to the disposal of legacy assets.

The Hongkong and Shanghai Banking Corporation recorded an increase in its ACF ratio to 75% at 31 December 2014 (2013: 72%), mainly because advances increased more than core deposits.

HSBC USA recorded an increase in its ACF ratio to 100% at 31 December 2014 (2013: 85%), mainly because of growth in customer advances.

HSBC UK, The Hongkong and Shanghai Banking Corporation and HSBC USA are defined in footnotes 26 to 28 on page 202. The ACF ratio is discussed on page 216.

Customer deposit markets

(On constant currency basis)

Retail Banking and Wealth Management

RBWM customer account balances increased by 4%, driven by our two home markets of the UK and Hong Kong and the majority of our priority growth markets.

Commercial Banking

Customer accounts increased by 7% in 2014, driven by growth in Payments and Cash Management accounts in our two home markets.

Global Banking and Markets

Customer accounts increased by 2% in 2014, mainly from a rise in Payments and Cash Management accounts.

Global Private Banking

GPB customer account balances decreased by 10% compared with the end of 2013 following the continued repositioning of the GPB business and a client portfolio disposal.

Wholesale senior funding markets

Conditions in the bank wholesale debt markets were generally positive in 2014, supporting increased primary market issuance volumes across the capital structure from banks when compared with 2013. Periods of volatility remained, however, particularly during the latter months of the year when concerns around the decline in the oil price and growth in Europe combined with a variety of other factors to leave the outlook uncertain, with market confidence affected as a result.

In 2014, we issued the equivalent of US$20bn (2013: US$16bn) of senior term debt securities in the public capital markets in a range of currencies and maturities from a number of Group entities.

Liquidity regulation

(Unaudited)

The European adoption of the Basel Committee framework (legislative texts known as the Capital Requirements Regulation and Directive CRR/CRD IV) was published in June 2013, and required the reporting of the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) to European regulators from January 2014, which was subsequently delayed until 30 June 2014. A significant level of interpretation has been required to report and calculate the LCR as defined in the CRR text as certain areas were only addressed by the finalisation of the LCR delegated act in January 2015, which will not become a regulatory standard until 1 October 2015. The European calibration of NSFR is still pending following the Basel Committee s final recommendation in October 2014.

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Management of liquidity and funding risk

(Audited)

Our liquidity and funding risk management framework (LFRF) employs two key measures to define, monitor and control the liquidity and funding risk of each of our operating entities. The ACF ratio is used to monitor the structural long-term funding position, and the stressed coverage ratio, incorporating Group-defined stress scenarios, is used to monitor the resilience to severe liquidity stresses.

The three principal entities listed in the tables below represented 66% (2013: 66%) of the Group s customer accounts. Including the other principal entities, the percentage was 95% (2013: 94%).

Advances to core funding ratio

The table to the right shows the extent to which loans and advances to customers in our principal banking entities were financed by reliable and stable sources of funding.

ACF limits set for principal operating entities at 31 December 2014 ranged between 80% and 120%.

Core funding represents the core component of customer deposits and any term professional funding with a residual contractual maturity beyond one year. Capital is excluded from our definition of core funding.

Stressed coverage ratios

The ratios tabulated below express stressed cash inflows as a percentage of stressed cash outflows over both one-month and three-month time horizons. Operating entities are required to maintain a ratio of 100% or greater out to three months.

Inflows included in the numerator of the stressed coverage ratio are generated from liquid assets net of

assumed haircuts, and cash inflows related to assets contractually maturing within the time period.

In general, customer advances are assumed to be renewed and as a result do not generate a cash inflow.

Advances to core funding ratios[25]

(Audited)

	At 31 December	
	2014	2013
	%	%

HSBC UK[26]		
Year-end	**97**	100
Maximum	**102**	107
Minimum	**97**	100
Average	**100**	104
The Hongkong and Shanghai Banking Corporation[27]		
Year-end	**75**	72
Maximum	**75**	77
Minimum	**72**	70
Average	**74**	74
HSBC USA[28]		
Year-end	**100**	85
Maximum	**100**	85
Minimum	**85**	78
Average	**95**	82
Total of HSBC s other principal entities[29]		
Year-end	**92**	93
Maximum	**94**	93
Minimum	**92**	89
Average	**93**	91

For footnotes, see page 202.

The one-month stressed coverage ratio for HSBC UK increased as certain assets previously treated as realisable under stress between 1 and 3 months were reassessed as being either realisable within 1 month or beyond 3 months. The three-month stressed coverage ratio remained broadly unchanged.

The stressed coverage ratios for the other entities remained broadly unchanged.

Stressed one-month and three-month coverage ratios[25]

(Audited)

	Stressed one-month coverage ratios at 31 December		Stressed three-month coverage ratios at 31 December	
	2014	2013	**2014**	2013
	%	%	**%**	%
HSBC UK[26]				
Year-end	**117**	106	**109**	109
Maximum	**117**	114	**109**	109
Minimum	**102**	100	**103**	101
Average	**107**	106	**104**	103
The Hongkong and Shanghai Banking Corporation[27]				
Year-end	**117**	119	**112**	114
Maximum	**119**	131	**114**	126
Minimum	**114**	113	**111**	109
Average	**116**	119	**112**	114
HSBC USA[28]				

Year-end	**111**	114	**104**	110
Maximum	**122**	126	**111**	119
Minimum	**108**	110	**104**	109
Average	**115**	115	**107**	112
Total of HSBC s other principal entities[29]				
Year-end	**121**	121	**108**	114
Maximum	**121**	128	**115**	119
Minimum	**114**	113	**108**	109
Average	**117**	120	**110**	113

For footnotes, see page 202.

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Liquid assets of HSBC s principal operating entities

The table below shows the estimated liquidity value (before assumed haircuts) of assets categorised as liquid and used for the purposes of calculating the three-month stressed coverage ratios, as defined under the LFRF.

The level of liquid assets reported reflects the stock of unencumbered liquid assets at the reporting date, adjusted for the effect of reverse repo, repo and collateral swaps maturing within three months as the liquidity value of these transactions is reflected as a contractual cash flow reported in the net contractual cash flow table.

Like reverse repo transactions with residual contractual maturities within three months, unsecured interbank

loans maturing within three months are not included in liquid assets, but are treated as contractual cash inflows.

Liquid assets are held and managed on a stand-alone operating entity basis. Most of the liquid assets shown are held directly by each operating entity s Balance Sheet Management function, primarily for the purpose of managing liquidity risk, in line with the LFRF.

Liquid assets also include any unencumbered liquid assets held outside Balance Sheet Management for any other purpose. The LFRF gives ultimate control of all unencumbered assets and sources of liquidity to Balance Sheet Management.

For a summary of our liquid asset policy and definitions of the classifications shown in the table below, see the Appendix to Risk on page 217.

Liquid assets of HSBC s principal entities

(Audited)

	Estimated liquidity value[30]	
	31 December 2014 US$m	31 December 2013 US$m
HSBC UK[26]		
Level 1	**131,756**	168,877
Level 2	**4,688**	1,076
Level 3	**66,011**	63,509
	202,455	233,462
The Hongkong and Shanghai Banking Corporation[27]		

Level 1	**109,683**	108,713
Level 2	**4,854**	5,191
Level 3	**7,043**	7,106
	121,580	121,010
HSBC USA[28]		
Level 1	**51,969**	43,446
Level 2	**15,184**	12,709
Level 3	**197**	5,044
Other	**9,492**	8,000
	76,842	69,199
Total of HSBC s other principal entities[29]		
Level 1	**141,659**	144,774
Level 2	**10,419**	12,419
Level 3	**13,038**	13,663
	165,116	170,856

For footnotes, see page 202.

All assets held within the liquid asset portfolio are unencumbered.

Liquid assets held by HSBC UK decreased as a result of switching from central bank reserves to short-term reverse repo placements. A corresponding improvement can be seen in HSBC UK s net repo cash flow shown in the net contractual cash flow table.

Liquid assets held by The Hongkong and Shanghai Banking Corporation remained broadly unchanged.

Liquid assets held by HSBC USA increased, mainly due to a reduction in short-term repos and the reclassification of some assets as liquid in line with the LFRF.

Net contractual cash flows

The following table quantifies the contractual cash flows from interbank and intra-Group loans and deposits, and

reverse repo, repo (including intra-Group transactions) and short positions for the principal entities shown. These contractual cash inflows and outflows are reflected gross in the numerator and denominator, respectively, of the one and three-month stressed coverage ratios and should be considered alongside the level of liquid assets.

Outflows included in the denominator of the stressed coverage ratios include the principal outflows associated with the contractual maturity of wholesale debt securities reported in the table headed Wholesale funding cash flows payable by HSBC under financial liabilities by remaining contractual maturities on page 170.

For a summary of our policy and definitions of the classifications shown in the table below, see the Appendix to Risk on page 218.

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Net cash inflows/(outflows) for interbank and intra-Group loans and deposits and reverse repo, repo and short positions

(Audited)

	At 31 December 2014		At 31 December 2013	
	Cash flows within 1 month	Cash flows from 1 to 3 months	Cash flows within 1 month	Cash flows from 1 to 3 months
	US$m	US$m	US$m	US$m
Interbank and intra-Group loans and deposits				
HSBC UK[26]	**(14,110)**	**(2,846)**	(19,033)	(5,272)
The Hongkong and Shanghai Banking Corporation[27]	**(1,277)**	**6,862**	2,314	7,487
HSBC USA[28]	**(18,353)**	**1,648**	(24,268)	729
Total of HSBC s other principal entities[29]	**(1,322)**	**6,158**	4,295	10,149
Reverse repo, repo, stock borrowing, stock lending and outright short positions (including intra-Group)				
HSBC UK[26]	**(16,070)**	**11,551**	(39,064)	149
The Hongkong and Shanghai Banking Corporation[27]	**8,139**	**8,189**	12,662	4,297
HSBC USA[28]	**(4,928)**		(11,001)	
Total of HSBC s other principal entities[29]	**(22,110)**	**(11,120)**	(40,223)	9,551

For footnotes, see page 202.

Contingent liquidity risk arising from committed lending facilities

(Audited)

The Group s operating entities provide commitments to various counterparties. In terms of liquidity risk, the most significant risk relates to committed lending facilities which, whilst undrawn, give rise to contingent liquidity risk as they could be drawn during a period of liquidity stress. Commitments are given to customers and committed lending facilities are provided to consolidated multi-seller conduits established to enable clients to access flexible market-based sources of finance (see page 443), consolidated securities investment conduits and third-party sponsored conduits.

The consolidated securities investment conduits include Solitaire Funding Limited (Solitaire) and Mazarin Funding Limited (Mazarin). They issue asset-backed commercial paper secured against the portfolio of securities held by them. At 31 December 2014, HSBC

UK had undrawn committed lending facilities to these conduits of US$11bn (2013: US$15bn), of which Solitaire represented US$9.5bn (2013: US$11bn) and the remaining US$1.6bn (2013: US$4bn) pertained to Mazarin. Although HSBC UK provides a liquidity facility, Solitaire and Mazarin have no need to draw on it so long as HSBC purchases the commercial paper issued, which it intends to do for the foreseeable future. At 31 December 2014, the commercial paper issued by Solitaire and Mazarin was entirely held by HSBC UK. Since HSBC controls the size of the portfolio of securities held by these conduits, no contingent liquidity risk exposure arises as a result of these undrawn committed lending facilities.

The table below shows the level of undrawn commitments to customers outstanding for the five largest single facilities and the largest market sector, and the extent to which they are undrawn.

The Group s contractual undrawn exposures at 31 December monitored under the contingent liquidity risk limit structure

(Audited)

	HSBC UK[26]		HSBC USA[28]		HSBC Canada		The Hongkong and Shanghai Banking Corporation[27]	
	2014 US$bn	2013 US$bn	**2014 US$bn**	2013 US$bn	**2014 US$bn**	2013 US$bn	**2014 US$bn**	2013 US$bn
Commitments to conduits								
Consolidated multi-seller conduits								
total lines	**9.8**	10.1	**2.3**	2.5	**0.2**	1.0		
largest individual lines	**0.9**	0.7	**0.5**	0.5	**0.2**	0.7		
Consolidated securities investment conduits								
total lines	**11.1**	14.8						
Third party conduits total lines			**0.1**	0.7				
Commitments to customers								
five largest[31]	**2.6**	4.4	**7.1**	6.3	**1.7**	1.5	**1.5**	2.4
largest market sector[32]	**16.6**	9.5	**10.0**	8.2	**3.5**	3.4	**3.2**	2.7

For footnotes, see page 202.

Report of the Directors: Financial Review (continued)

Sources of funding

(Audited)

Our primary sources of funding are customer current accounts and customer savings deposits payable on demand or at short notice. We issue wholesale securities (secured and unsecured) to supplement our customer deposits and change the currency mix, maturity profile or location of our liabilities.

The Funding sources and uses table below, which provides a consolidated view of how our balance sheet is funded, should be read in light of the LFRF, which requires operating entities to manage liquidity and funding risk on a stand-alone basis.

The table analyses our consolidated balance sheet according to the assets that primarily arise from

operating activities and the sources of funding primarily supporting these activities. The assets and liabilities that do not arise from operating activities are presented as a net balancing source or deployment of funds.

The level of customer accounts continued to exceed the level of loans and advances to customers. The positive funding gap was predominantly deployed in liquid assets cash and balances with central banks and financial investments as required by the LFRF.

Loans and other receivables due from banks continued to exceed deposits taken from banks. The Group remained a net unsecured lender to the banking sector.

For a summary of sources and utilisation of repos and stock lending, see the Appendix to Risk on page 219.

Funding sources and uses[33]

(Audited)

	2014 US$m	2013 US$m
Sources		
Customer accounts[1]	**1,350,642**	1,361,297
Deposits by banks[1]	**77,426**	86,507
Repurchase agreements non-trading[1]	**107,432**	164,220
Debt securities issued	**95,947**	104,080
Subordinated liabilities	**26,664**	28,976
Financial liabilities designated at fair value	**76,153**	89,084
Liabilities under insurance contracts	**73,861**	74,181
Trading liabilities	**190,572**	207,025

repos	**3,798**	17,421
stock lending	**12,032**	12,218
settlement accounts	**17,454**	17,428
other trading liabilities	**157,288**	159,958
Total equity	**199,979**	190,459
At 31 December	**2,198,676**	2,305,829

For footnote, see page 202.

	2014 **US$m**	2013 US$m
Uses		
Loans and advances to customers[1]	**974,660**	992,089
Loans and advances to banks[1]	**112,149**	120,046
Repurchase agreements non-trading[1]	**161,713**	179,690
Trading assets	**304,193**	303,192
reverse repos	**1,297**	10,120
stock borrowing	**7,969**	10,318
settlement accounts	**21,327**	19,435
other trading assets	**273,600**	263,319
Financial investments	**415,467**	425,925
Cash and balances with central banks	**129,957**	166,599
Net deployment in other balance sheet assets and liabilities	**100,537**	118,288
At 31 December	**2,198,676**	2,305,829

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Report of the Directors: Financial Review (continued)

Cross-border, intra-Group and cross-currency liquidity and funding risk

(Unaudited)

The stand-alone operating entity approach to liquidity and funding mandated by the LFRF restricts the exposure of our operating entities to the risks that can arise from extensive reliance on cross-border funding. Operating entities manage their funding sources locally, focusing predominantly on the local customer deposit base. The RBWM, CMB and GPB customer relationships that give rise to core deposits within an operating entity generally reflect a local customer relationship with that operating entity. Access to public debt markets is co-ordinated globally by the Global Head of Balance Sheet Management and the Group Treasurer with Group ALCO monitoring all planned public debt issuance on a monthly basis. As a general principle, operating entities are only permitted to issue in their local currency and are encouraged to focus on local private placements. The public issuance of debt instruments in foreign currency is tightly controlled and generally restricted to HSBC Holdings and HSBC Bank.

A central principle of our stand-alone approach to LFRF is that operating entities place no future reliance on other Group entities. However, operating entities may, at their discretion, utilise their respective committed facilities from other Group entities if necessary. In addition, intra-Group large exposure limits are applied by national regulators to individual legal entities locally, which restricts the unsecured exposures of legal entities to the rest of the Group to a percentage of the lender s regulatory capital.

Our LFRF also considers the ability of each entity to continue to access foreign exchange markets under stress when a surplus in one currency is used to meet a deficit in another currency, for example, by using the foreign currency swap markets. Where appropriate, operating entities are required to monitor stressed coverage ratios and ACF ratios for non-local currencies and set limits for them. Foreign currency swap markets in currency pairs settled through the Continuous Link Settlement Bank are considered to be extremely deep and liquid and it is assumed that capacity to access these markets is not exposed to idiosyncratic risks. The table below shows the ACF ratios by material currencies for the year ended 31 December 2014.

Advances to core funding ratios by material currency[25]

(Unaudited)

	At 31 December 2014 %
HSBC UK[26]	
Local currency (sterling)	**98**
US dollars	**100**
Euros	**99**
Consolidated	**97**

The Hongkong and Shanghai Banking Corporation[27]		
Local currency (Hong Kong dollars)		**81**
US dollars		**74**
Consolidated		**75**
HSBC USA[28]		
Local currency (US dollars)		**100**
Consolidated		**100**
Total of HSBC s other principal entities[29]		
Local currency		**97**
US dollars		**101**
Consolidated		**92**

For footnotes, see page 202.

For all HSBC s operating entities, the only significant foreign currencies that exceed 5% of Group balance sheet liabilities are the Hong Kong dollar, euro, sterling and US dollar.

Wholesale term debt maturity profile

(Unaudited)

The maturity profile of our wholesale term debt obligations is set out in the table on page 170, Wholesale funding principal cash flows payable by HSBC under financial liabilities by remaining contractual maturities .

The balances in the table do not agree directly with those in the consolidated balance sheet as the table presents gross cash flows relating to principal payments and not the balance sheet carrying value, which includes debt securities and subordinated liabilities measured at fair value.

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Report of the Directors: Financial Review (continued)

Wholesale funding cash flows payable by HSBC under financial liabilities by remaining contractual maturities

(Unaudited)

	Due not more than 1 month US$m	Due over 1 month but not more than 3 months US$m	Due over 3 months but not more than 6 months US$m	Due over 6 months but not more than 9 months US$m	Due over 9 months but not more than 1 year US$m	Due over 1 year but not more than 2 years US$m	Due over 2 years but not more than 5 years US$m	Due over 5 years US$m	Total US$m
Debt securities issued	17,336	17,161	19,030	9,352	9,055	27,312	40,855	31,928	172,029
unsecured CDs and CP	5,637	9,337	9,237	4,793	3,010	3,506	4,158	185	39,863
unsecured senior MTNs	1,300	5,679	7,684	2,922	4,794	17,676	23,523	20,715	84,293
unsecured senior structured notes	1,363	1,082	2,049	1,149	979	4,757	8,444	6,789	26,612
secured covered bonds				205			2,765	2,942	5,912
secured ABCP	8,602								8,602
secured ABS	212	1,063	60	283	272	915	1,562		4,367
others	222					458	403	1,297	2,380
Subordinated liabilities		150		3	185	113	5,556	40,487	46,494
subordinated debt securities		150		3	185	113	5,556	34,750	40,757
preferred securities								5,737	5,737
At 31 December 2014	17,336	17,311	19,030	9,355	9,240	27,425	46,411	72,415	218,523

Debt securities issued	25,426	9,752	17,942	11,659	10,587	31,839	46,934	31,066	185,205
unsecured CDs and CP	7,589	7,206	9,867	3,239	5,043	4,449	2,749		40,142
unsecured senior MTNs	6,284	71	5,448	4,221	3,062	21,428	33,091	21,433	95,038
unsecured senior structured notes	987	1,423	1,952	1,689	1,718	3,712	6,036	5,021	22,538
secured covered bonds				1,250		225	2,747	3,317	7,539
secured ABCP	10,383								10,383
secured ABS	74	1,052	675	1,260	764	1,861	2,311		7,997
others	109					164		1,295	1,568
Subordinated liabilities		28	1,171	144	6	1,460	3,374	41,801	47,984
subordinated debt securities		28	1,171	144	6	460	3,374	34,899	40,082
preferred securities						1,000		6,902	7,902
At 31 December 2013	25,426	9,780	19,113	11,803	10,593	33,299	50,308	72,867	233,189

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Report of the Directors: Financial Review (continued)

Encumbered and unencumbered assets

(Unaudited)

The table on page 172, Analysis of on-balance sheet encumbered and unencumbered assets , summarises the total on and off-balance sheet assets that are capable of supporting future funding and collateral needs and shows the extent to which these assets are currently pledged for this purpose. The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the Group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement. An asset is therefore categorised as unencumbered if it has not been pledged against an existing liability. Unencumbered assets are further analysed into four separate sub-categories; readily realisable assets , other realisable assets , reverse repo/stock borrowing receivables and derivative assets and cannot be pledged as collateral .

At 31 December 2014, the Group held US$1,770bn of unencumbered assets that could be used to support potential future funding and collateral needs, representing 85% of the total assets that can support funding and collateral needs (on and off-balance sheet). Of this amount, US$765bn (US$684bn on-balance sheet) were assessed to be readily realisable.

Summary of assets available to support potential future funding and collateral needs (on and off-balance sheet)

(Unaudited)

	2014 **US$bn**	2013 US$bn
Total on-balance sheet assets	**2,634**	2,671
Less:		
Reverse repo/stock borrowing receivables and derivative assets	**(518)**	(482)
Other assets that cannot be pledged as collateral	**(281)**	(255)
Total on-balance sheet assets that can support funding and collateral needs	**1,835**	1,934
Add off-balance sheet assets:		
Fair value of collateral received from reverse repo/stock borrowing/derivatives that is available to sell or repledge	**257**	265

Total assets that can support funding and collateral needs (on and off-balance sheet)	**2,092**	2,199
Less:		
On-balance sheet assets pledged	**(146)**	(187)
Off-balance sheet collateral received from reverse repo/stock borrowing/derivatives which has been repledged or sold	**(176)**	(187)
Assets available to support future funding and collateral needs at 31 December	**1,770**	1,825

For a summary of our policy on collateral management and definition of encumbrance, see the Appendix to Risk on page 213.

Collateral

(Unaudited)

Off-balance sheet collateral received and pledged for reverse repo, stock borrowing and derivative transactions

The fair value of assets accepted as collateral that we are permitted to sell or repledge in the absence of default was US$257bn at 31 December 2014 (2013: US$265bn). The fair value of any such collateral sold or repledged was US$176bn (2013: US$187bn). We are obliged to return equivalent securities. These transactions are conducted under terms that are usual and customary to standard reverse repo, stock borrowing and derivative transactions.

The fair value of collateral received and repledged in relation to reverse repos, stock borrowing and

derivatives is reported on a gross basis. The related balance sheet receivables and payables are reported on a net basis where required under IFRSs offset criteria.

As a consequence of reverse repo, stock borrowing and derivative transactions where the collateral received could be but had not been sold or repledged, we held US$81bn (2013: US$78bn) of unencumbered collateral available to support potential future funding and collateral needs at 31 December 2014.

Analysis of on-balance sheet encumbered and unencumbered assets

The table below presents an analysis of on-balance sheet holdings only, and shows the amounts of balance sheet assets on a liquidity and funding basis that are encumbered. The table therefore excludes any available off-balance sheet holdings received in respect of reverse repos, stock borrowing or derivatives.

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Report of the Directors: Financial Review (continued)

Analysis of on-balance sheet encumbered and unencumbered assets

(Unaudited)

	Encumbered	Unencumbered				
	Assets pledged as collateral US$m	Readily realisable assets US$m	Other realisable assets US$m	Reverse repos/stock borrowing receivables and derivative assets US$m	Cannot be pledged as collateral US$m	Total US$m
Cash and balances at central banks		123,990	425		5,542	129,957
Items in the course of collection from other banks					4,927	4,927
Hong Kong Government certificates of indebtedness					27,674	27,674
Trading assets	59,162	182,305	17,869	9,266	35,591	304,193
Treasury and other eligible bills	1,994	14,122	4		50	16,170
debt securities	46,311	94,941	23		257	141,532
equity securities	10,857	62,855	1,497		40	75,249
loans and advances to banks		2,530	4,818	2,781	17,452	27,581
loans and advances to customers		7,857	11,527	6,485	17,792	43,661
Financial assets designated at fair value		177	2,330		26,530	29,037
Treasury and other eligible bills			52		4	56
debt securities		177	1,058		7,656	8,891
equity securities			1,139		18,867	20,006
loans and advances to banks and customers			81		3	84
Derivatives				345,008		345,008
Loans and advances to banks	178	3,573	74,231	762	33,405	112,149
Loans and advances to customers	24,329	92,238	840,241	1,170	16,682	974,660
Reverse repurchase agreements non-trading				161,713		161,713
Financial investments	61,785	275,732	22,780		55,170	415,467
Treasury and other eligible bills	3,176	75,896	2,167		278	81,517
debt securities	58,609	192,411	18,266		53,970	323,256
equity securities		7,425	2,347		922	10,694
	294	6,334	29,780		38,768	75,176

Prepayments, accrued income and other assets						
Current tax assets					**1,309**	**1,309**
Interest in associates and joint ventures		**22**	**17,875**		**284**	**18,181**
Goodwill and intangible assets					**27,577**	**27,577**
Deferred tax					**7,111**	**7,111**
At 31 December 2014	**145,748**	**684,371**	**1,005,531**	**517,919**	**280,570**	**2,634,139**
Cash and balances at central banks		161,240	269		5,090	166,599
Items in the course of collection from other banks					6,021	6,021
Hong Kong Government certificates of indebtedness					25,220	25,220
Trading assets	99,326	142,211	14,654	20,438	26,563	303,192
Treasury and other eligible bills	3,402	17,976	206			21,584
debt securities	83,563	57,850			231	141,644
equity securities	8,373	55,156	363			63,892
loans and advances to banks	1,796	2,813	6,151	5,263	11,861	27,884
loans and advances to customers	2,192	8,416	7,934	15,175	14,471	48,188
Financial assets designated at fair value	19	2,706	1,883		33,822	38,430
Treasury and other eligible bills					50	50
debt securities	19	826	776		10,968	12,589
equity securities		1,874	1,103		22,734	25,711
loans and advances to banks and customers		6	4		70	80
Derivatives				282,265		282,265
Loans and advances to banks	162	8,342	80,231		31,311	120,046
Loans and advances to customers	32,218	102,203	854,724	65	2,879	992,089
Reverse repurchase agreements non-trading				179,690		179,690
Financial investments	54,473	289,093	31,096		51,263	425,925
Treasury and other eligible bills	2,985	72,849	2,052		226	78,112
debt securities	51,488	210,516	25,720		50,949	338,673
equity securities		5,728	3,324		88	9,140
Prepayments, accrued income and other assets	1,028	16,788	24,619		34,407	76,842
Current tax assets					985	985
Interest in associates and joint ventures		12	16,356		272	16,640
Goodwill and intangible assets					29,918	29,918
Deferred tax					7,456	7,456
At 31 December 2013	187,226	722,595	1,023,832	482,458	255,207	2,671,318

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Report of the Directors: Financial Review (continued)

The US$24bn (2013: US$32bn) of loans and advances to customers reported in the table above as encumbered have been pledged predominantly to support the issuance of secured debt instruments such as covered bonds and ABSs, including asset-backed commercial paper issued by consolidated multi-seller conduits. It also includes those pledged in relation to any other form of secured borrowing.

In total, the Group pledged US$121bn (2013: US$150bn) of negotiable securities, predominantly as a result of market-making in securities financing to our clients.

Additional contractual obligations

Under the terms of our current collateral obligations under derivative contracts (which are ISDA compliant CSA contracts and contracts entered for pension obligations, and exclude the contracts entered for special purpose vehicles and additional termination events) and based on the positions at 31 December 2014, we estimate that we could be required to post additional collateral of up to US$0.5bn (2013: US$0.7bn) in the event of a one-notch downgrade in credit ratings, which would increase to US$1.2bn (2013: US$1.2bn) in the event of a two-notch downgrade.

Contractual maturity of financial liabilities

(Audited)

The balances in the table below do not agree directly with those in our consolidated balance sheet as the table incorporates, on an undiscounted basis, all cash flows relating to principal and future coupon payments (except for trading liabilities and derivatives not treated as hedging derivatives). Undiscounted cash flows payable in relation to hedging derivative liabilities are classified according to their contractual maturities. Trading liabilities and derivatives not treated as hedging derivatives are included in the On demand time bucket and not by contractual maturity.

A maturity analysis of repos and debt securities in issue included in trading liabilities is presented in Note 31 on the Financial Statements.

In addition, loans and other credit-related commitments and financial guarantees and similar contracts are generally not recognised on our balance sheet. The undiscounted cash flows potentially payable under financial guarantees and similar contracts are classified on the basis of the earliest date they can be called.

Cash flows payable by HSBC under financial liabilities by remaining contractual maturities

(Audited)

	On	Due within	Due between 3	Due between	Due after

	demand US$m	3 months US$m	and 12 months US$m	1 and 5 years US$m	5 years US$m
Deposits by banks	**52,682**	**17,337**	**3,600**	**3,580**	**390**
Customer accounts	**1,088,769**	**187,207**	**61,687**	**15,826**	**390**
Repurchase agreements non-trading	**8,727**	**91,542**	**6,180**	**23**	**1,057**
Trading liabilities	**190,572**				
Financial liabilities designated at fair value	**365**	**2,201**	**9,192**	**28,260**	**39,397**
Derivatives	**335,168**	**375**	**1,257**	**4,231**	**1,517**
Debt securities in issue	**9**	**32,513**	**30,194**	**37,842**	**7,710**
Subordinated liabilities		**737**	**1,256**	**10,003**	**42,328**
Other financial liabilities	**41,517**	**23,228**	**4,740**	**1,893**	**988**
	1,717,809	**355,140**	**118,106**	**101,658**	**93,777**
Loan and other credit-related commitments	**406,561**	**101,156**	**64,582**	**62,312**	**16,769**
Financial guarantees and similar contracts	**13,166**	**6,306**	**13,753**	**9,575**	**4,278**
At 31 December 2014	**2,137,536**	**462,602**	**196,441**	**173,545**	**114,824**
Deposits by banks	56,198	22,965	3,734	2,819	686
Customer accounts	1,097,159	196,048	57,243	15,520	726
Repurchase agreements non-trading	37,117	112,621	14,177		
Trading liabilities	207,025				
Financial liabilities designated at fair value	18,689	1,967	3,223	39,554	64,144
Derivatives	269,554	456	1,684	6,099	1,638
Debt securities in issue	2,528	35,401	33,695	46,141	6,526
Subordinated liabilities	55	391	2,687	11,871	44,969
Other financial liabilities	31,996	30,706	6,564	2,376	1,300
	1,720,321	400,555	123,007	124,380	119,989
Loan and other credit-related commitments	377,352	79,599	55,124	59,747	16,872
Financial guarantees and similar contracts	18,039	4,796	12,040	7,479	3,988
At 31 December 2013	2,115,712	484,950	190,171	191,606	140,849

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Report of the Directors: Financial Review (continued)

HSBC Holdings

(Audited)

Liquidity risk in HSBC Holdings is overseen by HALCO. Liquidity risk arises because of HSBC Holdings obligation to make payments to debt holders as they fall due. The liquidity risk related to these cash flows is managed by matching debt obligations with internal loan cash flows and by maintaining an appropriate liquidity buffer that is monitored by HALCO.

At 31 December 2014, the Group had US$9.2bn of CRD IV compliant non-common equity capital instruments, of which US$3.5bn were classified as tier 2 and US$5.7bn were classified as additional tier 1 (for details on the additional tier 1 instruments issued during the year see Note 35 on the Financial Statements). The balances in the table below do not agree directly

with those on the balance sheet of HSBC Holdings as the table incorporates, on an undiscounted basis, all cash flows relating to principal and future coupon payments (except for derivatives not treated as hedging derivatives). Undiscounted cash flows payable in relation to hedging derivative liabilities are classified according to their contractual maturities. Derivatives not treated as hedging derivatives are included in the On demand time bucket.

In addition, loan commitments and financial guarantees and similar contracts are generally not recognised on our balance sheet. The undiscounted cash flows potentially payable under financial guarantees and similar contracts are classified on the basis of the earliest date on which they can be called.

Cash flows payable by HSBC Holdings under financial liabilities by remaining contractual maturities

(Audited)

	On demand US$m	Due within 3 months US$m	Due between 3 and 12 months US$m	Due between 1 and 5 years US$m	Due after 5 years US$m
Amounts owed to HSBC undertakings	1,441	985	42	449	
Financial liabilities designated at fair value		210	642	6,345	19,005

Derivatives	**1,066**			**103**	
Debt securities in issue		**16**	**50**	**263**	**1,303**
Subordinated liabilities		**252**	**770**	**5,815**	**28,961**
Other financial liabilities		**1,132**	**158**		
	2,507	**2,595**	**1,662**	**12,975**	**49,269**
Loan commitments	**16**				
Financial guarantees and similar contracts	**52,023**				
At 31 December 2014	**54,546**	**2,595**	**1,662**	**12,975**	**49,269**
Amounts owed to HSBC undertakings	2,053	1,759	2,315	857	5,654
Financial liabilities designated at fair value		299	671	4,921	26,518
Derivatives	704				
Debt securities in issue		37	1,780	279	1,451
Subordinated liabilities		225	676	5,699	24,812
Other financial liabilities		885	284		
	2,757	3,205	5,726	11,756	58,435
Loan commitments	1,245				
Financial guarantees and similar contracts	52,836				
At 31 December 2013	56,838	3,205	5,726	11,756	58,435

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Market risk

sale

1 *Appendix to Risk risk policies and practices.*

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Report of the Directors: Financial Review (continued)

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

There were no material changes to our policies and practices for the management of market risk in 2014.

Exposure to market risk

Exposure to market risk is separated into two portfolios:

Trading portfolios comprise positions arising from market-making and warehousing of customer-derived positions. The interest rate risk on fixed-rate securities issued by HSBC Holdings is not included in Group VaR. The management of this risk is described on page 222.

Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from our insurance operations (see page 225).

Monitoring and limiting market risk exposures

Our objective is to manage and control market risk exposures while maintaining a market profile consistent with our risk appetite.

We use a range of tools to monitor and limit market risk exposures, including:

Sensitivity analysis includes the sensitivity of net interest income and the sensitivity of structural foreign exchange, which are used to monitor the market risk positions within each risk type;

Value at risk (VaR) is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence; and

In recognition of VaR s limitations we augment VaR with *stress testing* to evaluate the potential impact on portfolio values of more extreme, though plausible, events or movements in a set of financial variables. Examples of scenarios reflecting current market concerns are the slowdown in mainland China and the potential effects of a sovereign debt default, including its wider contagion effects.

A summary of our market risk management framework including current policies is provided in the Appendix to Risk on page 221.

Market risk in 2014

(Unaudited)

Global financial markets were characterised by low inflation and weak global growth, leading monetary authorities to maintain accommodative policies, using measures such as low interest rates and asset purchases.

With US data showing GDP growth, the US Federal Reserve s asset purchase programme came to an end. Despite this, US dollar bond yields fell further. Market focus switched to actions that the ECB can take to address the issues of low growth and deflation. A sustained period of deflation would have a severe detrimental impact on countries already in recession and with high debt to GDP ratios. 2014 can be characterised as a period of benign rates and equity markets in the G7 group of countries.

Against this backdrop, we maintained an overall defensive risk profile in our trading businesses. Defensive positions are characterised by low net open positions or the purchase of volatility protection via options trades. The lower trading VaR from defensive positioning was offset by an increase caused by lower diversification and regulatory changes to the calibrations used in calculating VaR. Non-trading VaR declined during the year as low interest rates, especially in US dollars, caused the duration of non-trading assets to decrease.

Trading portfolios

(Audited)

Value at risk of the trading portfolios

Trading VaR predominantly resides within Global Markets. This was higher at 31 December 2014 than at 31 December 2013 due to an increase in interest rate trading VaR, the removal of diversification effects within risk not in VaR (RNIV) and lower portfolio diversification benefit across asset classes.

The daily levels of total trading VaR over the last year are set out in the graph below.

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Daily VaR (trading portfolios), 99% 1 day (US$m)

(Unaudited)

The Group trading VaR for the year is shown in the table below.

Trading VaR, 99% 1 day[34]

(Audited)

	Foreign exchange and commodity US$m	Interest rate US$m	Equity US$m	Credit spread US$m	Portfolio diversification incl RNIV[35] US$m	Total[36] US$m
At 31 December 2014	**9.8**	**45.4**	**7.3**	**12.5**	**(14.3)**	**60.7**
Average	**16.9**	**39.5**	**6.9**	**13.7**	**(17.8)**	**59.2**
Maximum	**34.2**	**50.6**	**15.6**	**20.9**		**77.8**
At 31 December 2013	16.0	33.4	9.2	14.2	(20.7)	52.1
Average	15.2	33.4	5.1	16.5	(20.3)	49.9
Maximum	26.4	71.9	14.1	25.5		81.3

For footnotes, see page 202.

Back-testing

(Unaudited)

In 2014, the Group experienced one loss exception and two profit exceptions.

The loss exception was due primarily to losses from increased volatility in foreign exchange currencies and interest rates in some developed markets combined with flattening yield curves.

The profit exceptions were driven by the tightening of spreads, and exposures to emerging market foreign exchange and interest rates. There is no evidence of model errors or control failures.

The graph below shows the daily trading VaR against hypothetical profit and loss for the Group during 2014.
It excludes exceptions that were exempted by the PRA for regulatory capital purposes.

Back-testing of trading VaR against hypothetical profit and loss for the Group (US$m)

(Unaudited)

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Report of the Directors: Financial Review (continued)

Non-trading portfolios

(Audited)

Value at risk of the non-trading portfolios

Non-trading VaR of the Group includes contributions from all global businesses. There is no commodity risk in the non-trading portfolios. The decrease of non-trading VaR during 2014 was due primarily to the shortening of the duration in the non-trading book from lower interest rates, especially in US dollars. The credit spread risks component also added to a lower non-trading VaR as a result of the reduction in the overall position combined

with lower volatilities and credit spread baselines utilised in the VaR calculations. This movement included the reduction in credit spread risks relating to the Group s holdings of available-for-sale debt securities (excluding those held in insurance operations which are discussed further on page 194.

In the year, the decline in non-trading interest rate and credit spread VaR components was offset by a decrease in diversification benefit.

The daily levels of total non-trading VaR over the last year are set out in the graph below.

Daily VaR (non-trading portfolios), 99% 1 day (US$m)

(Unaudited)

The Group non-trading VaR for the year is shown in the table below.

Non-trading VaR, 99% 1 day

(Audited)

	Interest rate US$m	Credit spread US$m	Portfolio diversification US$m	Total US$m
At 31 December 2014	**88.2**	**62.5**	**(28.5)**	**122.2**

Average	**103.3**	**73.3**	**(37.4)**	**139.2**
Maximum	**147.7**	**91.9**		**189.0**
At 31 December 2013	150.6	80.4	(76.4)	154.6
Average	145.7	106.6	(82.1)	170.2
Maximum	221.7	135.7		252.3

The management of interest rate risk in the banking book is described further in Non-trading interest rate risk below, including the role of Balance Sheet Management (BSM).

Non-trading VaR excludes equity risk on available-for- sale securities, structural foreign exchange risk and interest rate risk on fixed rate securities issued by HSBC Holdings, the management of which is described in the relevant sections below. These sections together describe the scope of HSBC s management of market risks in non-trading books.

Credit spread risk for available-for-sale debt securities (including SICs)

The effect of movements in VaR credit spreads on our available-for-sale debt securities was US$81m (2013: US$113m) at 31 December 2014. This sensitivity includes the gross exposure for the securities investment conduits (SICs) consolidated within our balance sheet based on credit spread VaR. This sensitivity excludes losses which would have been absorbed by the capital note holders.

The decrease in this sensitivity at 31 December 2014 compared with 31 December 2013 was due mainly to reducing the overall positions and lower volatilities and credit spread baselines observed during the year.

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Report of the Directors: Financial Review (continued)

Equity securities classified as available for sale

Fair value of equity securities

(Audited)

	2014 US$bn	2013 US$bn
Private equity holdings[37]	**2.0**	2.7
Investment to facilitate ongoing business[38]	**1.2**	1.2
Other strategic investments	**7.5**	5.2
At 31 December	**10.7**	9.1

For footnotes, see page 202.

The fair value of equity securities classified as available for sale can fluctuate considerably. The table above sets out the maximum possible loss on shareholders equity

from available-for-sale equity securities. The increase in other strategic investments was largely due to the increase in the market value of the Industrial Bank investment offsetting the decrease in private equity holdings from the disposal of various direct and private equity fund investments.

Market risk balance sheet linkages

(Unaudited)

The information below and on page 180 aims to facilitate an understanding of linkages between line items in the balance sheet and positions included in our market risk disclosures, in line with recommendations made by the Enhanced Disclosure Task Force.

Balances included and not included in trading VaR

(Unaudited)

	Balance sheet	Balances included in trading VaR	Balances not included in trading VaR	Primary market risk sensitivities

	US$m	US$m	US$m	
At 31 December 2014				
Assets				
Cash and balances at central banks	**129,957**		**129,957**	**B**
Trading assets	**304,193**	**276,419**	**27,774**	**A**
Financial assets designated at fair value	**29,037**		**29,037**	**A**
Derivatives	**345,008**	**333,880**	**11,128**	**A**
Loans and advances to banks	**112,149**		**112,149**	**B**
Loans and advances to customers	**974,660**		**974,660**	**B**
Reverse repurchase agreements non-trading	**161,713**		**161,713**	**C**
Financial investments	**415,467**		**415,467**	**A**
Liabilities				
Deposits by banks	**77,426**		**77,426**	**B**
Customer accounts	**1,350,642**		**1,350,642**	**B**
Repurchase agreements non-trading	**107,432**		**107,432**	**C**
Trading liabilities	**190,572**	**170,576**	**19,996**	**A**
Financial liabilities designated at fair value	**76,153**		**76,153**	**A**
Derivatives	**340,669**	**334,199**	**6,470**	**A**
Debt securities in issue	**95,947**		**95,947**	**C**

The table represents account lines where there is some exposure to market risk according to the following asset classes:

A *Foreign exchange, interest rate, equity and credit spread.*

B *Foreign exchange and interest rate.*

C *Foreign exchange, interest rate and credit spread.*

The table above splits the assets and liabilities into two categories:

- those that are included in the trading book and are measured by VaR; and
- those that are not in the trading book and/or are not measured by VaR.

The breakdown of financial instruments included and not included in trading VaR provides a linkage with market risk to the extent that it is reflected in our risk framework. However, it is important to highlight that

the table does not reflect how we manage market risk, since we do not discriminate between assets and liabilities in our VaR model.

The assets and liabilities included in trading VaR give rise to a large proportion of the income included in net trading income. As set out on page 49, HSBC s net trading income in 2014 was US$6,760 (2013: US$8,690m). Adjustments to trading income such as valuation adjustments do not feed the trading VaR model.

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Report of the Directors: Financial Review (continued)

Market risk linkages to the accounting balance sheet

Trading assets and liabilities

The Group s trading assets and liabilities are in almost all cases originated by GB&M. The assets and liabilities are classified as held for trading if they have been acquired or incurred principally for the purpose of selling or repurchasing in the near term, or form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking. These assets and liabilities are treated as traded risk for the purposes of market risk management, other than a limited number of exceptions, primarily in Global Banking where the short-term acquisition and disposal of the assets are linked to other non-trading related activities such as loan origination.

Financial assets designated at fair value

Financial assets designated at fair value within HSBC are predominantly held within the Insurance entities. The majority of these assets are linked to policyholder liabilities for either unit-linked or insurance and investment contracts with DPF. The risks of these assets largely offset the market risk on the liabilities under the policyholder contracts, and are risk managed on a non-trading basis.

Financial liabilities designated at fair value

purposes. These arise when the derivative was entered into in order to manage risk arising from non-traded exposures. They include non-qualifying hedging derivatives and derivatives qualifying for fair value and cash flow hedge accounting. The use of non-qualifying hedges whose primary risks relate to interest rate and foreign exchange exposure is described on page 181. Details of derivatives in fair value and cash flow hedge accounting relationships are given in Note 16 on the Financial Statements. Our primary risks in respect of these instruments relate to interest rate and foreign exchange risks.

Loans and advances to customers

The primary risk on assets within loans and advances to customers is the credit risk of the borrower. The risk of these assets is treated as non-trading risk for market risk management purposes.

Financial investments

Financial investments include assets held on an available-for-sale and held-to-maturity basis. An analysis of the Group s holdings of these securities by accounting classification and issuer type is provided in Note 18 on the Financial Statements and by business activity on page 60. The majority of these securities are mainly held within Balance Sheet Management (BSM) in GB&M. The positions which are originated in order

Financial liabilities designated at fair value within HSBC are primarily fixed-rate securities issued by HSBC entities for funding purposes. An accounting mismatch would arise if the debt securities were accounted for at amortised cost because the derivatives which economically hedge market risks on the securities would be accounted for at fair value with changes recognised in the income statement. The market risks of these liabilities are treated as non-traded risk, the principal risks being interest rate and/or foreign exchange risks. We also incur liabilities to customers under investment contracts, where the liabilities on unit-linked contracts are based on the fair value of assets within the unit-linked funds. The exposures on these funds are treated as non-traded risk and the principal risks are those of the underlying assets in the funds.

Derivative assets and liabilities

We undertake derivative activity for three primary purposes; to create risk management solutions for clients, to manage the portfolio risks arising from client business and to manage and hedge our own risks. Most of our derivative exposures arise from sales and trading activities within GB&M and are treated as traded risk for market risk management purposes.

Within derivative assets and liabilities there are portfolios of derivatives which are not risk managed on a trading intent basis and are treated as non-traded risk for VaR measurement

to manage structural interest rate and liquidity risk are treated as non-trading risk for the purposes of market risk management. Available-for-sale security holdings within insurance entities are treated as non-trading risk and are largely held to back non-linked insurance policyholder liabilities.

The other main holdings of available-for-sale assets are the ABSs within GB&M s legacy credit business, which are treated as non-trading risk for market risk management purposes, the principal risk being the credit risk of the obligor.

The Group s held-to-maturity securities are principally held within the Insurance business. Risks of held-to-maturity assets are treated as non-trading for risk management purposes.

Repurchase (repo) and reverse repurchase (reverse repo) agreements non-trading

Reverse repo agreements, classified as assets, are a form of collateralised lending. HSBC lends cash for the term of the reverse repo in exchange for receiving collateral (normally in the form of bonds).

Repo agreements, classified as liabilities, are the opposite of reverse repo, allowing HSBC to obtain funding by providing collateral to the lender.

Both transaction types are treated as non-trading risk for market risk management and the primary risk is counterparty credit risk.

For information on the accounting policies applied to financial instruments at fair value, see Note 13 on the Financial Statements.

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Report of the Directors: Financial Review (continued)

Structural foreign exchange exposures

(Unaudited)

For our policies and procedures for managing structural foreign exchange exposures, see page 226 of the Appendix to Risk.

For details of structural foreign exchange exposures see Note 33 on the Financial Statements.

Non-trading interest rate risk

(Unaudited)

For our policies regarding the funds transfer pricing process for non-trading interest rate risk and liquidity and funding risk, see pages 226 and 219, respectively, of the Appendix to Risk.

Asset, Liability and Capital Management (ALCM) is responsible for measuring and controlling non-trading interest rate risk under the supervision of the Risk Management Meeting. Its primary responsibilities are:

- to define the rules governing the transfer of non-trading interest rate risk from the global businesses to BSM;
- to define the rules governing the interest rate risk behaviouralisation applied to non-trading assets/liabilities (see below);
- to ensure that all market interest rate risk that can be neutralised is transferred from the global businesses to BSM; and
- to define the rules and metrics for monitoring the residual interest rate risk in the global businesses, including any market risk that cannot be neutralised.

The different types of non-trading interest rate risk and the controls which we use to quantify and limit exposure to these risks can be categorised as follows:

- risk which is transferred to BSM and managed by BSM within a defined market risk mandate, predominantly through the use of fixed rate liquid assets (government bonds) held in available-for-sale portfolios and/or interest rate derivatives which are part of fair value hedging or cash flow hedging relationships. This non-trading interest rate risk is reflected in non-trading VaR, as well as in our net interest income (see below) or economic value of equity (EVE) sensitivity;

risk which remains outside BSM because it cannot be hedged or which arises due to our behaviouralised transfer pricing assumptions. This risk is not reflected in non-trading VaR, but is captured by our net interest income or EVE sensitivity and corresponding limits are part of our global and regional risk appetite statements for non-trading interest rate risk. A typical example would be margin compression created by unusually low rates in key currencies;

basis risk which is transferred to BSM when it can be hedged. Any residual basis risk remaining in the global businesses is reported to ALCO. This risk is not reflected in non-trading VaR, but is captured by our net interest income or EVE sensitivity. A typical example would be a managed rate savings product transfer-priced using a Libor-based interest rate curve; and

model risks which cannot be captured by non-trading VaR, net interest income or EVE sensitivity, but are controlled by our stress testing framework. A typical example would be prepayment risk on residential mortgages or pipeline risk.

Interest rate risk behaviouralisation

For our policies regarding interest risk behaviouralisation, see page 226 of the Appendix to Risk.

Third-party assets in Balance Sheet Management

(Unaudited)

For our BSM governance framework, see page 227 of the Appendix to Risk.

Third-party assets in BSM decreased by 9% during 2014. Deposits with central banks reduced by US$31bn, predominantly in Europe due to a combination of reduced repo activity and a decrease in balances with the ECB as deposit rates became negative. Loans and advances to banks decreased by US$6bn, mainly in Hong Kong and the rest of Asia. Financial investments reduced by US$8bn due to foreign exchange movements, net sales and maturities in Hong Kong and the Americas, partially offset by the increased deployment of funds into securities in Asia.

Third-party assets in Balance Sheet Management

(Unaudited)

	2014	2013
	US$m	US$m
Cash and balances at central banks	**103,008**	134,086
Trading assets	**4,610**	5,547
Financial assets designated at fair value		72
Loans and advances[1]:		
to banks	**53,842**	59,355
to customers	**1,931**	2,146
Reverse repurchase agreements	**59,172**	58,968
Financial investments	**306,763**	314,427
Other	**2,470**	3,700
At 31 December	**531,796**	578,301

For footnote, see page 202.

Sensitivity of net interest income

(Unaudited)

The table below sets out the effect on our future accounting net interest income (excluding insurance) of an incremental 25 basis points parallel rise or fall in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 January 2015. The sensitivities shown represent the change in the base case projected net interest income that would be expected under the two rate scenarios assuming that all other non-interest rate risk variables remain constant, and there are no management actions. In deriving our base case net interest income projections the re-pricing rate of assets and liabilities used is derived from current yield curves. The interest rate sensitivities are indicative and based on simplified scenarios. The limitations of this analysis are discussed in the Appendix to Risk on page 227.

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Report of the Directors: Financial Review (continued)

Assuming no management response, a sequence of such rises (up-shock) would increase planned net interest income for 2015 by US$885m (2014: US$938m), while a sequence of such falls (down-shock) would decrease planned net interest income by US$2,089m (2014: US$1,734m).

The net interest income (NII) sensitivity of the Group can be split into three key components; the structural sensitivity arising from the four global businesses excluding BSM and Markets, the sensitivity of the funding of the trading book (Markets) and the sensitivity of BSM.

The structural sensitivity is positive in a rising rate environment and negative in a falling rate environment. The sensitivity of the funding of the trading book is negative in a rising rate environment and positive in a falling rate environment, and in terms of the impact on profit the change in net interest income would be expected to be offset by a similar change in net trading income. The sensitivity of BSM will depend on its position. Typically, assuming no management response, the sensitivity of BSM is negative in a rising rate environment and positive in a falling rate environment.

The NII sensitivity figures below also incorporate the effect of any interest rate behaviouralisation applied and the effect of any assumed repricing across products under the specific interest rate scenario. They do not incorporate the effect of any management decision to change the HSBC balance sheet composition.

See page 227 in the Risk Appendix for more information about interest rate behaviouralisation and the role of BSM.

The NII sensitivity in BSM arises from a combination of the techniques that BSM use to mitigate the transferred interest rate risk and the methods they use to optimise net revenues in line with their defined risk mandate. The figures in the table below do not incorporate the effect of any management decisions within BSM, but in reality it is likely that there would be some short-term adjustment in BSM positioning to offset the NII effects of the specific interest rate scenario where necessary.

The NII sensitivity arising from the funding of the trading book is comprised of the expense of funding trading assets, while the revenue from these trading assets is reported in net trading income. This leads to an asymmetry in the NII sensitivity figures which is cancelled out in our global business results, where we include both net interest income and net trading income. It is likely, therefore, that the overall effect on profit before tax of the funding of the trading book will be much less pronounced than shown in the figures below.

The up-shock sensitivity remained broadly unchanged in 2014. The down-shock sensitivity increased predominantly due to a change in BSM s interest rate risk profile in US dollars.

Sensitivity of projected net interest income[39]

(Unaudited)

	US dollar bloc US$m	Rest of Americas bloc US$m	Hong Kong dollar bloc US$m	Rest of Asia bloc US$m	Sterling bloc US$m	Euro bloc US$m	Total US$m
Change in 2015 projected net interest income arising from a shift in yield curves of:							
+25 basis points at the beginning of each quarter	**209**	**(9)**	**245**	**265**	**321**	**(146)**	**885**
25 basis points at the beginning of each quarter	**(521)**	**(1)**	**(494)**	**(259)**	**(783)**	**(31)**	**(2,089)**
Change in 2014 projected net interest income arising from a shift in yield curves of:							
+25 basis points at the beginning of each quarter	(107)	12	327	236	598	(128)	938
25 basis points at the beginning of each quarter	(291)	(23)	(412)	(233)	(761)	(14)	(1,734)

For footnote, see page 202.

We monitor the sensitivity of reported reserves to interest rate movements on a monthly basis by assessing the expected reduction in valuation of available-for-sale portfolios and cash flow hedges due to parallel movements of plus or minus 100bps in all yield curves. These particular exposures form only a part

of our overall interest rate exposures. The accounting treatment of our remaining interest rate exposures, while economically largely offsetting the exposures shown in the below table, does not require revaluation movements to go to reserves.

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Report of the Directors: Financial Review (continued)

The table below describes the sensitivity of our reported reserves to the stipulated movements in yield curves and the maximum and minimum month-end figures during the year. The sensitivities are indicative and based on

simplified scenarios. The change in sensitivity of reported reserves is predominantly due to a reduction in the available-for-sale securities portfolio.

Sensitivity of reported reserves to interest rate movements

(Unaudited)

		Maximum impact	Minimum impact
	US$m	**US$m**	**US$m**
At 31 December 2014			
+ 100 basis point parallel move in all yield curves	**(3,696)**	**(5,212)**	**(3,696)**
As a percentage of total shareholders equity	**(1.9%)**	**(2.7%)**	**(1.9%)**
100 basis point parallel move in all yield curves	**3,250**	**4,915**	**3,250**
As a percentage of total shareholders equity	**1.7%**	**2.6%**	**1.7%**
At 31 December 2013			
+ 100 basis point parallel move in all yield curves	(5,762)	(5,992)	(5,507)
As a percentage of total shareholders equity	(3.2%)	(3.3%)	(3.0%)
100 basis point parallel move in all yield curves	5,634	5,786	4,910
As a percentage of total shareholders equity	3.1%	3.2%	2.7%

Defined benefit pension schemes

(Audited)

Market risk arises within our defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows.

HSBC s defined benefit pension schemes

(Audited)

	2014 US$bn	2013 US$bn
Liabilities (present value)	**42.1**	40.5
	%	%
Assets:		
Equities	**18**	18
Debt securities	**68**	70
Other (including property)	**14**	12
At 31 December	**100**	100

For details of our defined benefit schemes, see Note 6 on the Financial Statements, and for pension risk management see page 200.

Additional market risk measures applicable only to the parent company

(Audited)

The principal tools used in the management of market risk are VaR for foreign exchange rate risk and the projected sensitivity of HSBC Holdings net interest income to future changes in yield curves and interest rate gap repricing tables for interest rate risk.

Foreign exchange risk

Total foreign exchange VaR arising within HSBC Holdings in 2014 was as follows:

HSBC Holdings foreign exchange VaR

(Audited)

	2014 US$m	2013 US$m
At 31 December	**29.3**	54.1
Average	**42.1**	51.1
Minimum	**29.3**	46.7
Maximum	**50.0**	64.1

The foreign exchange risk largely arises from loans to subsidiaries of a capital nature that are not denominated in the functional currency of either the provider or the recipient and which are accounted for as financial assets. Changes in the carrying amount of these loans due to foreign exchange rate differences are taken directly to HSBC Holdings income statement. These loans, and most of the associated foreign exchange exposures, are eliminated on consolidation.

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Report of the Directors: Financial Review (continued)

Sensitivity of net interest income

(Audited)

HSBC Holdings monitors net interest income sensitivity over a five year time horizon reflecting the longer-term perspective on interest rate risk management appropriate to a financial services holding company. These sensitivities assume that any issuance where HSBC Holdings has an option to reimburse at a future call date is called at this date. The table below sets out the effect on HSBC Holdings future net interest income over a five

year time horizon of incremental 25 basis point parallel falls or rises in all yield curves worldwide at the beginning of each quarter during the 12 months from 1 January 2015.

Assuming no management actions, a sequence of such rises would increase planned net interest income for the next five years by US$600m (2013: increase of US$602m), while a sequence of such falls would decrease planned net interest income by US$539m (2013: decrease of US$464m).

Sensitivity of HSBC Holdings net interest income to interest rate movements[39]

(Audited)

	US dollar bloc US$m	Sterling bloc US$m	Euro bloc US$m	Total US$m
Change in projected net interest income as at 31 December arising from a shift in yield curves				
2014				
of + 25 basis points at the beginning of each quarter				
0-1 year	**78**	**9**	**2**	**89**
2-3 years	**281**	**17**	**34**	**332**
4-5 years	**138**	**17**	**24**	**179**
of 25 basis points at the beginning of each quarter				
0-1 year	**(58)**	**(9)**	**(1)**	**(68)**
2-3 years	**(276)**	**(16)**	**(12)**	**(304)**
4-5 years	**(138)**	**(17)**	**(12)**	**(167)**
2013				
of + 25 basis points at the beginning of each quarter				
0-1 year	104	(14)	2	92

2-3 years	382	(93)	38	327
4-5 years	245	(101)	38	182
of 25 basis points at the beginning of each quarter				
0-1 year	(53)	13	(2)	(42)
2-3 years	(300)	91	(33)	(242)
4-5 years	(243)	101	(38)	(180)

For footnote, see page 202.

The interest rate sensitivities tabulated above are indicative and based on simplified scenarios. The figures represent hypothetical movements in net interest income based on our projected yield curve scenarios, HSBC Holdings current interest rate risk profile and assumed changes to that profile during the next five years. Changes to assumptions concerning the risk profile over the next five years can have a significant impact on the net interest income sensitivity for that period. However, the figures do not take into account

the effect of actions that could be taken to mitigate this interest rate risk.

Interest rate repricing gap table

The interest rate risk on the fixed-rate securities issued by HSBC Holdings is not included within the Group VaR but is managed on a repricing gap basis. The interest rate repricing gap table below analyses the full-term structure of interest rate mismatches within HSBC Holdings balance sheet.

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Repricing gap analysis of HSBC Holdings

(Audited)

	Total US$m	Up to 1 year US$m	From over 1 to 5 years US$m	From over 5 to 10 years US$m	More than 10 years US$m	Non-interest bearing US$m
Cash at bank and in hand:						
balances with HSBC undertakings	**249**					**249**
Derivatives	**2,771**					**2,771**
Loans and advances to HSBC undertakings	**43,910**	**41,603**	**290**	**1,093**		**924**
Financial investments in HSBC undertakings	**4,073**	**3,010**		**731**		**332**
Investments in subsidiaries	**96,264**					**96,264**
Other assets	**597**					**597**
Total assets	**147,864**	**44,613**	**290**	**1,824**		**101,137**
Amounts owed to HSBC undertakings	**(2,892)**	**(1,877)**				**(1,015)**
Financial liabilities designated at fair values	**(18,679)**	**(850)**	**(5,472)**	**(5,400)**	**(4,263)**	**(2,694)**
Derivatives	**(1,169)**					**(1,169)**
Debt securities in issue	**(1,009)**			**(1,013)**		**4**
Other liabilities	**(1,415)**					**(1,415)**
Subordinated liabilities	**(17,255)**	**(779)**	**(3,766)**	**(2,000)**	**(10,195)**	**(515)**
Total equity	**(105,445)**					**(105,445)**
Total liabilities and equity	**(147,864)**	**(3,506)**	**(9,238)**	**(8,413)**	**(14,458)**	**(112,249)**
Off-balance sheet items attracting interest rate sensitivity		**(21,525)**	**7,295**	**7,400**	**5,763**	**1,067**
Net interest rate risk gap at 31 December 2014		**19,582**	**(1,653)**	**811**	**(8,695)**	**(10,045)**
Cumulative interest rate gap		**19,582**	**17,929**	**18,740**	**10,045**	
Cash at bank and in hand:						
balances with HSBC undertakings	407	357				50
Derivatives	2,789					2,789

Loans and advances to HSBC undertakings	53,344	49,979	290	1,239	645	1,191
Financial investments in HSBC undertakings	1,210	300		731		179
Investments in subsidiaries	92,695					92,695
Other assets	391					391
Total assets	150,836	50,636	290	1,970	645	97,295
Amounts owed to HSBC undertakings	(11,685)	(10,865)				(820)
Financial liabilities designated at fair values	(21,027)	(1,928)	(4,655)	(7,810)	(4,325)	(2,309)
Derivatives	(704)					(704)
Debt securities in issue	(2,791)	(1,722)			(1,069)	
Other liabilities	(1,375)					(1,375)
Subordinated liabilities	(14,167)		(3,030)	(2,066)	(8,912)	(159)
Total equity	(99,087)					(99,087)
Total liabilities and equity	(150,836)	(14,515)	(7,685)	(9,876)	(14,306)	(104,454)
Off-balance sheet items attracting interest rate sensitivity		(18,620)	4,382	9,876	4,421	(59)
Net interest rate risk gap at 31 December 2013		17,501	(3,013)	1,970	(9,240)	(7,218)
Cumulative interest rate gap		17,501	14,488	16,458	7,218	

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Report of the Directors: Financial Review (continued)

Operational risk

(Unaudited)

1 *Appendix to Risk risk policies and practices.*

Operational risk is relevant to every aspect of our business and covers a wide spectrum of issues, in particular legal, compliance, security and fraud. Losses arising from breaches of regulation and law, unauthorised activities, error, omission, inefficiency, fraud, systems failure or external events all fall within the definition of operational risk.

Responsibility for minimising operational risk lies with HSBC s management and staff. Each regional, global business, country, business unit and functional head is required to maintain oversight over the operational risks and internal controls of the business and operational activities for which they are responsible.

A summary of our current policies and practices regarding operational risk is provided in the Appendix to Risk on page 228.

Operational risk management framework

The Group Operational Risk function and the operational risk management framework (ORMF) directs business management in discharging their responsibilities.

The ORMF defines minimum standards and processes, and the governance structure for operational risk and internal control across the Group. To implement the ORMF a three lines of defence model is used for the management of risk, as described below:

Three lines of defence

A diagrammatic representation of the ORMF is presented on page 187.

Activity to embed the use of our operational risk management framework continued in 2014. At the same time, we are streamlining operational risk management processes and harmonising framework components and risk management processes. This is expected to lead to a stronger operational risk management culture and more forward-looking risk insights to enable businesses to determine whether material risks are being managed within the Group s risk appetite and whether further action is required. In addition, the Security and Fraud Risk and Financial Crime Compliance functions have built a Financial Intelligence Unit (FIU) which provides intelligence on the potential risks of financial crime posed by customers and business prospects to enable better risk management decision-making. The FIU provides context and expertise to identify, assess and understand financial crime risks holistically in clients, sectors and markets.

Articulating our risk appetite for material operational risks helps the organisation understand the level of risk HSBC is willing to accept. The Group operational risk appetite statement is approved annually by the GRC. The Group risk appetite statement, which includes operational risk appetite metrics, was approved by the HSBC Holdings Board. Monitoring operational risk exposure against risk appetite on a regular basis and implementing our risk acceptance process drives risk awareness in a forward-looking manner. It assists management in determining whether further action is required.

Operational risk and control assessments (RCAs) are performed by individual business units and functions. The risk and control assessment process is designed to provide business areas and functions with a forward looking view of operational risks and an assessment of the effectiveness of controls, and a tracking mechanism for action plans so that they can proactively manage operational risks within acceptable levels. Risk and control assessments are reviewed and updated at least annually.

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Operational risk management framework

RCAs are used to inform the evaluation of the effectiveness of controls over top risks.

Key Indicators are used to help monitor the risks and controls.

Scenarios provide management with a quantified view of our top and emerging operational risks.

Internal incidents are used to forecast typical losses.

External sources are used to inform the assessment of extreme scenarios.

Appropriate means of mitigation and controls are considered. These include:

- making specific changes to strengthen the internal control environment;
- investigating whether cost-effective insurance cover is available to mitigate the risk; and
- other means of protecting us from loss.

In addition, an enhanced scenario analysis process has been implemented across material legal entities to improve the quantification and management of material risks.

Operational risk in 2014

During 2014, our operational risk profile continued to be dominated by compliance and legal risks as referred to under Top and emerging risks on page 118. Losses were realised relating to events that occurred in previous years. These events included the possible historical mis-selling of payment protection insurance (PPI) products in the UK (see Note 29 on the Financial Statements). A number of mitigating actions continue to be taken to prevent future mis-selling incidents.

The incidence of regulatory and other proceedings against financial service firms is increasing. Proposed changes relating to capital and liquidity requirements, remuneration and/or taxes could increase our cost of doing business, reducing future profitability. We remain subject to a number of regulatory proceedings including investigations and reviews by various national regulatory, competition and enforcement authorities relating to certain past submissions made by panel banks and the process for making submissions in connection with the

setting of Libor and other interbank offered and benchmark interest rates. There are also investigations into foreign exchange, precious metals and credit default swap-related activities in progress. In response, we have undertaken a number of initiatives, including the restructuring of our Compliance sub-functions, enhancing our governance and oversight, measures to implement Global Standards as described on page 26 and other measures put in place designed to ensure we have the appropriate people, processes and procedures to manage emerging risks and new products and business.

For further details see Compliance risk on page 189 and for details of the investigations and legal proceedings see Note 40 on the Financial Statements.

In November 2014, the UK FCA and the US Commodity Futures Trading Commission (CFTC) each announced having concluded regulatory settlements with a number of banks, including HSBC Bank plc, in connection with their respective investigations of trading and other conduct involving foreign exchange benchmark rates. Under the settlement terms, HSBC Bank plc agreed to pay a financial penalty to the FCA and a civil monetary penalty to the CFTC and to undertake various remedial actions. For further information, see Note 40 on the Financial Statements.

We have undertaken a review of our compliance with the fixed-sum unsecured loan agreement requirements of the UK Consumer Credit Act (CCA). A liability has been recognised within Accruals, deferred income and other liabilities for the repayment of interest to customers where annual statements did not remind them of their right to partially prepay the loan, notwithstanding that the customer loan documentation did include this right.

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There is uncertainty as to whether other technical requirements of the CCA have been met, for which we have assessed an additional contingent liability. For further details see Note 40 on the Financial Statements.

We have settled claims by the US Federal Housing Finance Agency in relation to the purchase of mortgage backed securities by the Federal National Mortgage Associations (Fannie Mae) and the Federal Home Loan Mortgage Association (Freddie Mac) between 2005 and 2007. For further information, see Note 40 on the Financial Statements.

Other operational risks included:

fraud risks: the threat of fraud perpetrated by or against our customers, especially in retail and commercial banking, may grow during adverse economic conditions. We increased monitoring, analysed root causes and reviewed internal controls to enhance our defences against external attacks and reduce the level of loss in these areas. In addition, Group Security and Fraud Risk worked closely with the global businesses to continually assess these threats as they evolved and adapt our controls to mitigate these risks;

level of change creating operational complexity: the Global Risk function is engaged with business management in business transformation initiatives to ensure robust internal controls are maintained, including through participation in all relevant management committees. The Global Transactions Team has developed an enhanced risk management framework to be applied to the management of disposal risks;

information security: the security of our information and technology infrastructure is crucial for maintaining our banking services and protecting our customers and the HSBC brand. A failure of the control framework which protects this could have implications for the wider financial sector and result in direct financial loss and/or the loss of customer data and other sensitive information which could undermine both our reputation and our ability to retain the trust of our customers. Programmes of work have been ongoing to strengthen internal security controls to prevent unauthorised access to our systems which may affect live services or facilitate data loss or fraud.
In common with other banks and multinational organisations, we continue to be a target of increasingly sophisticated cyber-attacks such as distributed denial of service attacks which can affect the availability of customer-facing websites. In addition, reliance on standard internet technologies, protocols and services means we are subject to wide-scale remediation when flaws are reported in these technologies. Lessons learnt from attacks experienced within the industry and information sharing with other financial institutions, government agencies and external intelligence
providers allows us to develop a better understanding of our own susceptibilities and to develop scenarios to test against. They will continue to be a focus of ongoing initiatives to strengthen the control environment. Significant investment has already been made in enhancing controls around data access, the heightened monitoring of potential cyber-attacks and continued training to raise staff awareness. This is an area that will require continual investment in our operational processes and contingency plans;

vendor risk management: we continue to focus on the management of vendor risks including making good progress with the implementation of the supplier performance management programme with our most important suppliers. Additional focus is put on the screening of suppliers to enable HSBC to identify if any suppliers are on a sanctions list and to exit such relationships. Vendor risk management is a core element of third party risk management; and

compliance with regulatory agreements and orders: Failure to implement our obligations under the DPAs could have a material adverse effect on our results and operations. Legal proceedings are discussed in Note 40 on the Financial Statements and further details regarding compliance risk are set out below.

Other operational risks are also monitored and managed through the use of the ORMF.

Further information on the nature of these risks is provided in Top and emerging risks on page 118.

Frequency and amount of operational risk losses

The profile of operational risk incidents and associated losses is summarised below, showing the distribution of operational risk incidents in terms of their frequency of occurrence and total loss amount in US dollars.

Operational losses rose in 2014, driven by UK customer redress programme charges and settlements relating to legal and regulatory matters.

As in 2013, the operational risk incident profile in 2014 comprised both high frequency, low impact events and high impact events that occurred much less frequently. For example, losses due to external fraud incidents such as credit card fraud occurred more often than other types of event, but the amounts involved were often small in value. By contrast, operational risk incidents in the compliance category were relatively low frequency events, but the total cost was significant.

The number of fraud cases was broadly unchanged during 2014 due to the continued strong control environment.

Losses due to significant historical events, including the possible mis-selling of PPI products in the UK and the incidence of regulatory matters described in Note 40 on the Financial Statements remained substantial in 2014**.**

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Frequency of operational risk incidents by risk category (individual loss >US$10k)

Distribution of operational risk losses in US dollars by risk category

Compliance risk

(Unaudited)

Compliance risk is the risk that we fail to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice, and incur fines and penalties and suffer damage to our business as a consequence.

In 2014, we completed the restructuring of our Compliance sub-function within Global Risk into two new sub-functions: Financial Crime Compliance and Regulatory Compliance, appropriately supported by shared Compliance Chief Operating Officer, Assurance and Reputational Risk Management teams. We continue to ensure that the Compliance sub-functions, through

their operation and the execution of the Group strategy, including measures to implement Global Standards, are well positioned to meet increased levels of regulation and scrutiny from regulators and law enforcement agencies. In addition, the measures we have put in place are designed to ensure we have the appropriate people, processes and procedures to manage emerging risks and new products and business.

Enhanced global AML and sanctions policies, incorporating risk appetite, were approved by the Board in January 2014. The policies adopt and seek to enforce the highest or most effective standards globally, including a globally consistent approach to knowing our customers.

The policies are being implemented in phases through the development and application of procedures required to embed them in our day to day business operations globally. The overriding policy objective is for every employee to engage in only the right kind of business, conducted in the right way .

HSBC has fulfilled all of the requirements imposed by the DANY DPA, which expired by its terms at the end of the two-year period of that agreement in December 2014. Breach of the US DPA at any time during its term may allow the DoJ to prosecute HSBC Holdings or HSBC Bank USA in relation to the matters which are the subject of the US DPA. For further information, see Regulatory commitments and consent orders on page 120.

In May 2014, the Board approved a globally consistent approach to the management of regulatory conduct designed to ensure we deliver fair outcomes for our customers and conduct orderly and transparent operations in financial markets. Implementation of the global conduct approach is managed through the global lines of business and functions and covers all our business and operational activities. Examples of these activities are disclosed in Conduct of business on page 121.

It is clear that the level of inherent compliance risk that we face will continue to remain high for the foreseeable future. However, we consider that good progress is being made and will continue to be made in ensuring that we are well placed to effectively manage those risks.

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Report of the Directors: Financial Review (continued)

Risk management of insurance operations

(Audited)

Sensitivities to non-economic assumptions

1 *Appendix to Risk policies and practices.*

The majority of the risk in our insurance business derives from manufacturing activities and can be categorised as insurance risk and financial risk. Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (HSBC). Financial risks include market risk, credit risk and liquidity risk.

There were no material changes to our policies and practices for the management of risks arising in the insurance operations in 2014.

A summary of HSBC s policies and practice regarding the risk management of insurance operations and the main contracts we manufacture is provided in the Appendix to Risk on page 231.

HSBC s bancassurance model

(Unaudited)

We operate an integrated bancassurance model which provides insurance products principally for customers with whom we have a banking relationship. Insurance products are sold through all global businesses, but predominantly by RBWM and CMB through our branches and direct channels worldwide.

The insurance contracts we sell relate to the underlying needs of our banking customers, which we can identify from our point-of-sale contacts and customer knowledge. The majority of sales are of savings and investment products and term and credit life contracts.

By focusing largely on personal and SME lines of business we are able to optimise volumes and diversify individual insurance risks.

Where we have operational scale and risk appetite, mostly in life insurance, these insurance products are manufactured by HSBC subsidiaries. Manufacturing insurance allows us to retain the risks and rewards associated with writing insurance contracts by keeping part of the underwriting profit, investment income and distribution commission within the Group.

Where we do not have the risk appetite or operational scale to be an effective insurance manufacturer, we engage with a handful of leading external insurance companies in order to provide insurance products to our customers through our banking network and direct channels. These arrangements are generally structured with our exclusive strategic partners and earn the Group a combination of commissions, fees and a share of profits.

We distribute insurance products in all of our geographical regions. We have core life insurance manufacturing entities, the majority of which are direct subsidiaries of legal banking entities, in seven countries (Argentina, Brazil, Mexico, France, the UK, Hong Kong and Singapore). There are also life insurance manufacturing subsidiaries in mainland China, Malaysia and Malta.

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Risk management of insurance operations in 2014

We measure the risk profile of our insurance manufacturing businesses using an economic capital approach, where assets and liabilities are measured on a market value basis and a capital requirement is held to ensure that there is less than a 1 in 200 chance of insolvency over the next year, given the risks that the businesses are exposed to. In 2014 we aligned the measurement approach for market, credit and insurance risks in the economic capital model to the new pan-European Solvency II insurance capital regulations, which are applicable from 2016.

The risk profile of our life insurance manufacturing businesses did not change materially during 2014 and liabilities to policyholders on these contracts remained constant at US$74bn (2013: US$74bn). However, a notable change arose in the UK where HSBC Life (UK) Ltd entered into an agreement to sell its pensions business.

The full effect will only be recognised once regulatory approval is received and the portfolio is transferred to the purchaser.

Asset and liability matching

(Audited)

A principal tool used to manage exposures to both financial and insurance risk, in particular for life insurance contracts, is asset and liability matching. In many markets in which we operate it is neither possible nor appropriate to follow a perfect asset and liability matching strategy. For long-dated non-linked contracts, in particular, this results in a duration mismatch between assets and liabilities. We therefore structure portfolios to support projected liabilities from non-linked contracts.

The tables below show the composition of assets and liabilities by contract and by geographical region and demonstrate that there were sufficient assets to cover the liabilities to policyholders in each case at the end of 2014.

Balance sheet of insurance manufacturing subsidiaries by type of contract

(Audited)

Insurance contracts				Investment contracts				
With DPF	Unit-linked	Annuities	Other[40]	With DPF[41]	Unit-linked	Other	Other assets[42]	Total
US$m	US$m	US$m	US$m	US$m	US$m	US$m	US$m	US$m
29,040	**11,278**	**1,517**	**6,253**	**24,238**	**2,561**	**4,322**	**5,732**	**84,941**

Financial assets									
trading assets			3						3
financial assets designated at fair value	4,304	11,111	533	782	6,346	2,223	1,684	1,713	28,696
derivatives	12	1		1	101	1	10	73	199
financial investments	21,152		886	5,167	15,677		1,807	3,812	48,501
other financial assets	3,572	166	95	303	2,114	337	821	134	7,542
Reinsurance assets	190	262		617				2	1,071
PVIF[43]								5,307	5,307
Other assets and investment properties	698	328	23	107	831	7	26	7,383	9,403
Total assets	**29,928**	**11,868**	**1,540**	**6,977**	**25,069**	**2,568**	**4,348**	**18,424**	**100,722**
Liabilities under investment contracts						2,542	4,155		6,697
designated at fair value						2,542	3,770		6,312
carried at amortised cost							385		385
Liabilities under insurance contracts	29,479	11,820	1,473	6,021	25,068				73,861
Deferred tax[44]	12		11	18				1,180	1,221
Other liabilities								8,577	8,577
Total liabilities	**29,491**	**11,820**	**1,484**	**6,039**	**25,068**	**2,542**	**4,155**	**9,757**	**90,356**
Total equity								**10,366**	**10,366**
Total liabilities and equity at 31 December 2014[45]	**29,491**	**11,820**	**1,484**	**6,039**	**25,068**	**2,542**	**4,155**	**20,123**	**100,722**

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	Insurance contracts				Investment contracts				
	With DPF US$m	Unit-linked US$m	Annuities US$m	Other[40] US$m	With DPF[41] US$m	Unit-linked US$m	Other US$m	Other assets[42] US$m	Total US$m
Financial assets	26,382	13,348	1,651	4,728	25,676	9,720	4,375	5,846	91,726
trading assets			3						3
financial assets designated at fair value	3,850	13,131	532	761	6,867	9,293	1,706	1,757	37,897
derivatives	1	3			215	5		55	279
financial investments	19,491		959	3,780	16,556		1,853	3,745	46,384
other financial assets	3,040	214	157	187	2,038	422	816	289	7,163
Reinsurance assets	182	291	522	439				2	1,436
PVIF[43]								5,335	5,335
Other assets and investment properties	757	284	23	113	791	19	31	546	2,564
Total assets	27,321	13,923	2,196	5,280	26,467	9,739	4,406	11,729	101,061
Liabilities under investment contracts						9,730	4,209		13,939
designated at fair value						9,730	3,761		13,491
carried at amortised cost							448		448
Liabilities under insurance contracts	26,920	13,804	2,158	4,872	26,427				74,181
Deferred	12		17	1				1,163	1,193

tax[44]									
Other liabilities								2,048	2,048
Total liabilities	26,932	13,804	2,175	4,873	26,427	9,730	4,209	3,211	91,361
Total equity								9,700	9,700
Total liabilities and equity at 31 December 2013[45]	26,932	13,804	2,175	4,873	26,427	9,730	4,209	12,911	101,061

For footnotes, see page 202.

Our most significant life insurance products are investment contracts with DPF issued in France, insurance contracts with DPF issued in Hong Kong and unit-linked contracts issued in Latin America, Hong Kong and the UK.

Our exposure to financial risks arising in the above balance sheet varies depending on the type of contract issued. For unit-linked contracts, the policyholder bears the majority of the exposure to financial risks whereas, for non-linked contracts, the majority of financial risks are borne by the shareholder (HSBC). For contracts with DPF, the shareholder is exposed to financial risks to the extent that the exposure cannot be managed by utilising any discretionary participation (or bonus) features within the policy contracts issued.

As noted above, during the year HSBC entered into an agreement to sell its UK pensions business, and the related balances are reported as a disposal group held for sale under IFRS 5 (and are therefore included within the Other assets column in the table above). The disposal group comprises US$6.8bn of total liabilities, being liabilities under unit-linked investment contracts, unit-linked insurance contracts and annuity contracts. It also comprises US$6.8bn of total assets, being financial and reinsurance assets backing the liabilities, and the associated PVIF on these contracts. The transfer is subject to regulatory approvals and is expected to complete in the second half of 2015. As part of the transaction we also entered into a reinsurance agreement transferring certain risks and rewards of the business to the purchaser from 1 January 2014 until completion of the transaction. A gain of US$42m was recognised on entering into this reinsurance agreement.

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Balance sheet of insurance manufacturing subsidiaries by geographical region[46]

(Audited)

	Europe US$m	Asia[6] US$m	Latin America US$m	Total US$m
Financial assets	**30,178**	**47,443**	**7,320**	**84,941**
trading assets			**3**	**3**
financial assets designated at fair value	**10,610**	**12,497**	**5,589**	**28,696**
derivatives	**172**	**27**		**199**
financial investments	**16,947**	**30,010**	**1,544**	**48,501**
other financial assets	**2,449**	**4,909**	**184**	**7,542**
Reinsurance assets	**308**	**748**	**15**	**1,071**
PVIF[43]	**711**	**4,175**	**421**	**5,307**
Other assets and investment properties	**7,650**	**1,145**	**608**	**9,403**
Total assets	**38,847**	**53,511**	**8,364**	**100,722**
Liabilities under investment contracts:				
designated at fair value	**1,585**	**4,727**		**6,312**
carried at amortised cost			**385**	**385**
Liabilities under insurance contracts	**27,312**	**39,990**	**6,559**	**73,861**
Deferred tax[44]	**273**	**806**	**142**	**1,221**
Other liabilities	**7,932**	**460**	**185**	**8,577**
Total liabilities	**37,102**	**45,983**	**7,271**	**90,356**
Total equity	**1,745**	**7,528**	**1,093**	**10,366**
Total liabilities and equity at 31 December 2014[45]	**38,847**	**53,511**	**8,364**	**100,722**
Financial assets	41,557	42,352	7,817	91,726
trading assets			3	3
financial assets designated at fair value	20,742	11,420	5,735	37,897
derivatives	272	7		279
financial investments	18,080	26,505	1,799	46,384
other financial assets	2,463	4,420	280	7,163
Reinsurance assets	823	596	17	1,436
PVIF[43]	1,156	3,730	449	5,335
Other assets and investment properties	868	1,101	595	2,564
Total assets	44,404	47,779	8,878	101,061
Liabilities under investment contracts:				
designated at fair value	8,760	4,731		13,491

carried at amortised cost			448	448
Liabilities under insurance contracts	31,786	35,619	6,776	74,181
Deferred tax[44]	407	645	141	1,193
Other liabilities	1,474	371	203	2,048
Total liabilities	42,427	41,366	7,568	91,361
Total equity	1,977	6,413	1,310	9,700
Total liabilities and equity at 31 December 2013[45]	44,404	47,779	8,878	101,061

For footnotes, see page 202.

Movement in total equity of insurance operations

(Audited)

	Total equity	
	2014	2013
	US$m	US$m
At 1 January	**9,700**	9,989
Change in PVIF of long-term insurance business[43]	**261**	525
Return on net assets	**1,835**	848
Capital transactions	**(673)**	(590)
Disposals of subsidiaries/portfolios	**1**	(675)
Exchange differences and other	**(758)**	(397)
At 31 December	**10,366**	9,700

For footnote, see page 202.

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Financial risks

(Audited)

Details on the nature of financial risks and how they are managed are provided in the Appendix to Risk on page 232.

Financial risks can be categorised into:

- *market risk* risk arising from changes in the fair values of financial assets or their future cash flows from fluctuations in variables such as interest rates, credit spreads, foreign exchange rates and equity prices;
- *credit risk* the risk of financial loss following the failure of third parties to meet their obligations; and
- *liquidity risk* the risk of not being able to make payments to policyholders as they fall due as there are insufficient assets that can be realised as cash.

The following table analyses the assets held in our insurance manufacturing subsidiaries at 31 December 2014 by type of contract, and provides a view of the exposure to financial risk. For unit-linked contracts, which pay benefits to policyholders determined by reference to the value of the investments supporting the policies, we typically designate assets at fair value; for non-linked contracts, the classification of the assets is driven by the nature of the underlying contract.

Financial assets held by insurance manufacturing subsidiaries

(Audited)

	Unit-linked contracts[47] US$m	Non-linked contracts[48] US$m	Other assets[49] US$m	Total US$m
Trading assets				
Debt securities		3		3
Financial assets designated at fair value	13,334	13,649	1,713	28,696
Treasury bills		40	16	56
Debt securities	4,589	3,507	618	8,714
Equity securities	8,745	10,102	1,079	19,926
Financial investments				
Held-to-maturity: debt securities		21,789	2,494	24,283

Available-for-sale:		**22,899**	**1,319**	**24,218**
debt securities		**22,899**	**1,290**	**24,189**
equity securities			**29**	**29**
Derivatives	**2**	**124**	**73**	**199**
Other financial assets[49]	**503**	**6,905**	**134**	**7,542**
Total financial assets at 31 December 2014[45]	**13,839**	**65,369**	**5,733**	**84,941**
Trading assets				
Debt securities		3		3
Financial assets designated at fair value	22,424	13,716	1,757	37,897
Treasury bills			50	50
Debt securities	7,809	3,910	546	12,265
Equity securities	14,615	9,806	1,161	25,582
Financial investments				
Held-to-maturity: debt securities		21,784	2,142	23,926
Available-for-sale:		20,855	1,603	22,458
debt securities		20,855	1,594	22,449
equity securities			9	9
Derivatives	8	216	55	279
Other financial assets[49]	636	6,238	289	7,163
Total financial assets at 31 December 2013[45]	23,068	62,812	5,846	91,726

For footnotes, see page 202.

Approximately 67% of financial assets were invested in debt securities at 31 December 2014 (2013: 64%) with 24% (2013: 28%) invested in equity securities.

Under unit-linked contracts, premium income less charges levied is invested in a portfolio of assets. We manage the financial risks of this product on behalf of the policyholders by holding appropriate assets in segregated funds or portfolios to which the liabilities are linked. These assets represented 16% (2013: 25%) of the total financial assets of our insurance manufacturing subsidiaries at the end of 2014. The reduction of US$9.3bn in the value of assets backing unit-linked contracts is largely due to the classification of US$6.3bn of assets relating to the UK pensions business as held for

sale (see page 192) and the transfer of US$2.9bn assets backing other unit-linked investment contracts to a third party during the year.

The remaining financial risks are managed either solely on behalf of the shareholder, or jointly on behalf of the shareholder and policyholders where DPF exist.

Market risk

(Audited)

Market risk arises when mismatches occur between product liabilities and the investment assets which back them. For example, mismatches between asset and liability yields and maturities give rise to interest rate risk.

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Our current portfolio of assets includes debt securities issued at a time when yields were higher than those observed in the current market. As a result, yields on extant holdings of debt securities exceed those available on current issues.

Long-term insurance or investment products may incorporate benefits that are guaranteed. Fixed guaranteed benefits, for example for annuities in payment, are reserved for as part of the calculation of liabilities under insurance contracts.

The risk of shareholder capital being required to meet liabilities to policyholders increases in products that offer guaranteed financial returns where current yields fall below guaranteed levels for a prolonged period. Reserves are held against the cost of guarantees, calculated by stochastic modelling. Where local rules require, these reserves are held through policyholder liabilities. Any remainder is accounted for as a deduction

to PVIF on the relevant product. The table below shows the total reserve held for the cost of guarantees, the range of investment returns on assets supporting these products and the implied investment return that would enable the business to meet the guarantees.

The financial guarantees offered on some portfolios exceeded the current yield on the assets that back them. The cost of guarantees increased to US$777m (2013: US$575m) primarily because of falling yields in France throughout 2014. As these yields fell, the cost of guarantees on closed portfolios reported in the 2.1%-4.0% and 4.1%-5.0% categories increased, driven by reduced reinvestment yield assumptions. In addition, there was a closed portfolio in Hong Kong with a guaranteed rate of 5.0% compared with the current yield of 4.1%. We reduced short-term bonus rates paid to policyholders on certain DPF contracts to manage the immediate strain on the business.

Financial return guarantees[45,50]

(Audited)

	2014					2013				
	Investment returns implied by guarantee %		**Current yields %**		**Cost of guarantees US$m**	Investment returns implied by guarantee %		Current yields %		Cost of guarantees US$m
Capital		**0.0**	**0.0**	**3.5**	**81**		0.0	0.0	4.4	57
Nominal annual return	**0.1**	**2.0**	**3.6**	**3.6**	**6**	0.1	2.0	4.1	4.1	9
Nominal annual return[51]	**2.1**	**4.0**	**3.5**	**4.1**	**646**	2.1	4.0	4.2	4.4	471

Nominal annual return	**4.1**	**5.0**	**3.5**	**4.1**	**30**	4.1	5.0	4.1	4.4	25
Real annual return[52]	**0.0**	**6.0**	**4.7**	**7.5**	**14**	0.0	6.0	6.4	6.4	13
At 31 December					**777**					575

For footnotes, see page 202.

In addition to the above, a deduction from PVIF of US$53m (2013: US$134m) is made in respect of the modelled cost of guaranteed annuity options attached to certain unit-linked pension products in Brazil.

The following table illustrates the effects of selected interest rate, equity price and foreign exchange rate scenarios on our profit for the year and the total equity of our insurance manufacturing subsidiaries.

Where appropriate, we include the impact of the stress on the PVIF in the results of the sensitivity tests. The relationship between the profit and total equity and the risk factors is non-linear and, therefore, the results disclosed should not be extrapolated to measure sensitivities to different levels of stress. The sensitivities

are stated before allowance for management actions which may mitigate the effect of changes in market rates. The sensitivities presented allow for adverse changes in policyholder behaviour that may arise in response to changes in market rates.

The effects of +/-100 basis points parallel shifts in yield curves have increased from 2013 to 2014, driven mainly by falling yields and a flattening of the yield curve in France during 2014. In the low yield environment the projected cost of options and guarantees described above is particularly sensitive to yield curve movements. The market value of available-for-sale bonds is also sensitive to yield curve movements hence the larger opposite stresses on equity.

Sensitivity of HSBC s insurance manufacturing subsidiaries to market risk factors

(Audited)

	2014		2013	
	Effect on profit after tax US$m	**Effect on total equity US$m**	Effect on profit after tax US$m	Effect on total equity US$m
+ 100 basis points parallel shift in yield curves	**290**	**(345)**	151	(199)
100 basis points parallel shift in yield curves[53]	**(549)**	**214**	(230)	139
10% increase in equity prices	**180**	**180**	149	149
10% decrease in equity prices	**(153)**	**(153)**	(129)	(129)
10% increase in US dollar exchange rate compared to all currencies	**54**	**54**	21	21
10% decrease in US dollar exchange rate compared to all currencies	**(54)**	**(54)**	(21)	(21)

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Credit risk

(Audited)

Credit risk can give rise to losses through default and can lead to volatility in our income statement and balance sheet figures through movements in credit spreads, principally on the US$53bn (2013: US$51bn) bond portfolio supporting non-linked contracts and shareholders funds.

The sensitivity of the profit after tax of our insurance subsidiaries to the effects on asset values of increases in credit spreads was a reduction of US$7m (2013: US$21m). The sensitivity of total equity was a reduction of US$9m (2013: US$46m). The sensitivities are relatively small because the vast majority of the debt securities held by our insurance subsidiaries are classified as either held to maturity or available for sale, and consequently any changes in the fair value of these financial investments, absent impairment, would have no effect

on the profit after tax (or to total equity in the case of the held-to-maturity securities). We calculate the sensitivity based on a one-day movement in credit spreads over a two-year period. A confidence level of 99%, consistent with our Group VaR, is applied.

Credit quality

(Audited)

The following table presents an analysis of treasury bills, other eligible bills and debt securities within our insurance business by measures of credit quality.

Only assets supporting liabilities under non-linked insurance and investment contracts and shareholders funds are included in the table as financial risk on assets supporting unit-linked liabilities is predominantly borne by the policyholder. 84.8% (2013: 83.4%) of the assets included in the table are invested in investments rated as strong .

For a definition of the five credit quality classifications, see page 207.

Treasury bills, other eligible bills and debt securities in HSBC s insurance manufacturing subsidiaries

(Audited)

	Neither past due nor impaired				
	Strong	Good	Satisfactory	Sub-standard	Total
	US$m	US$m	US$m	US$m	US$m

Supporting liabilities under non-linked insurance and investment contracts					
Trading assets debt securities	**3**				**3**
Financial assets designated at fair value	**2,550**	**530**	**214**	**255**	**3,549**
treasury and other eligible bills	**5**			**35**	**40**
debt securities	**2,545**	**530**	**214**	**220**	**3,509**
Financial investments debt securities	**38,515**	**4,312**	**1,662**	**200**	**44,689**
	41,068	**4,842**	**1,876**	**455**	**48,241**
Supporting shareholders funds[54]					
Financial assets designated at fair value	**214**	**322**	**30**	**69**	**635**
treasury and other eligible bills				**16**	**16**
debt securities	**214**	**322**	**30**	**53**	**619**
Financial investments debt securities	**3,378**	**196**	**154**	**54**	**3,782**
	3,592	**518**	**184**	**123**	**4,417**
Total[45]					
Trading assets debt securities	**3**				**3**
Financial assets designated at fair value	**2,764**	**852**	**244**	**324**	**4,184**
treasury and other eligible bills	**5**			**51**	**56**
debt securities	**2,759**	**852**	**244**	**273**	**4,128**
Financial investments debt securities	**41,893**	**4,508**	**1,816**	**254**	**48,471**
At 31 December 2014	**44,660**	**5,360**	**2,060**	**578**	**52,658**
Supporting liabilities under non-linked insurance and investment contracts					
Trading assets debt securities	3				3
Financial assets designated at fair value	2,780	691	224	215	3,910
debt securities	2,780	691	224	215	3,910
Financial investments debt securities	36,113	4,596	1,699	231	42,639
	38,896	5,287	1,923	446	46,552
Supporting shareholders funds[54]					
Financial assets designated at fair value	191	298	73	34	596
treasury and other eligible bills	50				50
debt securities	141	298	73	34	546
Financial investments debt securities	3,356	176	139	65	3,736
	3,547	474	212	99	4,332
Total[45]					
Trading assets debt securities	3				3
Financial assets designated at fair value	2,971	989	297	249	4,506
treasury and other eligible bills	50				50
debt securities	2,921	989	297	249	4,456
Financial investments debt securities	39,469	4,772	1,838	296	46,375
At 31 December 2013	42,443	5,761	2,135	545	50,884

For footnotes, see page 202.

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Credit risk also arises when assumed insurance risk is ceded to reinsurers. The split of liabilities ceded to reinsurers and outstanding reinsurance recoveries, analysed by credit quality, is shown below. Our exposure

to third parties under the reinsurance agreements described in the Appendix to Risk on page 235 is included in this table.

Reinsurers share of liabilities under insurance contracts[45]

(Audited)

	Neither past due nor impaired				Past due but	
	Strong	Good	Satisfactory	Sub-standard	not impaired	Total
	US$m	US$m	US$m	US$m	US$m	US$m
Unit-linked insurance	**75**	**185**				**260**
Non-linked insurance[55]	**751**	**11**	**10**			**772**
At 31 December 2014	**826**	**196**	**10**			**1,032**
Reinsurance debtors	**11**	**6**			**21**	**38**
Unit-linked insurance	72	218				290
Non-linked insurance[55]	1,103	8	7			1,118
At 31 December 2013	1,175	226	7			1,408
Reinsurance debtors	17	1			10	28

For footnotes, see page 202.

Liquidity risk

(Audited)

The following tables show the expected undiscounted cash flows for insurance contract liabilities and the remaining contractual maturity of investment contract liabilities at 31 December 2014.

The liquidity risk exposure is borne in conjunction with policyholders for the majority of our business, and wholly borne by the policyholder in the case of unit-linked business.

The profile of the expected maturity of the insurance contracts at 31 December 2014 remained comparable with 2013.

Expected maturity of insurance contract liabilities[45]

(Audited)

	Expected cash flows (undiscounted)				
	Within 1 year US$m	1-5 years US$m	5-15 years US$m	Over 15 years US$m	Total US$m
Unit-linked insurance	**709**	**3,280**	**9,243**	**14,544**	**27,776**
Non-linked insurance[55]	**3,504**	**12,718**	**29,905**	**33,108**	**79,235**
At 31 December 2014	**4,213**	**15,998**	**39,148**	**47,652**	**107,011**
Unit-linked insurance	1,106	3,609	9,757	13,725	28,197
Non-linked insurance[55]	3,977	11,731	26,848	31,306	73,862
At 31 December 2013	5,083	15,340	36,605	45,031	102,059

For footnotes, see page 202.

Remaining contractual maturity of investment contract liabilities

(Audited)

	Liabilities under investment contracts issued by insurance manufacturing subsidiaries[46]			
	Unit-linked investment contracts US$m	Investment contracts with DPF US$m	Other investment contracts US$m	Total US$m
Remaining contractual maturity:				
due within 1 year	**151**		**389**	**540**
due over 1 year to 5 years	**133**			**133**
due over 5 years to 10 years	**194**			**194**
due after 10 years	**766**			**766**
undated[56]	**1,298**	**25,068**	**3,765**	**30,131**
At 31 December 2014	**2,542**	**25,068**	**4,154**	**31,764**
Remaining contractual maturity:				
due within 1 year	232		454	686
due over 1 year to 5 years	778			778
due over 5 years to 10 years	852			852
due after 10 years	2,254			2,254

undated[56]	5,614	26,427	3,755	35,796
At 31 December 2013	9,730	26,427	4,209	40,366

For footnotes, see page 202.

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Insurance risk

Insurance risk is principally measured in terms of liabilities under the contracts in force.

A principal risk we face is that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income. The cost of claims and benefits can be influenced by many factors, including

mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities. The following table analyses our life insurance risk exposures by geographical region and by type of business. The insurance risk profile and related exposures remain largely consistent with those observed at 31 December 2013.

Analysis of insurance risk liabilities under insurance contracts[46]

(Audited)

	Europe US$m	Asia US$m	Latin America US$m	Total US$m
Non-linked insurance[55]	**829**	**34,261**	**1,883**	**36,973**
Insurance contracts with DPF[57]	**367**	**29,112**		**29,479**
Credit life	**56**	**87**		**143**
Annuities	**71**	**127**	**1,275**	**1,473**
Other	**335**	**4,935**	**608**	**5,878**
Unit-linked insurance	**1,415**	**5,729**	**4,676**	**11,820**
Investment contracts with DPF[41,57]	25,068			25,068
Liabilities under insurance contracts at 31 December 2014	**27,312**	**39,990**	**6,559**	**73,861**
Non-linked insurance[55]	1,383	30,554	2,013	33,950
Insurance contracts with DPF[57]	380	26,540		26,920
Credit life	130	74		204
Annuities	622	129	1,407	2,158
Other	251	3,811	606	4,668
Unit-linked insurance	3,976	5,065	4,763	13,804
Investment contracts with DPF[41,57]	26,427			26,427

Liabilities under insurance contracts at 31 December 2013	31,786	35,619	6,776	74,181

For footnotes, see page 202.

Our most significant life insurance products are insurance contracts with DPF issued in Hong Kong, investment contracts with DPF issued in France and unit-linked contracts issued in Latin America, Hong Kong and the UK.

Sensitivities to non-economic assumptions

(Audited)

Policyholder liabilities and PVIF for life manufacturers are determined by reference to non-economic assumptions including mortality and/or morbidity, lapse rates and expense rates. The table below shows the sensitivity of profit and total equity to reasonably possible changes in these non-economic assumptions at that date across all our insurance manufacturing subsidiaries.

Mortality and morbidity risk is typically associated with life insurance contracts. The effect on profit of an increase in mortality or morbidity depends on the type of business being written. Our largest exposures to mortality and morbidity risk exist in Brazil, France and Hong Kong.

Sensitivity to lapse rates depends on the type of contracts being written. For insurance contracts, claims are funded by premiums received and income earned on the investment portfolio supporting the liabilities. For a portfolio of term assurance, an increase

in lapse rates typically has a negative effect on profit due to the loss of future premium income on the lapsed policies. However, some contract lapses have a positive effect on profit due to the existence of policy surrender charges. Brazil, France, Hong Kong and the UK are where we are most sensitive to a change in lapse rates.

Expense rate risk is the exposure to a change in the cost of administering insurance contracts. To the extent that increased expenses cannot be passed on to policyholders, an increase in expense rates will have a negative effect on our profits.

Sensitivity analysis

(Audited)

	2014 US$m	2013 US$m
Effect on profit after tax and total equity at 31 December		
10% increase in mortality and/or morbidity rates	**(65)**	(76)
10% decrease in mortality and/or morbidity rates	**72**	79
10% increase in lapse rates[57]	**(108)**	(119)
10% decrease in lapse rates[57]	**122**	133
10% increase in expense rates	**(106)**	(101)
10% decrease in expense rates	**106**	100

For footnote, see page 202.

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Other material risks

1 *Appendix to Risk risk policies and practices.*

Reputational risk

(Unaudited)

Reputational risk is the failure to meet stakeholder expectations as a result of any event, behaviour, action or inaction, either by HSBC itself, our employees or those with whom we are associated, that might cause stakeholders to form a negative view of HSBC.

Reputational risk relates to perceptions, whether based on fact or otherwise. Stakeholders expectations are constantly changing and thus reputational risk is dynamic and varies between geographies, groups and individuals. As a global bank, HSBC shows unwavering commitment to operating, and to be seen to be operating, to the high standards we have set for ourselves in every jurisdiction. Reputational risk might result in financial or non-financial impacts, loss of confidence, adverse effects on our ability to keep and attract customers, or other consequences. Any lapse in standards of integrity, compliance, customer service or operating efficiency represents a potential reputational risk.

A number of measures to address the requirements of the US DPA and otherwise to enhance our AML, sanctions and other regulatory compliance frameworks have been taken and/or are ongoing. These measures, which should also serve over time to enhance our reputational risk management, include the following:

- simplifying our business through the progressive implementation of our Group strategy, including the adoption of a global financial crime risk filter, which should help to standardise our approach to doing business in higher risk countries;

- an increase in reputational risk resources in each region in which we operate and the introduction of a central case management and tracking process for reputational risk and client relationship matters;

- the creation of combined reputational risk and client selection committees within the global businesses with a clear process to escalate and address matters at the appropriate level;

- the continued roll-out of training and communication about the HSBC Values Programme that defines the way everyone in the Group should act and seeks to ensure that the Values are embedded into our operations; and

- the continuous development and implementation of the Global Standards around financial crime compliance, which underpin our businesses. This includes ensuring globally consistent application of policies that govern AML and sanctions compliance programmes.

In July 2014, the new reputational risk and customer selection policies were issued which define a consistent and structured approach to managing these risks:

- *Reputational risk (new policy)*: defines reputational risk and sets out HSBC s approach to managing it;

- *Customer selection and business acceptance (new policy): outlines the risk factors to be considered when a new customer relationship is identified;*

- *Customer selection and exit management:* establishes the globally sustainable approach to customer selection and exit management for all accounts and relationships in all business lines. This details the criteria under which escalation or approval is required; and

- *Sixth filter:* customers operating in high risk jurisdictions carry particular financial crime risks and may require specific approvals, or be considered for an exit, if the relationship exceeds HSBC s global risk appetite.

HSBC has zero tolerance for knowingly engaging in any business, activity or association where foreseeable reputational damage has not been considered and mitigated. There must be no barriers to open discussion and the escalation of issues that could affect the Group negatively. While there is a level of risk in every aspect of business activity, appropriate consideration of potential harm to HSBC s good name must be a part of all business decisions.

Detecting and preventing illicit actors access to the global financial system calls for constant vigilance and we will continue to cooperate closely with all governments to achieve success. This is integral to the execution of our strategy, to HSBC Values and to preserving and enhancing our reputation.

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Fiduciary risk

(Unaudited)

Fiduciary risk is the risk to the Group of breaching our fiduciary duties when we act in a fiduciary capacity as trustee or investment manager or as mandated by law or regulation.

A fiduciary duty is one where HSBC holds, manages, oversees or has responsibility for assets for a third party that involves a legal and/or regulatory duty to act with a high standard of care and with good faith. A fiduciary must make decisions and act in the interests of the third party and must place the wants and needs of the client first, above the needs of the Group.

We may be held liable for damages or other penalties caused by failure to act in accordance with these duties. Fiduciary duties may also arise in other circumstances, such as when we act as an agent for a principal, unless the fiduciary duties are specifically excluded (e.g. under the agency appointment contract).

Our principal fiduciary businesses (the designated businesses) have developed fiduciary risk appetite statements for their various fiduciary roles and have put in place key indicators to monitor their related risks.

Pension risk

(Audited)

We operate a number of defined benefit and defined contribution pension plans throughout the world. The majority of pension risk arises from the Group s defined benefit plans of which the largest is the HSBC Bank (UK) Pension Scheme (the principal plan).

During 2014, a new global pension risk framework was established, with accompanying new global policies on the management of risks related to defined benefit and defined contribution plans. In addition, a new Global Pensions Oversight Committee was established to oversee the running of all pension plans sponsored by HSBC around the world.

At 31 December 2014, the Group s aggregate defined benefit pension plan obligation was US$42bn and the net asset was US$2.7bn (2013: US$40bn and US$0.1bn, respectively). The increase in the net asset was mainly due to the increase in the principal plan s assets exceeding the increase in its benefit obligation. Of the Group total amounts, the principal plan contributed US$30bn to the defined benefit obligation and US$4.8bn to the net asset. The principal plan is the largest contributor to pension risk in the Group.

The principal plan

(Audited)

The principal plan is overseen by a corporate trustee who has fiduciary responsibility for the operation of the pension scheme. The principal plan comprises a defined benefit section and a defined contribution section. Unless stated otherwise, this narrative relates to the defined benefit section.

The investment strategy of the principal plan is to hold the majority of assets in bonds, with the remainder in a more diverse range of investments, and includes a portfolio of interest rate and inflation swaps in order to reduce interest rate risk and inflation risk (see Note 41 in the Financial Statements). The target asset allocation of the principal plan at the year-end is shown below. HSBC and the trustee have developed a general framework which, over time, will see the plan s asset strategy evolve to be less risky: this is described in further detail below.

The principal plan target asset allocation

	2014 %	2013 %
Equities[58]	**19.4**	19.4
Bonds	**64.5**	64.5
Alternative assets[59]	**10.6**	10.6
Property	**5.5**	5.5
Cash[60]		
At 31 December	**100.0**	100.0

For footnotes, see page 202.

The latest actuarial valuation of the principal plan was made as at 31 December 2011 by C G Singer, Fellow of the Institute and Faculty of Actuaries, of Towers Watson Limited. At that date, the market value of the plan s assets was £18bn (US$28bn) (including assets relating to both the defined benefit and defined contribution plans, and additional voluntary contributions). The market value of the plan assets represented 100% of the amount expected to be required, on the basis of the assumptions adopted, to provide the benefits accrued to members after allowing for expected future increases in earnings under the projected unit method. There was therefore no resulting surplus/deficit and hence no recovery plan was required.

The expected cash flows from the principal plan were projected by reference to the Retail Price Index (RPI) swap break-even curve at 31 December 2011. Salary increases were assumed to be 0.5% per annum above RPI and inflationary pension increases, subject to a minimum of 0% and a maximum of 5% (maximum of 3% per annum in respect of service accrued since 1 July 2009), were assumed to be in line with RPI. The projected cash flows were discounted at the Libor swap curve at 31 December 2011 plus a margin for the expected return on the investment strategy of 160bps per annum. The mortality experience of the principal plan s pensioners over the six-year period (2006-2011) was analysed and, on the basis of this analysis, the mortality assumptions were set, based on the SAPS S1 series of tables adjusted to reflect the pensioner experience. Allowance was made for future improvements to mortality rates in line with the Continuous Mortality Investigation core projections with a long-run improvement rate set at 2% for males and 1.5% for females. The benefits expected to be payable from the defined benefit plan from 2015 are shown in the chart below.

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Future benefit payments (US$m)

As part of the 31 December 2011 valuation, calculations were also made of the amount of assets that might be needed to meet the liabilities if the principal plan was discontinued and the members benefits bought out with an insurance company (although in practice this may not be possible for a plan of this size) or the Trustee continued to run the plan without the support of HSBC. The amount required under this approach was estimated to be £26bn (US$41bn) as at 31 December 2011. In arriving at this estimation, a more prudent assumption about future mortality was made than for the assessment of the ongoing position and it was assumed that the Trustee would alter the investment strategy to be an appropriately matched portfolio of UK government bonds. An explicit allowance for expenses was also included.

HSBC and the trustee have developed a general framework which, over time, will see the principal plan s asset strategy evolve to be less risky and further aligned to the expected future cash-flows, referred to as the Target Matching Portfolio (TMP). The TMP would therefore contain sufficient assets, the majority of which will be bond-like in nature, which are more closely aligned to the liability profile. Progress towards the TMP can be achieved by asset returns in excess of that assumed and/or additional funding. In 2013, HSBC agreed to make general framework contributions of £64m (US$100m) in each of the calendar years 2013, 2014 and 2015 as well as £128m (US$200m) in 2016. Further contributions have been agreed to be made in future years, which are linked to the continued implementation of the general framework.

HSBC Bank is also making contributions to the principal plan in respect of the accrual of benefits

of defined benefit section members. Since April 2013, HSBC has paid contributions at the rate of 43% of pensionable salaries (less member contributions).Contribution levels will be reviewed as part of the next actuarial valuation, which has an effective date of 31 December 2014. The results of this valuation are expected to be included in the Annual Report and Accounts 2015.

Future developments

(Unaudited)

Future service accrual for active members of the defined benefit section will cease with effect from 30 June 2015. All active members of the defined benefit section will become members of the defined contribution section from 1 July 2015, and their accrued defined benefit pensions based on service to 30 June 2015 will continue to be linked to final salary on retirement (underpinned by increases in CPI). The defined benefit service cost will therefore reduce to zero from 1 July 2015 and the defined contribution service cost will increase.

Defined contribution plans

Our global strategy is to move from defined benefit pension provisions to defined contribution, dependent on local legislative requirements and emerging practice. In defined contribution pension plans, the sponsor contributions are known, while the ultimate benefit will vary, typically with investment returns achieved by employee investment choices. While the market risk of defined contribution plans is significantly less than that of defined benefit plans, the Bank is still exposed to operational and reputational risk.

Sustainability risk

(Unaudited)

Assessing the environmental and social impacts of providing finance to our customers is integral to our overall risk management processes.

In 2014, we issued new policies on forestry, agricultural commodities, World Heritage Sites and Ramsar Wetlands, following an extensive internal and external review of our previous forestry policy. The results of two independent reviews into the content and implementation of our previous policy were published on www.hsbc.com.

A summary of our current policies and practices regarding reputational risk, pension risk and sustainability risk is provided in the Appendix to Risk on page 235.

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Footnotes to Risk

Credit risk

1 *From 1 January 2014, non-trading reverse repos and repos are presented as separate lines in the balance sheet. Previously, non-trading reverse repos were included within Loans and advances to banks and Loans and advances to customers and non-trading repos were included within Deposits by banks and Customer accounts . Comparative data have been re-presented accordingly.*
2 *At 31 December 2014, the credit quality of financial guarantees and similar contracts was: US$17bn strong, US$16bn good, US$12bn satisfactory, and US$2bn sub-standard.*
3 *The amount of the loan commitments reflects, where relevant, the expected level of take-up of pre-approved loan offers made by mailshots to personal customers. In addition to those amounts, there is a further maximum possible exposure to credit risk of US$71bn (2013: US$34bn), reflecting the full take-up of loan commitments. The take-up of such offers is generally at modest levels. At 31 December 2014, the credit quality of loan and other credit-related commitments was: US$322bn strong, US$191bn good, US$127bn satisfactory, US$10bn sub-standard and US$0.8bn impaired.*
4 *From 1 January 2014, the geographical region Asia replaced the geographical regions previously reported as Hong Kong and Rest of Asia-Pacific (see Note 23 on the Financial Statements for further details). Comparative data have been re-presented to reflect this change.*
5 *Financial includes loans and advances to banks.*
6 *First lien residential mortgages include Hong Kong Government Home Ownership Scheme loans of US$3.4bn at 31 December 2014 (2013: US$3.2bn). Where disclosed, earlier comparatives were 2012: US$3.2bn; 2011: US$3.3bn; 2010: US$3.5bn.*
7 *Other personal lending includes second lien mortgages and other property-related lending.*
8 *Other commercial loans and advances include advances in respect of agriculture, transport, energy and utilities.*
9 *Impairment allowances are not reported for financial instruments, for which the carrying amount is reduced directly for impairment and not through the use of an allowance account.*
10 *Impairment is not measured for assets held in trading portfolios or designated at fair value as assets in such portfolios are managed according to movements in fair value, and the fair value movement is taken directly to the income statement. Consequently, we report all such balances under Neither past due nor impaired .*
11 *Loans and advances to customers includes asset-backed securities that have been externally rated as strong (2014: US$1.2bn; 2013: US$1.7bn), good (2014: US$256m; 2013: US$255m), satisfactory (2014: US$332m; 2013: US$200m), sub-standard (2014: US$94m; 2013: US$283m) and impaired (2014: US$128m; 2013: US$252m).*
12 *Collectively assessed impairment allowances are allocated to geographical segments based on the location of the office booking the allowances or provisions.*
13 *Included within Exchange and other movements is US$0.4bn of impairment allowances reclassified to held for sale (2013: US$0.2bn).*
14 *Of the US$2,724m (2013: US$3,580m) of renegotiated loans, US$608m (2013: US$716m) were neither past due nor impaired, US$1m (2013: US$52m) was past due but not impaired and US$2,115m (2013: US$2,812m) were*

impaired.

15 *French Banking Federation Master Agreement Relating to Transactions on Forward Financial Instruments plus CSA equivalent.*

16 *The German Master Agreement for Financial Derivative Transactions.*

17 *HSBC Finance lending is shown on a management basis and includes loans transferred to HSBC USA Inc. which are managed by HSBC Finance.*

18 *Property acquired through foreclosure is initially recognised at the lower of the carrying amount of the loan or its fair value less estimated costs to sell (initial foreclosed property carrying amount). The average gain/loss on sale of foreclosed properties is calculated as cash proceeds less the initial foreclosed properties carrying amount divided by the unpaid loan principal balance prior to write-down (excluding any accrued finance income) plus certain other ancillary disbursements that, by law, are reimbursable from the cash proceeds (e.g. real estate tax advances) and were incurred prior to our taking title to the property. This ratio represents the portion of our total loss on foreclosed properties that occurred after we took title to the property.*

19 *The average total gain/loss on foreclosed properties includes both the gain/loss on sale of the foreclosed property as discussed in footnote 18 and the cumulative write-downs recognised on the loans up to the time we took title to the property.*

20 *Included in this category are loans of US$1.5bn (2013: US$1.9bn) that have been re-aged once and were less than 60 days past due at the point of re-age. These loans are not classified as impaired following re-age due to the overall expectation that these customers will perform on the original contractual terms of their borrowing in the future.*

21 *Currency translation is the effect of translating the results of subsidiaries and associates for the previous year at the average rates of exchange applicable in the current year.*

22 *Negative numbers are favourable: positive numbers are unfavourable.*

23 *Carrying amount of the net principal exposure.*

24 *Total includes holdings of ABSs issued by Freddie Mac and Fannie Mae.*

Liquidity and funding

25 *The most favourable metrics are smaller advances to core funding and larger stressed one-month and three-month coverage ratios.*

26 *The HSBC UK entity shown comprises four 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 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.*

27 *The Hongkong and Shanghai Banking Corporation represents the Group in Hong Kong, including its overseas branches. Each branch is monitored and controlled for liquidity and funding risk purposes as a stand-alone operating entity.*

28 *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.*

29 *The total shown for other principal HSBC operating entities represents the combined position of all the other operating entities overseen directly by the Risk Management Meeting of the GMB.*

30 *Estimated liquidity value represents the expected realisable value of assets prior to management assumed haircuts.*

31 *The undrawn balance for the five largest committed liquidity facilities provided to customers other than facilities to conduits.*

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32 *The undrawn balance for the total of all committed liquidity facilities provided to the largest market sector, other than facilities to conduits.*
33 *The residual contractual maturity profile of the balance sheet is set out on in Note 31 on the Financial Statements.*

Market risk

34 *Trading portfolios comprise positions arising from the market-making and warehousing of customer-derived positions.*
35 *Portfolio diversification is the market risk dispersion effect of holding a portfolio containing different risk types. It represents the reduction in unsystematic market risk that occurs when combining a number of different risk types, for example, interest rate, equity and foreign exchange, together in one portfolio. It is measured as the difference between the sum of the VaR by individual risk type and the combined total VaR. A negative number represents the benefit of portfolio diversification. As the maximum occurs on different days for different risk types, it is not meaningful to calculate a portfolio diversification benefit for these measures. For presentation purposes, portfolio diversification within the trading portfolio includes VaR-based RNIV.*
36 *The total VaR is non-additive across risk types due to diversification effects.*
37 *Investments in private equity are primarily made through managed funds that are subject to limits on the amount of investment. Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio as a whole. Regular reviews are performed to substantiate the valuation of the investments within the portfolio.*
38 *Investments held to facilitate ongoing business include holdings in government-sponsored enterprises and local stock exchanges.*
39 *Instead of assuming that all interest rates move together, we group our interest rate exposures into currency blocs whose rates are considered likely to move together. See Cautionary statement regarding forward-looking statements .*

Risk management of insurance operations

40 *Other includes term assurance, credit life insurance, universal life insurance and remaining non-life insurance.*
41 *Although investment contracts with discretionary participation features (DPF) are financial investments, HSBC continues to account for them as insurance contracts as permitted by IFRS 4.*
42 *The Other assets column shows shareholder assets as well as assets and liabilities classified as held for sale. The majority of the assets for insurance businesses classified as held for sale are reported as Other assets and investment properties and totalled US$6.8bn at 31 December 2014 (31 December 2013: nil). The majority of these assets were debt and equity securities. All liabilities for insurance businesses classified as held for sale are reported in Other liabilities and totalled US$6.8bn at 31 December 2014 (31 December 2013: nil). The majority of these liabilities were liabilities under insurance contracts and liabilities under investment contracts.*
43 *Present value of in-force long-term insurance contracts and investment contracts with DPF.*
44 *Deferred tax includes the deferred tax liabilities arising on recognition of PVIF.*
45

Does not include associated insurance company SABB Takaful Company or joint venture insurance company Canara HSBC Oriental Bank of Commerce Life Insurance Company Limited.

46 *HSBC has no insurance manufacturing subsidiaries in the Middle East and North Africa or North America.*

47 *Comprise unit-linked life insurance contracts and linked long-term investment contracts.*

48 *Comprise non-linked insurance contracts and non-linked long-term investment contracts.*

49 *Comprise mainly loans and advances to banks, cash and intercompany balances with other non-insurance legal entities.*

50 *The cost of guarantees figure presented comprises the modelled cost of guarantees under products manufactured by our insurance subsidiaries, including both the cost of guarantees reserved for through policyholder liabilities and the amount accounted for as a deduction to PVIF. This is considered to provide more relevant information than the total liabilities to policyholders established for guaranteed products manufactured by our insurance subsidiaries as disclosed in prior periods.*

51 *A block of contracts in France with guaranteed nominal annual returns in the range 1.25%-3.72% are reported entirely in the 2.1%-4.0% category in line with the average guaranteed return of 2.7% offered to policyholders by these contracts.*

52 *Real annual return guarantees provide the policyholder a guaranteed return in excess of the rate of inflation, and are supported by inflation-linked debt securities with yields that are also expressed in real terms.*

53 *Where a 100 basis point parallel shift in the yield curve would result in a negative interest rate, the effects on profit after tax and total equity have been calculated using a minimum rate of 0%.*

54 *Shareholders funds comprise solvency and unencumbered assets.*

55 *Non-linked insurance includes remaining non-life business.*

56 *In most cases, policyholders have the option to terminate their contracts at any time and receive the surrender values of their policies. These may be significantly lower than the amounts shown.*

57 *Insurance contracts and investment contracts with DPF can give policyholders the contractual right to receive, as a supplement to their guaranteed benefits, additional benefits that may be a significant portion of the total contractual benefits, but whose amount and timing are determined by HSBC. These additional benefits are contractually based on the performance of a specified pool of contracts or assets, or the profit of the company issuing the contracts.*

Pension risk

58 *In 2014, option overlay strategies which are expected to improve the risk/return profile of the equity allocation were implemented.*

59 *Alternative assets includes ABSs, MBSs and infrastructure assets.*

60 *Whilst there is no target cash allocation, the amount of cash is expected to vary between 0-5% depending upon the liquidity requirements of the scheme, which will affect the actual allocation of bonds correspondingly.*

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Risk elements in the loan portfolio

61 *In addition to the numbers presented there were US$0.5bn of impaired loans (2013: US$0.2bn); US$1m unimpaired loans contractually more than 90 days past due as to principal or interest (2013: US$40m); and US$ nil of troubled debt restructurings (not included in the classifications above) (2013: US$70m), all relating to assets held for sale at 31 December 2014.*

62 *Assets held for resale represent assets obtained by taking possession of collateral held as security for financial assets.*

63 *Ratio excludes trading loans classified as in default.*

Country distribution of outstandings and cross-border exposures

64 *These balances were between 0.75% and 1% of total assets. All other balances were above 1%.*

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Appendix to Risk

Risk policies and practices

This appendix describes the significant policies and practices employed by HSBC in managing our credit risk, liquidity and funding, market risk, operational risk (including compliance risk, legal risk and fiduciary risk), insurance risk, reputational risk, pension risk and sustainability risk.

Risk governance

(Unaudited)

Our strong risk governance reflects the importance placed by the Board and the Group Risk Committee (GRC) on shaping the Group s risk strategy and managing risks effectively. It is supported by a clear policy framework of risk ownership, a risk appetite process through which the types and levels of risk that we are prepared to accept in executing our strategy are articulated and monitored, performance scorecards cascaded from the GMB that align business and risk objectives, and the accountability of all staff for identifying, assessing and managing risks within the scope of their assigned responsibilities. This personal accountability, reinforced by the governance structure, mandatory learning and our approach to remuneration, helps to foster a disciplined and constructive culture of risk management and control throughout HSBC.

The executive and non-executive risk governance structures and their interactions are set out in the following table. Each major operating subsidiary has established a board committee with non-executive responsibility for oversight of risk-related matters and an executive committee with responsibility for risk-related matters.

Governance structure for the management of risk

Authority	Membership	Responsibilities include:
Board	Executive and non-executive Directors	Approving risk appetite, strategy and performance targets for the Group

		Approving appointment of chief risk officers of subsidiary companies
		Encouraging a strong risk governance culture which shapes the Group s attitude to risk
GRC	Independent non-executive Directors	Advising the Board on:
		risk appetite and alignment with strategy
		alignment of remuneration with risk appetite (through advice to the Group Remuneration Committee)
		risks associated with proposed strategic acquisitions and disposals
		Overseeing high-level risk related matters
		Reviewing the effectiveness of the Group s systems of risk management and internal controls (other than over financial reporting)
		Overseeing the maintenance and development of a supportive culture in relation to the management of risk
Financial System Vulnerabilities Committee	Non-executive Directors, including the Chairman of the Group Remuneration Committee, and	Overseeing controls and procedures designed to identify areas of exposure to financial crime or system abuse

	co-opted non-director members	
		Overseeing matters relating to anti-money laundering, sanctions, terrorist financing and proliferation financing
		Reviewing policies and procedures to ensure continuing obligations to regulatory and law enforcement agencies are met
Conduct & Values Committee	Independent non-executive Directors	Ensuring that in the conduct of its business, HSBC treats all stakeholders fairly
		Advising the Board on HSBC policies, procedures and standards to ensure that the Group conducts business responsibly and consistently adheres to the HSBC Values

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Authority	Membership	Responsibilities include:
Risk Management Meeting of the GMB	Group Chief Risk Officer Chief Legal Officer Group Chief Executive Group Finance Director All other Group Managing Directors	Formulating high-level global risk policy Exercising delegated risk management authority Overseeing implementation of risk appetite and controls Monitoring all categories of risk and determining appropriate mitigating action Promoting a supportive Group culture in relation to risk management and conduct Implementing Global Standards throughout the Group
Global Risk Management Board	Group Chief Risk Officer Chief Risk Officers of HSBC s global businesses and regions	Supporting the Risk Management Meeting and the Group Chief Risk Officer in providing strategic direction for the Global Risk function, setting priorities and overseeing their execution

	Heads of Global Risk sub-functions	Overseeing consistent approach to accountability for, and mitigation of, risk across the Global Risk function
Global Business Risk Management Committees	Global Business Chief Risk Officer Global Business Chief Executive Global Business Chief Financial Officer Heads of Global Risk sub-functions, as appropriate	Forward looking assessment of changes in Global Business activities or the markets in which it operates, analysing the possible risk impact and taking appropriate action Overseeing the implementation of Global Business risk appetite and controls Monitoring all categories of risk and determining appropriate mitigating actions Promoting a strong risk culture
Regional Risk Management Committees	Regional Chief Risk Officer Regional Chief Executive Officer Regional Chief Financial Officer Regional Global Business Chief Heads of Global Risk sub-functions, as appropriate	Formulating regional specific risk policy Overseeing the implementation of regional risk appetite and controls Monitoring all categories of risk and determining appropriate mitigating actions Promoting a strong risk culture
Subsidiary board committees responsible for risk-related matters and global business risk committees	Independent non-executive directors and/or HSBC employees with no line or functional responsibility for the activities of the relevant	Providing reports to the GRC or intermediate risk committee on risk-related matters and internal controls (other than over financial reporting) of relevant subsidiaries or businesses, as requested

	subsidiary or global business, as appropriate

The governance framework also defines the required structure of committees for Risk sub-functions, stress testing and other key areas at Group, global business, regional and country level.

Risk appetite

(Unaudited)

Our risk appetite framework is underpinned by the following core characteristics. These are applied to define the risk appetite statements on Group-wide, global business and regional levels.

Strong capital position: defined by a strong CET1 ratio and overall capital structure, both from a regulatory and internal perspective, which is not overly leveraged;

Conservative liquidity management: defined by a diversified funding structure and a conservative discipline whereby subsidiaries plan their contingency liquidity requirements on the assumption that there is no lender of last resort , either in the form of local supervisory intervention or via support from HSBC Holdings;

Strong balance sheet: core to HSBC s philosophy, generating a resilient stream of earnings;

Strong brand: our brand the world s leading international bank is of paramount importance as is the Group s reputation and the quality of its business ethics;

Risk must be commensurate with returns: returns should be generated in line with the risk taken and in alignments with strategic plans and risk management policies;

Robust Group structure of separate legal entities: the legal entity structure provides the potential for firewalls to mitigate liquidity and capital contagion in crisis situations;

The global business mix should produce sustainable long-term earnings growth: our global businesses should be suitably diversified to provide a stream of non-volatile, predictable earnings;

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Risk diversification: the globally diverse nature of our activities produces significant risk diversification benefits which must be closely assessed on an ongoing basis and reflected in our capital requirements; and

Financial crime risk: our overarching approach and appetite to financial crime risk is that the Group will not tolerate operating without systems and controls in place aimed at preventing and detecting financial crime and will not conduct business with individuals or entities we believe are engaged in illicit behaviour.

Credit risk

Credit risk management

(Audited)

The role of an independent credit control unit is fulfilled by the Global Risk function. Credit approval authorities are delegated by the Board to certain executive officers of HSBC Holdings. Similar credit approval authorities are delegated by the boards of subsidiary companies to executive officers of the relevant subsidiaries. In each major subsidiary, a Chief Risk Officer reports to the local Chief Executive Officer on credit-related issues, while maintaining a direct functional reporting line to the Group Chief Risk Officer in Global Risk. Details of the roles and responsibilities of the credit risk management function and the policies and procedures for managing credit risk are set out below. There were no significant changes in 2014.

The high-level oversight and management of credit risk provided globally by the Credit Risk function in Global Risk

to formulate Group credit policy. Compliance, subject to approved dispensations, is mandatory for all operating companies which must develop local credit policies consistent with Group policies;

to guide operating companies on our appetite for credit risk exposure to specified market sectors, activities and banking products and controlling exposures to certain higher-risk sectors;

to undertake an independent review and objective assessment of risk. Global Risk assesses all commercial non-bank credit facilities and exposures over designated limits, prior to the facilities being committed to customers or transactions being undertaken;

to monitor the performance and management of portfolios across the Group;

to control exposure to sovereign entities, banks and other financial institutions, as well as debt securities which are not held solely for the purpose of trading;

to set Group policy on large credit exposures, ensuring that concentrations of exposure by counterparty, sector or geography do not become excessive in relation to our capital base, and remain within internal and regulatory limits;

to control our cross-border exposures (see page 207);

to maintain and develop our risk rating framework and systems, the governance of which is under the general oversight of the Group Model Oversight Committee (MOC). The Group MOC meets bi-monthly and reports to the Risk Management Meeting. It is chaired by the risk function and its membership is drawn from Global Risk and relevant global functions or businesses;

to report to the Risk Management Meeting, the GRC and the Board on high risk portfolios, risk concentrations, country limits and cross-border exposures, large impaired accounts, impairment allowances, stress testing results and recommendations and retail portfolio performance; and

to act on behalf of HSBC Holdings as the primary interface, for credit-related issues, with the Bank of England, the PRA, local regulators, rating agencies, analysts and counterparts in major banks and non-bank financial institutions.

Principal objectives of our credit risk management

to maintain across HSBC a strong culture of responsible lending and a robust risk policy and control framework;

- to both partner and challenge our businesses in defining, implementing and continually re-evaluating our risk appetite under actual and scenario conditions; and

- to ensure there is independent, expert scrutiny of credit risks, their costs and their mitigation.

Concentration of exposure

(Audited)

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics or such counterparties are engaged in similar activities or operate in the same geographical areas or industry sectors so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. We use a number of controls and measures to minimise undue concentration of exposure in our portfolios across industry, country and global business. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Wrong-way risk occurs when a counterparty s exposures are adversely correlated with its credit quality. There are two types of wrong-way risk:

- general wrong-way risk occurs when the probability of counterparty default is positively correlated with general risk factors such as, for example, where the counterparty is resident and/or incorporated in a higher-risk country and seeks to sell a non-domestic currency in exchange for its home currency; and

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- specific wrong-way risk occurs when the exposure to a particular counterparty is positively correlated with the probability of counterparty default, such as a reverse repo on the counterparty s own bonds. It is HSBC policy that specific wrong-way transactions are approved on a case-by-case basis.

We use a range of tools to monitor and control wrong-way risk, including requiring the business to obtain prior approval before undertaking wrong-way risk transactions outside pre-agreed guidelines.

Cross-border exposures

We assess the vulnerability of countries to foreign currency payment restrictions, including economic and political factors, when considering impairment allowances on cross-border exposures. Impairment allowances are assessed in respect of all qualifying exposures within vulnerable countries unless these exposures and the inherent risks are:

- performing, trade-related and of less than one year s maturity;
- mitigated by acceptable security cover which is, other than in exceptional cases, held outside the country concerned;
- in the form of securities held for trading purposes for which a liquid and active market exists, and which are measured at fair value daily; and
- performing facilities with a principal (excluding security) of US$1m or below and/or with maturity dates shorter than three months.

Credit quality of financial instruments

(Audited)

Our credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. In the case of individually significant accounts that are predominantly within our wholesale businesses, risk ratings are reviewed regularly and any amendments are implemented promptly. Within our retail businesses, risk is assessed and managed using a wide range of risk and pricing models to generate portfolio data.

Our risk rating system facilitates the internal ratings based approach under the Basel framework adopted by the Group to support calculation of our minimum credit regulatory capital requirement. Our credit quality classifications are defined below.

Special attention is paid to problem exposures in order to accelerate remedial action. When appropriate, our operating companies use specialist units to provide customers with support to help them avoid default wherever possible.

Group and regional Credit Review and Risk Identification teams regularly review exposures and processes in order to provide an independent, rigorous assessment of credit risk across the Group, reinforce secondary risk management controls and share best practice. Internal audit, as a tertiary control function, focuses on risks with a global perspective and on the design and effectiveness of primary and secondary controls, carrying out oversight audits via the sampling of global and regional control frameworks, themed audits of key or emerging risks and project audits to assess major change initiatives.

The five credit quality classifications defined below each encompass a range of granular internal credit rating grades assigned to wholesale and retail lending businesses and the external ratings attributed by external agencies to debt securities.

Credit quality classification

(Unaudited)

	Debt securities and other bills	Wholesale lending and derivatives		Retail lending	
	External credit rating	Internal credit rating	12 month probability of default %	Internal credit rating[1]	Expected loss %
Quality classification					
Strong	**A and above**	**CRR[2]1 to CRR2**	**0 0.169**	**EL[3]1 to EL2**	**0 0.999**
Good	**BBB+ to BBB**	**CRR3**	**0.170 0.740**	**EL3**	**1.000 4.999**
Satisfactory	**BB+ to B and unrated**	**CRR4 to CRR5**	**0.741 4.914**	**EL4 to EL5**	**5.000 19.999**
Sub-standard	**B- to C**	**CRR6 to CRR8**	**4.915 99.999**	**EL6 to EL8**	**20.000 99.999**
Impaired	**Default**	**CRR9 to CRR10**	**100**	**EL9 to EL10**	**100+ or defaulted[4]**

1 *We observe the disclosure convention that, in addition to those classified as EL9 to EL10, retail accounts classified EL1 to EL8 that are delinquent by 90 days or more are considered impaired, unless individually they have been assessed as not impaired (see page 136, Past due but not impaired gross financial instruments).*
2 *Customer risk rating.*
3 *Expected loss.*
4 *The EL percentage is derived through a combination of PD and LGD, and may exceed 100% in circumstances where the LGD is above 100% reflecting the cost of recoveries.*

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Quality classification definitions

Strong exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss. Retail accounts operate within product parameters and only exceptionally show any period of delinquency.

Good exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minimal following the adoption of recovery processes.

Satisfactory exposures require closer monitoring and demonstrate an average to fair capacity to meet financial commitments, with moderate default risk. Retail accounts typically show only short periods of delinquency, with any losses expected to be minor following the adoption of recovery processes.

Sub-standard exposures require varying degrees of special attention and default risk is of greater concern. Retail portfolio segments show longer delinquency periods of generally up to 90 days past due and/or expected losses are higher due to a reduced ability to mitigate these through security realisation or other recovery processes.

Impaired exposures have been assessed as impaired. These include wholesale exposures where the bank considers that either the customer is unlikely to pay its credit obligations in full, without recourse by the bank to the actions such as realising security if held, or the customer is past due more than 90 days on any material credit obligation; retail accounts include loans and advances classified as EL9 to EL10, and for those classified EL1 to EL8 they are greater than 90 days past due unless individually they have been assessed as not impaired; and renegotiated loans that have met the requirements to be disclosed as impaired and have not yet met the criteria to be returned to the unimpaired portfolio (see below).

The customer risk rating (CRR) 10-grade scale summarises a more granular underlying 23-grade scale of obligor probability of default (PD). All HSBC customers are rated using the 10 or 23-grade scale, depending on the degree of sophistication of the Basel II approach adopted for the exposure.

Each CRR band is associated with an external rating grade by reference to long-run default rates for that grade, represented by the average of issuer-weighted historical default rates. This mapping between internal and external ratings is indicative and may vary over time.

The expected loss (EL) 10-grade scale for retail business summarises a more granular underlying EL scale for this customer segment; this combines obligor and facility/product risk factors in a composite measure.

For debt securities and certain other financial instruments, external ratings have been aligned to the five quality classifications based upon the mapping of related CRR to external credit grade. The most recent mapping review resulted in B being mapped to CRR5. Accordingly B ratings are now mapped to Satisfactory . This represents a change in disclosure mapping unrelated to changes in counterparty creditworthiness.

Renegotiated loans and forbearance

(Audited)

A range of forbearance strategies is employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default, foreclosure or repossession. They include extended payment terms, a reduction in interest or principal repayments, approved external debt management plans, debt consolidations, the deferral of foreclosures and other forms of loan modifications and re-ageing.

Our policies and practices are based on criteria which enable local management to judge whether repayment is likely to continue. These typically provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has showed a willingness to repay their loan and is expected to be able to meet the revised obligations.

Identifying renegotiated loans

The contractual terms of a loan may be modified for a number of reasons including changing market conditions, customer retention and other factors not related to the current or potential credit deterioration of a customer. When the contractual payment terms of a loan are modified because we have significant concerns about the borrower s ability to meet contractual payments when due, these loans are classified as renegotiated loans .

For retail lending our credit risk management policy sets out restrictions on the number and frequency of renegotiations, the minimum period an account must have been opened before any renegotiation can be considered and the number of qualifying payments that must be received. The application of this policy varies according to the nature of the market, the product and the management of customer relationships through the occurrence of exceptional events. When considering whether there is significant concern regarding a customer s ability to meet contractual loan repayments when due, we assess the customer s delinquency status, account behaviour, repayment history, current financial situation and continued ability to repay. If the customer is not meeting contractual repayments or it is evident that they will be unable to do so without the renegotiation, there will be a significant concern regarding their ability to meet contractual payments, and the loan will be disclosed as impaired, unless the concession granted is insignificant as discussed below.

Report of the Directors: Financial Review (continued)

For loan restructurings in wholesale lending, indicators of significant concerns regarding a borrower s ability to pay include:

- the debtor is currently in default on any of its debt;
- the debtor has declared or is in the process of declaring bankruptcy or entering into a similar process;
- there is significant doubt as to whether the debtor will continue to be a going concern;
- currently, the debtor has securities that have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange as a result of trading or financial difficulties;
- based on estimates and projections that only encompass current business capabilities, the Group forecasts that the debtor s entity-specific cash flows will be insufficient to service the debt (both interest and principal) in accordance with the contractual terms of the existing agreement through maturity. In this instance, actual payment default may not yet have occurred; and
- absent the modification, the debtor cannot obtain funds from sources other than its existing creditors at an effective interest rate equal to the current market interest rate for similar debt for a non-distressed debtor.

Where the modification of a loan s contractual payment terms represents a concession for economic or legal reasons relating to the borrower s financial difficulty, and is a concession that we would not otherwise consider, then the renegotiated loan is disclosed as impaired in accordance with our impaired loan disclosure convention described in more detail on page 212, unless the concession is insignificant and there are no other indicators of impairment. Insignificant concessions are primarily restricted to our CML portfolio in HSBC Finance, where loans which are in the early stages of delinquency (less than 60 days delinquent) and typically have the equivalent of two payments deferred for the first time, are excluded from our impaired loan classification, as the contractual payment deferrals are deemed to be insignificant compared with payments due on the loan as a whole. For details of HSBC Finance s loan renegotiation programmes and portfolios, see pages 154 and 155.

Credit quality classification of renegotiated loans

(Audited)

Under IFRSs, an entity is required to assess whether there is objective evidence that financial assets are impaired at the end of each reporting period. A loan is impaired and an impairment allowance is recognised when there is objective evidence of a loss event that has an effect on the cash flows of the loan which can be reliably estimated. Granting a concession to a customer that we would not otherwise consider, as a result of their financial difficulty, is objective evidence of impairment and impairment losses are measured accordingly.

A renegotiated loan is presented as impaired when:

- there has been a change in contractual cash flows as a result of a concession which the lender would otherwise not consider, and it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full.

This presentation applies unless the concession is insignificant and there are no other indicators of impairment.

The renegotiated loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that are assessed for impairment on a collective basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

For retail lending the minimum period of payment performance required depends on the nature of loans in the portfolio, but is typically not less than six months. Where portfolios have more significant levels of forbearance activity, such as that undertaken by HSBC Finance, the minimum repayment performance period required may be substantially more (for further details on HSBC Finance see page 153). Payment performance periods are monitored to ensure they remain appropriate to the levels of recidivism observed within the portfolio. These performance periods are in addition to a minimum of two payments which must be received within a 60-day period for the customer to initially qualify for the renegotiation (in the case of HSBC Finance, in certain circumstances, for example where debt has been restructured in bankruptcy proceedings, fewer or no qualifying payments may be required). The qualifying payments are required in order to demonstrate that the renegotiated terms are sustainable for the borrower. For corporate and commercial loans, which are individually assessed for impairment and where non-monthly payments are more commonly agreed, the history of payment performance will depend on the underlying structure of payments agreed as part of the restructuring.

Renegotiated loans are classified as unimpaired where the renegotiation has resulted from significant concern about a borrower s ability to meet their contractual payment terms but the renegotiated terms are based on current market rates and contractual cash flows are expected to be collected in full following the renegotiation. Unimpaired renegotiated loans also include previously impaired renegotiated loans that have demonstrated satisfactory performance over a period of time or have been assessed based on all available evidence as having no remaining indicators of impairment.

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Loans that have been identified as renegotiated retain this designation until maturity or derecognition. When a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, such as in some debt consolidations, the new loan is disclosed as renegotiated.

When determining whether a loan that is restructured should be derecognised and a new loan recognised, we consider the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument. The following are examples of circumstances that, individually or in aggregate, are likely to result in this test being met and derecognition accounting being applied:

- an uncollateralised loan becomes fully collateralised;
- the addition or removal of cross-collateralisation provisions;
- removal or addition of conversion features attached to the loan agreement;
- a change in the currency in which the principal or interest is denominated;
- a change in the liquidation preference or ranking of the instrument; or
- the contract is altered in any other manner so that the terms under the new or modified contract are substantially different from those under the original contract.

The following are examples of factors that we consider may indicate that the revised loan is a substantially different financial instrument, but are unlikely to be conclusive in themselves:

- changes in guarantees or loan covenants provided;
- less significant changes to collateral arrangements; or
- the addition of repayment provisions or prepayment premium clauses.

Renegotiated loans and recognition of impairment allowances

(Audited)

For retail lending, renegotiated loans are segregated from other parts of the loan portfolio for collective impairment assessment to reflect the higher rates of losses often encountered in these segments. When empirical evidence indicates an increased propensity to default and higher losses on such accounts, such as for re-aged loans in the US, the use of roll-rate methodology ensures these factors are taken into account when calculating impairment allowances by applying roll rates specifically calculated on the pool of loans subject to forbearance. When the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, a basic formulaic approach based on historical loss rate experience is used. As a result of our roll-rate methodology, we recognise collective impairment allowances on homogeneous groups of loans, including renegotiated loans, where there is historical evidence that there is a likelihood that loans in these groups will progress through the various stages of delinquency, and ultimately prove irrecoverable as a result of events occurring before the balance sheet date. This treatment applies irrespective of whether or not those loans are presented as impaired in accordance with our impaired loans disclosure convention. When we consider that there are additional risk factors inherent in the portfolios that may not be fully reflected in the statistical roll rates or historical experience, these risk factors are taken into account by adjusting the impairment allowances derived solely from statistical or historical experience. For further details of the risk factor adjustments see Note 1k on the Financial Statements.

In the corporate and commercial sectors, renegotiated loans are typically assessed individually. Credit risk ratings are intrinsic to the impairment assessment. A distressed restructuring is classified as an impaired loan. The individual impairment assessment takes into account the higher risk of the non-payment of future cash flows inherent in renegotiated loans.

Corporate and commercial forbearance

(Unaudited)

In the corporate and commercial sectors, forbearance activity is undertaken selectively where it has been identified that repayment difficulties against the original terms have already materialised, or are very likely to materialise. These cases are treated as impaired loans where:

- the customer is experiencing, or is very likely to experience, difficulty in meeting a payment obligation to the Group (i.e. due to current credit distress); and
- the Group is offering to the customer revised payment arrangements which constitute a concession (i.e. it is offering terms it would not normally be prepared to offer).

These cases are described as distressed restructurings. The agreement of a restructuring which meets the criteria above requires all loans, advances and counterparty exposures to the customer to be treated as impaired. Against the background of this requirement, as a customer approaches the point at which it becomes clear that there is an increasing risk that a restructuring of this kind might be necessary, the exposures will typically be regarded as sub-standard to reflect the deteriorating credit risk profile and will be graded as impaired when the restructure is proposed for approval, or sooner if there is sufficient concern regarding the customer s likeliness to pay.

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For the purposes of determining whether changes to a customer s agreement should be treated as a distressed restructuring the following types of modification are regarded as concessionary:

- transfers from the customer of receivables from third parties, real estate, or other assets to satisfy fully or partially a debt;
- issuance or other granting of an equity interest to satisfy fully or partially a debt unless the equity interest is granted pursuant to existing terms for converting the debt into an equity interest; and
- modification of the terms of a debt, such as one or more of the following:
  - reduction (absolute or contingent) of the stated interest rate for the remaining original life of the debt;
  - extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk;
  - reduction (absolute or contingent) of the face amount or maturity amount of the debt; and
  - reduction (absolute or contingent) of accrued interest.

Modifications that are unrelated to payment arrangements, such as the restructuring of collateral or security arrangements or the waiver of rights under covenants within documentation, are not regarded by themselves to be evidence of credit distress affecting payment capacity. Typically, covenants are in place to give the Group rights of repricing or acceleration, but they are frequently set at levels where payment capacity has yet to be affected, providing rights of action at earlier stages of credit deterioration. Such concessions do not directly affect the customer s ability to service the original contractual debt and are not reported as renegotiated loans. However, where a customer requests a non-payment related covenant waiver, the significance of the underlying breach of covenant will be considered together with any other indicators of impairment, and where there is a degree of severity of credit distress indicating uncertainty of payment, all available evidence will be considered in determining whether a loss event has occurred. The waiver will not, however, trigger classification as a renegotiated loan as payment terms have not been modified.

When both payment-related and non-payment related modifications are made together as a result of significant concerns regarding the payment of contractual cash flows, the loan is treated as a distressed restructuring and disclosed as a renegotiated loan.

Within corporate and commercial business segments, modifications of several kinds are frequently agreed for a customer contemporaneously. Transfer to an interest-only arrangement is the most common type of modification granted in the UK, whether in isolation or in combination with other concessions. Throughout the rest of the world, term extensions occur more frequently with other types of concession such as interest rate changes occurring less often.

In assessing whether payment-related forbearance is a satisfactory and sustainable strategy, the customer s entire exposure and facilities will be reviewed and their ability to meet the terms of both the revised obligation and other credit facilities not amended in the renegotiation is assessed. Should this assessment identify that a renegotiation will not deal with a customer s payment capacity issues satisfactorily, other special management options may be applied.

This process may identify the need to provide assistance to a customer specifically to restructure their business operations and activities so as to restore satisfactory payment capacity.

When considering acceptable restructuring terms we consider the ability of the customer to be able to service the revised interest payments as a necessity. When principal payment modifications are considered, again we require the customer to be able to comply with the revised terms as a necessary pre-condition for the restructuring to proceed. When principal payments are modified resulting in permanent forgiveness, or when it is otherwise considered that there is no longer a realistic prospect of recovery of outstanding principal, the affected balances are written off. When principal repayments are postponed, it is expected that the customer will be capable of paying in line with the renegotiated terms, including instances when the postponed principal repayment is expected from refinancing. In all cases, a loan renegotiation is only granted when the customer is expected to be able to meet the revised terms.

Modifications may be made on a temporary basis when time is needed for the customer to make arrangements for payment, when deterioration in payment capacity is expected to be acute but short lived, or when more time is needed to accommodate discussions regarding a more permanent accommodation with other bankers, for example in syndicated facilities where multilateral negotiation commonly features.

If a restructuring proceeds and the customer demonstrates satisfactory performance over a period of time, the case may be returned to a non-impaired grade (CRR1-8) provided no other indicators of impairment remain. Such a case cannot be returned to a non-impaired grade when a specific impairment allowance remains against any of the customer s credit facilities. The period of performance will vary depending on the frequency of payments to be made by the customer under the amended agreement and the extent to which the customer s financial position is considered to have improved.

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Report of the Directors: Financial Review (continued)

Impairment assessment

(Audited)

It is our policy that each operating company in HSBC creates impairment allowances for impaired loans promptly and appropriately, when there is objective evidence that impairment of a loan or portfolio of loans has occurred.

For details of our impairment policies on loans and advances and financial investments, see Note 1k on the Financial Statements.

Impairment and credit risk mitigation

The existence of collateral has an effect when calculating impairment on individually assessed impaired loans. When we no longer expect to recover the principal and interest due on a loan in full or in accordance with the original terms and conditions, it is assessed for impairment. If exposures are secured, the current net realisable value of the collateral will be taken into account when assessing the need for an impairment allowance. No impairment allowance is recognised in cases where all amounts due are expected to be settled in full on realisation of the security.

Personal lending portfolios are generally assessed for impairment on a collective basis as the portfolios typically consist of large groups of homogeneous loans. Two methods are used to calculate allowances on a collective basis: a roll-rate methodology or a more basic formulaic approach based on historical losses. In 2014, we reviewed the impairment allowance methodology used for retail banking and small business portfolios across the Group to ensure that the assumptions used in our collective assessment models continued to appropriately reflect the period of time between a loss event occurring and the account proceeding to delinquency and eventual write-off.

The historical loss methodology is typically used to calculate collective impairment allowances for secured or low default portfolios such as mortgages until the point at which they are individually identified and assessed as impaired. For loans which are collectively assessed using historical loss methodology, the historical loss rate is derived from the average contractual write-off net of recoveries over a defined period. The net contractual write-off rate is the actual amount of loss experienced after the realisation of collateral and receipt of recoveries.

A roll-rate methodology is more commonly adopted for unsecured portfolios when there are sufficient volumes of empirical data to develop robust statistical models. In certain circumstances mortgage portfolios have a statistically significant number of defaults and losses available, enabling reliable roll rates to be generated. In these cases a roll-rate methodology is applied until the point at which the loans are individually identified and assessed as impaired, and the average loss rate for each delinquency bucket is adjusted to reflect the average loss expected following realisation of security and receipt of recoveries. The average loss expected is derived from average historical collateral realisation values.

The nature of the collective allowance assessment prevents individual collateral values or LTV ratios from being included within the calculation. However, the loss rates used in the collective assessment are adjusted for the collateral realisation experiences which will vary depending on the LTV composition of the portfolio. For example, mortgage portfolios under a historical loss rate methodology with lower LTV ratios will typically experience lower loss history and consequently a lower net contractual write-off rate.

For wholesale collectively assessed loans, historical loss methodologies are applied to measure loss event impairments which have been incurred but not reported. Loss rates are derived from the observed contractual write-off net of recoveries over a defined period, typically no less than 60 months. The net contractual write-off rate is the actual or expected amount of loss experienced after realisation of collateral and receipt of recoveries. These historical loss rates are adjusted by an economic factor which amends the historical averages to better represent current economic conditions affecting the portfolio. In order to reflect the likelihood of a loss event not being identified and assessed an emergence period assumption is applied which reflects the period between a loss occurring and its identification. The emergence period is estimated by management for each identified portfolio. The factors that may influence this estimation include economic and market conditions, customer behaviour, portfolio management information, credit management techniques and collection and recovery experiences in the market. The emergence period is assessed empirically on a periodic basis and may vary over time as these factors change.

Write-off of loans and advances

(Audited)

For details of our policy on the write-off of loans and advances, see Note 1k on the Financial Statements.

In HSBC Finance, the carrying amounts of residential mortgage and second lien loans in excess of net realisable value are written off at or before the time foreclosure is completed or settlement is reached with the borrower. If there is no reasonable expectation of recovery, and foreclosure is pursued, the loan is normally written off no later than the end of the month in which the loan becomes 180 days contractually past due. We regularly obtain new appraisals for these collateral dependent loans (every 180 days) and adjust carrying values to the most recent appraisal if they have improved or deteriorated as the best estimate of the cash flows that will be received on the disposal of the collateral.

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Unsecured personal facilities, including credit cards, are generally written off at between 150 and 210 days past due, the standard period being the end of the month in which the account becomes 180 days contractually delinquent. Write-off periods may be extended, generally to no more than 360 days past due but, in very exceptional circumstances, to longer than that figure in a few countries where local regulation or legislation constrain earlier write-off or where the realisation of collateral for secured real estate lending takes this time.

In retail lending, final write-off should occur within 60 months of the default at the latest.

In the event of bankruptcy or analogous proceedings, write-off may occur earlier than at the periods stated above. Collections procedures may continue after write-off.

Impairment methodologies

(Audited)

To identify objective evidence of impairment for available-for-sale ABSs, an industry standard valuation model is normally applied which uses data with reference to the underlying asset pools and models their projected future cash flows. The estimated future cash flows of the securities are assessed at the specific financial asset level to determine whether any of them are unlikely to be recovered as a result of loss events occurring on or before the reporting date.

The principal assumptions and inputs to the models are typically the delinquency status of the underlying loans, the probability of delinquent loans progressing to default, the prepayment profiles of the underlying assets and the loss severity in the event of default. However, the models utilise other variables relevant to specific classes of collateral to forecast future defaults and recovery rates. Management uses externally available data and applies judgement when determining the appropriate assumptions in respect of these factors. We use a modelling approach which incorporates historically observed progression rates to default to determine if the decline in aggregate projected cash flows from the underlying collateral will lead to a shortfall in contractual cash flows. In such cases, the security is considered to be impaired.

In respect of CDOs, expected future cash flows for the underlying collateral are assessed to determine whether there is likely to be a shortfall in the contractual cash flows of the CDO.

When a security benefits from a contract provided by a monoline insurer that insures payments of principal and interest, the expected recovery on the contract is assessed in determining the total expected credit support available to the ABS.

Loan Management Unit

(Unaudited)

The HSBC Loan Management Unit (LMU) is a front line customer contact department within Wholesale Credit and Market Risk that assumes responsibility for managing business customer relationships requiring intensive and close control where the bank s lending is at risk. LMU operates on a regional basis across the Group and is independent of the originating business management units. It reports locally to the chief credit officer position. Customers are identified and transferred to LMU by business management or the Wholesale Credit and Market Risk approval teams.

Customers managed by LMU are normally operating outside the Group s risk appetite. They typically show symptoms of significant financial difficulty, the management team displays limited experience of managing a business in distress and the management and financial information provided to the bank is insufficient and unreliable.

The levels of customer exposure under management and the size of the LMU team varies between countries depending on the breadth of business undertaken locally but LMU will always manage highly distressed situations where individual customer exposure exceeds US$1.5m.

The primary focus of LMU is to protect the bank s capital and minimise losses by working consensually with customers to promote and support viable recovery strategies wherever achievable, with the ultimate intention of returning the customer to front line relationship management. In some cases, rehabilitation is not possible and LMU will consider a range of options to protect the bank s exposure and solvency of the customer. On occasion, it is not possible to find a satisfactory solution and the customer may file for insolvency or local equivalent. In all outcomes, LMU seeks to treat customers fairly, sympathetically and positively, in a professional way with transparent processes and procedures.

Remediation and restructuring strategies available in the business and LMU include granting a customer various types of concessions while seeking to enhance the ability of the customer to ultimately repay the Group which could include enhancing the overall security available to the bank. Any decision to approve a concession will be a function of the region s specific country and sector appetite, the key metrics of the customer, the market environment, the loan structure and security. Internal reviews on customers managed directly by LMU are performed on a scheduled basis in accordance with relevant accounting guidelines, credit policies and national banking regulations. Under certain circumstances, concessions granted may result in the loan being classified as a renegotiated loan.

Collateral and other credit enhancements held

(Audited)

Loans and advances held at amortised cost

The Group s practice is to lend on the basis of customers ability to meet their obligations out of cash flow resources rather than rely on the value of security offered. Depending on a customer s standing and the type of product, facilities may be provided without security. For other lending, a charge over collateral is obtained and considered in determining the credit decision and pricing. In the event of default, the bank may utilise the collateral as a source of repayment. Depending on its form, collateral can have a significant financial effect in mitigating our exposure to credit risk.

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Additionally, risk may be managed by employing other types of collateral and credit risk enhancements such as second charges, other liens and unsupported guarantees, but the valuation of such mitigants is less certain and their financial effect has not been quantified.

Refinance risk

(Audited)

Many types of lending require the repayment of a significant proportion of the principal at maturity. Typically, the mechanism of repayment for the customer is through the acquisition of a new loan to settle the existing debt. Refinance risk arises where a customer is unable to repay such term debt on maturity, or to refinance debt at commercial rates. When there is evidence that this risk may apply to a specific contract, HSBC may need to refinance the loan on concessionary terms that it would not otherwise have considered, in order to recoup the maximum possible cash flows from the contract and potentially avoid the customer defaulting on the repayment of principal. When there is sufficient evidence that borrowers, based on their current financial capabilities, may fail at maturity to repay or refinance their loans, these loans are disclosed as impaired with recognition of a corresponding impairment allowance where appropriate.

Nature of HSBC s securitisation and other structured exposures

(Audited)

Mortgage-backed securities (MBS s) are securities that represent interests in groups of mortgages and provide investors with the right to receive cash from future mortgage payments (interest and/or principal). An MBS which references mortgages with different risk profiles is classified according to the highest risk class.

Collateralised debt obligations (CDO s) are securities backed by a pool of bonds, loans or other assets such as asset-backed securities (ABS s). CDOs may include exposure to sub-prime or Alt-A mortgage assets where these are part of the underlying assets or reference assets. As there is often uncertainty surrounding the precise nature of the underlying collateral supporting CDOs, all CDOs supported by residential mortgage-related assets are classified as sub-prime. Our holdings of ABSs and CDOs and direct lending positions, and the categories of mortgage collateral and lending activity, are described overleaf.

Our exposure to non-residential mortgage-related ABSs includes securities with collateral relating to commercial property mortgages, leveraged finance loans, student loans, and other assets such as securities with other receivable-related collateral.

Definitions and classifications of ABSs and CDOs

Definition	Classification

Categories of ABSs and CDOs		
Sub-prime	Loans to customers who have limited credit histories, modest incomes or high debt-to-income ratios or have experienced credit problems caused by occasional delinquencies, prior charge-offs, bankruptcy or other credit-related actions.	For US mortgages, a FICO score of 620 or less has primarily been used to determine whether a loan is sub-prime. For non-US mortgages, management judgement is used.
US Home Equity Lines of Credit (HELoC s) (categorised within Sub-prime)	A form of revolving credit facility provided to customers, which is supported in the majority of circumstances by a second lien or lower ranking charge over residential property.	Holdings of HELoCs are classified as sub-prime.
US Alt-A	Lower risk loans than sub-prime, but they share higher risk characteristics than lending under fully conforming standard criteria.	US credit scores and the completeness of documentation held (such as proof of income), are considered when determining whether an Alt-A classification is appropriate. Non sub-prime mortgages in the US are classified as Alt-A if they are not eligible for sale to the major US Government mortgage agencies or sponsored entities.
US Government agency and sponsored enterprises mortgage-related assets	Securities that are guaranteed by US Government agencies such as the Government National Mortgage Association (Ginnie Mae), or by US Government sponsored entities including Fannie Mae and Freddie Mac.	Holdings of US Government agency and US Government sponsored enterprises mortgage-related assets are classified as prime exposures.

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Categories of ABSs and CDOs	Definition	Classification
UK non-conforming mortgages (categorised within Sub-prime)	UK mortgages that do not meet normal lending criteria. Examples include mortgages where the expected level of documentation is not provided (such as income with self-certification), or where poor credit history increases risk and results in pricing at a higher than normal lending rate.	UK non-conforming mortgages are treated as sub-prime exposures.
Other residential mortgages	Residential mortgages, including prime mortgages, that do not meet any of the classifications described above.	Prime residential mortgage-related assets are included in this category.

Liquidity and funding

(Audited)

The management of liquidity and funding is primarily undertaken locally (by country) in our operating entities in compliance with the Group s liquidity and funding risk management framework (the LFRF), and with practices and limits set by the GMB through the Risk Management Meeting and approved by the Board. These limits vary according to the depth and the liquidity of the markets in which the entities operate. Our general policy is that each defined operating entity should be self-sufficient in funding its own activities. Where transactions exist between operating entities, they are reflected symmetrically in both entities.

As part of our Asset, Liability and Capital Management (ALCM) structure, we have established ALCOs at Group level, in the regions and in operating entities. The terms of reference of all ALCOs include the monitoring and control of liquidity and funding.

The primary responsibility for managing liquidity and funding within the Group s framework and risk appetite resides with the local operating entities ALCOs. Our most significant operating entities are overseen by regional ALCOs, Group ALCO and the Risk Management Meeting. The remaining smaller operating entities are overseen by regional ALCOs, with appropriate escalation of significant issues to Group ALCO and the Risk Management Meeting.

Operating entities are predominately defined on a country basis to reflect our local management of liquidity and funding. Typically, an operating entity will be defined as a single legal entity. However, to take account of the situation where operations in a country are booked across multiple subsidiaries or branches:

- an operating entity may be defined as a wider sub-consolidated group of legal entities if they are incorporated in the same country, liquidity and funding are freely fungible between the entities and permitted by local regulation, and the definition reflects how liquidity and funding are managed locally; or
- an operating entity may be defined more narrowly as a principal office (branch) of a wider legal entity operating in multiple countries, reflecting the local country management of liquidity and funding.

The Risk Management Meeting reviews and agrees annually the list of entities it directly oversees and the composition of these entities.

Primary sources of funding

(Audited)

Customer deposits in the form of current accounts and savings deposits payable on demand or at short notice form a significant part of our funding, and we place considerable importance on maintaining their stability. For deposits, stability depends upon maintaining depositor confidence in our capital strength and liquidity, and on competitive and transparent pricing.

We also access wholesale funding markets by issuing senior secured and unsecured debt securities (publically and privately) and borrowing from the secured repo markets against high quality collateral, in order to obtain funding for non-banking subsidiaries that do not accept deposits, to align asset and liability maturities and currencies and to maintain a presence in local wholesale markets.

The management of liquidity and funding risk

(Audited)

Inherent liquidity risk categorisation

We place our operating entities into one of two categories (low and medium) to reflect our assessment of their inherent liquidity risk considering political, economic and regulatory factors within the host country and factors specific to the operating entities themselves, such as their local market, market share and balance sheet strength. The categorisation involves management judgement and is based on the perceived liquidity risk of an operating entity relative to other entities in the Group. The categorisation is intended to reflect the possible impact of a liquidity event, not the probability of an event, and forms part of our risk appetite. It is used to determine the prescribed stress scenario that we require our operating entities to be able to withstand and manage to.

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Report of the Directors: Financial Review (continued)

Core deposits

A key element of our internal framework is the classification of customer deposits into core and non-core based on our expectation of their behaviour during periods of liquidity stress. This characterisation takes into account the inherent liquidity risk categorisation of the operating entity originating the deposit, the nature of the customer and the size and pricing of the deposit. No deposit is considered to be core in its entirety unless it is contractually collateralising a loan. The core deposit base in each operating entity is considered to be a long-term source of funding and therefore is assumed not to be withdrawn in the liquidity stress scenario that we use to calculate our principal liquidity risk metrics.

The three filters considered in assessing whether a deposit in any operating entity is core are:

- *price:* any deposit priced significantly above market or benchmark rates is generally treated as entirely non-core;
- *size:* depositors with total funds above certain monetary thresholds are excluded. Thresholds are established by considering the business line and inherent liquidity risk categorisation; and
- *line of business:* the element of any deposit remaining after the application of the price and size filters is assessed on the basis of the line of business with which the deposit is associated. The proportion of any customer deposit that can be considered core under this filter is between 35% and 90%.

Repo transactions and bank deposits cannot be classified as core deposits.

Advances to core funding ratio

Core customer deposits are an important source of funding to finance lending to customers, and mitigate against reliance on short-term wholesale funding. Limits are placed on operating entities to restrict their ability to increase loans and advances to customers without corresponding growth in core customer deposits or long-term debt funding with a residual maturity beyond one year; this measure is referred to as the advances to core funding ratio.

Advances to core funding ratio limits are set by the Risk Management Meeting for the most significant operating entities, and by regional ALCOs for smaller operating entities, and are monitored by ALCM teams. The ratio describes loans and advances to customers as a percentage of the total of core customer deposits and term funding with a remaining term to maturity in excess of one year. In general, customer loans are assumed to be renewed and are included in the numerator of the ratio, irrespective of the contractual maturity date. Reverse repo arrangements are excluded from the advances to core funding ratio.

Stressed coverage ratios

Stressed coverage ratios are derived from stressed cash flow scenario analyses and express stressed cash inflows as a percentage of stressed cash outflows over one-month and three-month time horizons.

The stressed cash inflows include:

- inflows (net of assumed haircuts) expected to be generated from the realisation of liquid assets; and
- contractual cash inflows from maturing assets that are not already reflected as a utilisation of liquid assets.

In line with the approach adopted for the advances to core funding ratio, customer loans are generally assumed not to generate any cash inflows under stress scenarios and are therefore excluded from the numerator of the stressed coverage ratio, irrespective of the contractual maturity date.

A stressed coverage ratio of 100% or higher reflects a positive cumulative cash flow under the stress scenario being monitored. Group operating entities are required to maintain a ratio of 100% or more out to three months under the combined market-wide and HSBC-specific stress scenario defined by the inherent liquidity risk categorisation of the operating entity concerned.

Compliance with operating entity limits is monitored by ALCM teams and reported monthly to the Risk Management Meeting for the main operating entities and to regional ALCOs for the smaller operating entities.

Stressed scenario analysis

(Unaudited)

We use a number of standard Group stress scenarios designed to model:

- combined market-wide and HSBC-specific liquidity crisis scenarios; and
- market-wide liquidity crisis scenario.

These scenarios are modelled by all operating entities. The appropriateness of the assumptions for each scenario is reviewed by ALCM regularly and formally approved by the Risk Management Meeting and the Board annually as part of the liquidity and funding risk appetite approval process.

Stressed cash outflows are determined by applying a standard set of prescribed stress assumptions to the Group s cash flow model. Our framework prescribes the use of two market-wide scenarios and two further combined market-wide and HSBC-specific stress scenarios of increasing severity. In addition to our standard stress scenarios, individual operating entities are required to design their own scenarios to reflect specific local market conditions, products and funding bases.

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The two combined market-wide and HSBC-specific scenarios model a more severe scenario than the market-wide scenario. The relevant combined market-wide and HSBC-specific stress scenario that an operating entity manages to is based upon its inherent liquidity risk categorisation. The key assumptions factored into the two combined market-wide and HSBC-specific stress scenarios are summarised as follows:

- all non-core deposits are deemed to be withdrawn within three months (80% within one month), with the level of non-core deposits dependent on the operating entity s inherent liquidity risk categorisation;
- the ability to access interbank funding and unsecured term debt markets ceases for the duration of the scenario;
- the ability to generate funds from illiquid asset portfolios (securitisation and secured borrowing) is restricted to 25-75% of the lower of issues in the last six months or expected issues in the next six months. The restriction is based on current market conditions and is dependent on the operating entity s inherent liquidity risk categorisation;
- the ability to access repo funding ceases for any asset not classified as liquid under our liquid asset policy for the duration of the scenario;
- drawdowns on committed lending facilities must be consistent with the severity of the market stress being modelled and dependent on the inherent liquidity risk categorisation of the operating entity;
- outflows are triggered by a defined downgrade in long-term ratings. We maintain an ongoing assessment of the appropriate number of notches to reflect;
- customer loans are assumed to be renewed at contractual maturity;
- interbank loans and reverse repos are assumed to run off contractually; and
- assets defined as liquid assets are assumed to be realised in cash ahead of their contractual maturity, after applying a defined stressed haircut of up to 20%.

Liquid assets of HSBC s principal operating entities

(Audited)

Stressed scenario analysis and the numerator of the coverage ratio include the assumed cash inflows that would be generated from the realisation of liquid assets, after applying the appropriate stressed haircut. These assumptions are made on the basis of management s expectation of when an asset is deemed to be realisable.

Liquid assets are unencumbered assets that meet the Group s definition of liquid assets and are either held outright or as a consequence of a reverse repo transaction with a residual contractual maturity beyond the time horizon of the stressed coverage ratio being monitored. Any unencumbered asset held as a result of reverse repo transactions with a contractual maturity within the time horizon of the stressed coverage ratio being monitored is excluded from the stock of liquid assets and is instead reflected as a contractual cash inflow.

Our framework defines the asset classes that can be assessed locally as high quality and realisable within one month and between one month and three months. Each local ALCO has to be satisfied that any asset which may be treated as liquid in accordance with the Group s liquid asset policy will remain liquid under the stress scenario being managed to.

Inflows from the utilisation of liquid assets within one month can generally only be based on confirmed withdrawable central bank deposits or the sale or repo of government and quasi-government exposures generally restricted to those denominated in the sovereign s domestic currency. High quality ABSs (predominantly US MBSs) and covered bonds are also included but inflows assumed for these assets are capped.

Inflows after one month are also reflected for high quality non-financial and non-structured corporate bonds and equities within the most liquid indices.

Internal categorisation	Cash inflow recognised	Asset classes
Level 1		
	Within one month	Central government
		Central bank (including confirmed withdrawable reserves)
		Supranationals
		Multilateral development banks
		Coins and banknotes

Level 2	Within one month but capped	Local and regional government
		Public sector entities
		Secured covered bonds and pass-through ABSs
		Gold
Level 3	From one to three months	Unsecured non-financial entity securities
		Equities listed on recognised exchanges and within liquid indices

Any entity owned and controlled by central or local/regional government but not explicitly guaranteed is treated as a public sector entity.

Any exposure explicitly guaranteed is reflected as an exposure to the ultimate guarantor.

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In terms of the criteria used to ensure liquid assets are of a high quality, the Group s liquid asset policy sets out the following additional criteria:

1. Central bank and central government exposures denominated in the domestic currency of the related sovereign and held onshore in the domestic banking system qualify as level 1 liquid assets.

2. Central bank and central government exposures denominated in the domestic currency of the related sovereign and held offshore must be risk weighted 20% or lower under the Basel standardised risk weighting methodology to qualify as level 1 liquid assets.

3. Central bank and central government exposures denominated in a currency other than the currency of the related sovereign (i.e. foreign currency) must be risk weighted 20% or lower under the Basel standardised risk weighting methodology and issued in a limited number of major currencies to qualify as level 1 liquid assets.

   The treatment of eurozone countries using the euro as their domestic currency depends on whether the exposures are held onshore in the domestic banking system or offshore. Central bank and central government exposures held onshore in the domestic banking system qualify as level 1 liquid assets under criteria 1, but central bank and central government exposures held offshore are considered to be denominated in a foreign currency under criteria 3.

4. Local/regional government exposures held onshore and considered by the local regulator to be the same risk as central government exposures can be considered central government exposures.

5. Supranationals and multilateral development banks must be 0% risk weighted under the Basel standardised risk-weighting methodology to qualify as level 1 liquid assets.

6. To qualify as a level 2 liquid asset, the exposure must be risk weighted 20% or lower under the Basel standardised risk-weighting methodology.

7. To qualify as a level 3 liquid asset, an unsecured non-financial corporate debt exposure must satisfy a minimum internal rating requirement.

On a case-by-case basis, operating entities are permitted to treat other assets as liquid if these assets are realistically assessed to be liquid under stress. These liquid assets are reported as Other , separately from level 1, level 2 and level 3 liquid assets.

Net cash flow arising from interbank and intragroup loans and deposits

Under the LFRF, a net cash inflow within three months arising from interbank and intra-Group loans and deposits will give rise to a lower liquid asset requirement. Conversely, a net cash outflow within three months arising from interbank and intra-Group loans and deposits will give rise to a higher liquid assets requirement.

Net cash flow arising from reverse repo, repo, stock borrowing, stock lending and outright short positions (including intra-Group)

A net cash inflow represents liquid resources in addition to liquid assets because any unencumbered asset held as a consequence of a reverse repo transaction with a residual contractual maturity within the stressed coverage ratio time period is not reflected as a liquid asset.

The impact of net cash outflow depends on whether the underlying collateral encumbered as a result will qualify as a liquid asset when released at the maturity of the repo. The majority of the Group s repo transactions are collateralised by liquid assets and, as such, any net cash outflow shown is offset by the return of liquid assets, which are excluded from the liquid asset table above.

Wholesale debt monitoring

(Unaudited)

Where wholesale debt term markets are accessed to raise funding, ALCO is required to establish cumulative rolling three-month and 12-month debt maturity limits to ensure no concentration of maturities within these timeframes.

Liquidity behaviouralisation

(Unaudited)

Liquidity behaviouralisation is applied to reflect our assessment of the expected period for which we are confident that we will have access to our liabilities, even under a severe liquidity stress scenario, and the expected period for which we must assume that we will need to fund our assets. Behaviouralisation is applied when the contractual terms do not reflect the expected behaviour. Liquidity behaviouralisation is reviewed and approved by local ALCO in compliance with policies set by the Risk Management Meeting. Our approach to liquidity risk management will often mean different approaches are applied to assets and liabilities. For example, management may assume a shorter life for liabilities and a longer-term funding requirement for assets. All core deposits are assumed under the Group s core/non-core and advances to core funding frameworks to have a liquidity behaviouralised life beyond one year and to represent a homogeneous source of core funding. The behaviouralisation of assets is far more granular and seeks to differentiate the period for which we must assume that we will need to fund the asset.

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Report of the Directors: Financial Review (continued)

Funds transfer pricing

(Unaudited)

Our funds transfer pricing policies give rise to a two-stage funds transfer pricing approach, reflecting the fact that we separately manage interest rate risk and liquidity and funding risk under different assumptions. They have been developed to be consistent with our risk management frameworks. Each operating entity is required to apply the Group s transfer pricing policy framework to determine for each material currency the most appropriate interest rate risk transfer pricing curve, a liquidity premium curve (which is the spread over the interest rate risk transfer pricing curve) and a liquidity recharge assessment (which is the spread under or over the interest rate risk transfer pricing curve).

The interest rate risk transfer pricing policy seeks to ensure that all market interest rate risk arising structurally from non-trading (banking book) assets and liabilities which is capable of being neutralised externally in the market or neutralised internally by off-setting transfers, is transferred to BSM to be managed centrally as non-trading market risk. For each material currency each operating entity employs a single interest rate risk transfer pricing curve. The transfer price curve used for this purpose reflects how BSM in each operating entity is best able to neutralise the interest rate risk in the market at the point of transfer. Where basis risk can be identified between the re-pricing basis of an external asset or external liability and the re-pricing basis of the interest rate risk transfer pricing curve, this basis risk may be transferred to BSM provided it can neutralise the basis risk in the market.

Liquidity and funding risk is transfer priced independently from interest rate risk because the liquidity and funding risk of an operating entity is transferred to ALCO to be managed centrally. ALCO monitors and manages the advances to core funding ratio and delegates the management of the liquid asset portfolio and execution of the wholesale term debt funding plan to BSM. This assists ALCO in ensuring the Group s stressed coverage ratios remain above 100% out to three months.

The liquidity and funding risk transfer price consists of two components:

- Liquidity recharge: the cost of holding the benchmark liquid asset (the yield under the transfer price) to meet stressed cash outflows. The benchmark liquid asset is decided by ALCO and based on the weighted average duration that can be achieved by investing in level 1 liquid assets, with a residual duration of up to one year.

- Liquidity premium: the assessed cost/value of term funding (the yield over the transfer price) to pay for term debt and core deposits.

The assessed cost of holding liquid assets is allocated to the outflows modelled by the Group s internal stressed coverage ratio framework.

Liquidity premium is charged to any asset that affects our three-month stressed coverage ratios based on the assessed behaviouralised liquidity life of the asset, with any asset affecting the Group s advances to core funding metric required to have a minimum behaviouralised life of at least one year, and the prevailing liquidity premium curve rate set by ALCO and calibrated in line with Group s calibration principles. Core deposits therefore share equally in the liquidity premiums charged to the assets they support, after deducting the cost of any term funding.

Repos and stock lending

GB&M provides collateralised security financing services to its clients, providing them with cash financing or specific securities. When cash is provided to clients against collateral in the form of securities, the cash provided is recognised on the balance sheet as a reverse repo. When securities are provided to clients against cash collateral the cash received is recognised on the balance sheet as a repo or, if the securities are equity securities, as stock lending.

Each operating entity manages its collateral through a central collateral pool, in line with the LFRF. When specific securities need to be delivered and the entity does not have them currently available within the central collateral pool, the securities are borrowed on a collateralised basis. When securities are borrowed against cash collateral the cash provided is recognised on the balance sheet as a reverse repo or, if the securities are equity securities, as stock borrowing.

Operating entities may also borrow cash against collateral in the form of securities, using the securities available in the central collateral pool. Repos and stock lending can be used in this way to fund the cash requirement arising from securities owned outright by Markets to facilitate client business, and the net cash requirement arising from financing client securities activity.

Reverse repos, stock borrowing, repos and stock lending are reported net when the IFRSs offsetting criteria are met. In some cases transactions to borrow or lend securities are collateralised using securities. These transactions are off-balance sheet.

Any security accepted as collateral for a reverse repo or stock borrowing transaction must be of very high quality and its value subject to an appropriate haircut. Securities borrowed under reverse repo or stock borrowing transactions can only be recognised as part of the liquidity asset buffer for the duration of the transactions and only if the security received is eligible under the liquid asset policy within the LFRF.

Credit controls are in place to ensure that the fair value of any collateral received remains appropriate to collateralise the cash or fair value of securities given.

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The effect of active collateral management

Collateral is managed on an operating entity basis, consistent with the approach adopted in managing liquidity and funding. Available collateral held by each operating entity is managed as a single collateral pool. In deciding which collateral to pledge, each operating entity seeks to optimise the use of the available collateral pool within the confines of the LFRF, irrespective of whether the collateral pledged is recognised on-balance sheet or was received in respect of reverse repo, stock borrowing or derivative transactions.

Managing collateral in this manner affects the presentation of asset encumbrance in that we may encumber on-balance sheet holdings while maintaining available unencumbered off-balance sheet holdings, even though we are not seeking to directly finance the on-balance sheet holdings pledged.

In quantifying the level of encumbrance of negotiable securities, the encumbrance is analysed by individual security. When a particular security is encumbered and we hold the security both on-balance sheet and off-balance sheet with the right to repledge, we assume for the purpose of this disclosure that the off-balance sheet holding received from the third party is encumbered ahead of the on-balance sheet holding.

An on-balance sheet encumbered and off-balance sheet unencumbered asset will occur, for example, if we receive a specific security as a result of a reverse repo/stock borrowing transaction, but finance the cash lent by pledging a generic collateral basket, even if the security received is eligible for the collateral basket pledged. It will also occur if we receive a generic collateral basket as a result of a reverse repo transaction but finance the cash lent by pledging specific securities, even if the securities pledged are eligible for the collateral basket.

Encumbered and unencumbered assets

Definitions of the categories included in the table Analysis of on-balance sheet encumbered and unencumbered assets :

Encumbered assets are assets on our balance sheet which have been pledged as collateral against an existing liability, and as a result are assets which are unavailable to the bank to secure funding, satisfy collateral needs or be sold to reduce potential future funding requirements.

Unencumbered readily realisable assets are assets regarded by the bank to be readily realisable in the normal course of business to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements, and are not subject to any restrictions on their use for these purposes.

Unencumbered other realisable assets are assets where there are no restrictions on their use to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements, but they are not readily realisable in the normal course of business in their current form.

Unencumbered reverse repo/stock borrowing receivables and derivative assets are assets related specifically to reverse repo, stock borrowing and derivative transactions. They are shown separately as these on-balance sheet assets cannot be pledged but often give rise to the receipt of non-cash assets which are not recognised on the balance sheet, and can additionally be used to raise secured funding, meet additional collateral requirements or be sold.

Unencumbered cannot be pledged as collateral are assets that have not been pledged and which we have assessed could not be pledged and therefore could not be used to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements. An example is assets held by the Group s insurance subsidiaries that back liabilities to policyholders and support the solvency of these entities.

Historically, the Group has not recognised any contingent liquidity value for assets other than those assets defined under the LFRF as being liquid assets, and any other negotiable instruments that under stress are assumed to be realisable after three months, even though they may currently be realisable. This approach has generally been driven by our risk appetite not to place any reliance on central banks. In a few cases, we have recognised the contingent value of discrete pools of assets, but the amounts involved are insignificant. As a result, we have reported the majority of our loans and advances to customers and banks in the category Other realisable assets as management would need to perform additional actions in order to make the assets transferable and readily realisable.

Additional information

The amount of assets pledged to secure liabilities reported in Note 19 on the Financial Statements may be greater than the book value of assets reported as being encumbered in the table on page 172. Examples of where such differences occur are:

ABSs and covered bonds, where the amount of liabilities issued plus the required mandatory over-collateralisation is lower than the book value of assets pledged to the pool. Any difference is categorised in the table above as Unencumbered readily realisable assets ;

negotiable securities held by custodians or settlement agents, where a floating charge has been given over the entire holding to secure intra-day settlement liabilities, are only reported as encumbered to the extent that we have a liability to the custodian or settlement agent at the reporting date, with the balance reported as Unencumbered readily realisable assets ; and assets pre-positioned with central banks or government agencies are only reported as encumbered to the extent that we have secured funding with the collateral. The unutilised pre-positioned collateral is reported as Unencumbered readily realisable assets .

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Securities reflected on the balance sheet that are pledged as collateral against an existing liability or lent are reflected as encumbered for the duration of the transaction. When securities are received as collateral or borrowed, and when we have the right to sell or re-pledge these securities, they are reflected as available and unencumbered for the duration of the transaction, unless re-pledged or sold. Further analysis regarding the encumbrance of securities resulting from repos and stock lending and available unencumbered assets arising from reverse repos and stock borrowing is provided under the heading Encumbered and unencumbered assets on page 171.

In the normal course of business we do not seek to utilise repo financing as a source of funding to finance customer assets, beyond the collateralised security financing activities within Markets described above.

The original contractual maturity of reverse repo, stock borrowing, repo and stock lending is short term with the vast majority of transactions being for less than 90 days.

Management of cross-currency liquidity and funding risk

(Unaudited)

Our liquidity and funding risk framework also considers the ability of each entity to continue to access foreign exchange markets under stress when a surplus in one currency is used to meet a deficit in another currency, for example, by the use of the foreign currency swap markets. Where appropriate, operating entities are required to monitor stressed coverage ratios and advances to core funding ratios for non-local currencies.

HSBC Holdings

(Audited)

HSBC Holdings primary sources of cash are dividends received from subsidiaries, interest on and repayment of intra-group loans and interest earned on its own liquid funds. HSBC Holdings also raises ancillary funds in the debt capital markets through subordinated and senior debt issuance. Cash is primarily used for the provision of capital to subsidiaries, interest payments to debt holders and dividend payments to shareholders.

HSBC Holdings is also subject to contingent liquidity risk by virtue of loan and other credit-related commitments and guarantees and similar contracts issued. Such commitments and guarantees are only issued after due consideration of HSBC Holdings ability to finance the commitments and guarantees and the likelihood of the need arising.

HSBC Holdings actively manages the cash flows from its subsidiaries to optimise the amount of cash held at the holding company level. The ability of subsidiaries to pay dividends or advance monies to HSBC Holdings depends on, among other things, their respective local regulatory capital and banking requirements, statutory reserves, and financial and operating performance. During 2014 and 2013, none of the Group s subsidiaries experienced significant restrictions on paying dividends or repaying loans and advances. Also, there are no foreseen restrictions envisaged by our subsidiaries on paying dividends or repaying loans and advances. None of the subsidiaries which are excluded from our regulatory consolidation has capital resources below its minimum regulatory requirement.

Market risk

Market risk is the risk that movements in market factors, including foreign exchange rates and commodity prices, interest rates, credit spreads and equity prices, will reduce our income or the value of our portfolios.

Market risk exposures (including graphs and tables) are provided under Market Risk on page 175.

Exposure to market risk

(Unaudited)

Exposure to market risk is separated into two portfolios:

Trading portfolios comprise positions arising from market-making and the warehousing of customer-derived positions.

Non-trading portfolios comprise positions that primarily arise from the interest rate management of our retail and commercial banking assets and liabilities, financial investments designated as available for sale and held to maturity, and exposures arising from our insurance operations.

Where appropriate, we apply similar risk management policies and measurement techniques to both trading and non-trading portfolios. Our objective is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with our status as one of the world s largest banking and financial services organisations.

The nature of the hedging and risk mitigation strategies performed across the Group corresponds to the market risk management instruments available within each operating jurisdiction. These strategies range from the use of traditional market instruments, such as interest rate swaps, to more sophisticated hedging strategies to address a combination of risk factors arising at portfolio level.

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Overview of market risk in global businesses

(Unaudited)

The diagram below illustrates the main business areas where trading and non-trading market risks reside and market risk measures to monitor and limit exposures.

1 The interest rate risk on the fixed-rate securities issued by HSBC Holdings is not included in the Group VaR. The management of this risk is described on page 181.

Market risk governance

(Audited)

Market risk is managed and controlled through limits approved by the Risk Management Meeting of the GMB for HSBC Holdings and our various global businesses. These limits are allocated across business lines and to the Group s legal entities.

The management of market risk is principally undertaken in Global Markets, where 77% of the total value at risk of HSBC (excluding insurance) and almost all trading VaR resides, using risk limits approved by the GMB. VaR limits are set for portfolios, products and risk types, with market liquidity being a primary factor in determining the level of limits set.

Group Risk, an independent unit within Group Head Office, is responsible for our market risk management policies and measurement techniques. Each major operating entity has an independent market risk management and control function which is responsible for measuring market risk exposures in accordance with the policies defined by Group Risk, and monitoring and reporting these exposures against the prescribed limits on a daily basis. The market risk limits are governed according to the framework illustrated to the left.

Each operating entity is required to assess the market risks arising on each product in its business and to transfer them to either its local Markets unit for management, or to separate books managed under the supervision of the local ALCO.

Our aim is to ensure that all market risks are consolidated within operations that have the necessary skills, tools, management and governance to manage them. In certain cases where the market risks cannot be fully transferred, we identify the impact of varying scenarios on valuations or on net interest income resulting from any residual risk positions. Further details on the control and management process for residual risks are provided on page 224.

Model risk is governed through Model Oversight Committees (MOC s) at the regional and global Wholesale Credit and Market Risk levels. They have direct oversight and approval responsibility for all traded risk models utilised for risk measurement and management and stress testing. The MOCs prioritise the development of models, methodologies and practices used for traded risk management within the Group and ensure that they remain within our risk appetite and business plans. The Markets MOC reports into the Group MOC, which oversees all model risk types at Group level. Group MOC informs the Group Risk Management Meeting about material issues at least on a bi-annual basis. The Risk Management Meeting is the Group s Designated Committee according to regulatory rules and has delegated day-to-day governance of all traded risk models to the Markets MOC.

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Our control of market risk in the trading and non-trading portfolios is based on a policy of restricting individual operations to trading within a list of permissible instruments authorised for each site by Group Risk, of enforcing new product approval procedures, and of restricting trading in the more complex derivative products only to offices with appropriate levels of product expertise and robust control systems.

Market risk measures

(Audited)

Monitoring and limiting market risk exposures

Our objective is to manage and control market risk exposures while maintaining a market profile consistent with our risk appetite.

We use a range of tools to monitor and limit market risk exposures including sensitivity analysis, value at risk and stress testing.

Sensitivity analysis

(Unaudited)

Sensitivity analysis measures the impact of individual market factor movements on specific instruments or portfolios, including interest rates, foreign exchange rates and equity prices, such as the effect of a one basis point change in yield. We use sensitivity measures to monitor the market risk positions within each risk type. Sensitivity limits are set for portfolios, products and risk types, with the depth of the market being one of the principal factors in determining the level of limits set.

Value at risk

(Audited)

Value at risk (VaR) is a technique that estimates the potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The use of VaR is integrated into market risk management and is calculated for all trading positions regardless of how we capitalise those exposures. Where there is not an approved internal model, we use the appropriate local rules to capitalise exposures.

In addition, we calculate VaR for non-trading portfolios in order to have a complete picture of risk. Our models are predominantly based on historical simulation. VaR is calculated at a 99% confidence level for a one-day holding period. Where we do not calculate VaR explicitly, we use alternative tools as summarised in the Market Risk Stress Testing table found in the Stress testing section below.

Our VaR models derive plausible future scenarios from past series of recorded market rates and prices, taking into account inter-relationships between different markets and rates such as interest rates and foreign exchange rates. The models also incorporate the effect of option features on the underlying exposures.

The historical simulation models used incorporate the following features:

- historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
- potential market movements utilised for VaR are calculated with reference to data from the past two years; and
- VaR measures are calculated to a 99% confidence level and use a one-day holding period.

The nature of the VaR models means that an increase in observed market volatility will lead to an increase in VaR without any changes in the underlying positions.

We are committed to the ongoing development of our in-house risk models.

VaR model limitations

Although a valuable guide to risk, VaR should always be viewed in the context of its limitations. For example:

- the use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- the use of a holding period assumes that all positions can be liquidated or the risks offset during that period. This may not fully reflect the market risk arising at times of severe illiquidity, when the holding period may be insufficient to liquidate or hedge all positions fully;
- the use of a 99% confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- VaR is unlikely to reflect loss potential on exposures that only arise under conditions of significant market movement.

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Risk not in VaR framework

(Unaudited)

Our VaR model is designed to capture significant basis risks such as credit default swap versus bond, asset swap spreads and cross-currency basis. Other basis risks which are not completely covered in VaR, such as the Libor tenor basis, are complemented by our risk not in VaR (RNIV) calculations, and are integrated into our capital framework.

The RNIV framework therefore aims to capture and capitalise material market risks that are not adequately covered in the VaR model. An example of this is Libor-overnight index swap basis risk for minor currencies. In such instances the RNIV framework uses stress tests to quantify the capital requirement. On average in 2014, the capital requirement derived from these stress tests represented 2.6% of the total internal model-based market risk requirement.

Risks covered by RNIV represent 18% of market risk RWAs for models with regulatory approval and include those resulting from underlying risk factors which are not observable on a daily basis across asset classes and products, such as dividend risk and correlation risks.

Risk factors are reviewed on a regular basis and either incorporated directly in the VaR models, where possible, or quantified through the VaR-based RNIV approach or a stress test approach within the RNIV framework. The severity of the scenarios is calibrated to be in line with the capital adequacy requirements. The outcome of the VaR-based RNIV is included in the VaR calculation and back-testing; a stressed VaR RNIV is also computed for the risk factors considered in the VaR-based RNIV approach.

In 2014, we modified our RNIV model on a non-diversified basis across risk factors to comply with new PRA CRD IV implementation guidelines.

Level 3 assets

The fair values of Level 3 assets and liabilities in trading portfolios are disclosed on page 380, and represent only a small proportion of the overall trading portfolio. Market risk arising from Level 3 instruments is managed by various market risk techniques such as stress testing and notional limits. The table on page 384 shows the movement in Level 3 financial instruments.

Back-testing

We routinely validate the accuracy of our VaR models by back-testing them against both clean and hypothetical profit and loss against the corresponding VaR numbers. Hypothetical profit and loss excludes non-modelled items such as fees, commissions and revenues of intra-day transactions.

We would expect on average to see two or three profits and two or three losses in excess of VaR at the 99% confidence level over a one-year period. The actual number of profits or losses in excess of VaR over this period can therefore be used to gauge how well the models are performing. To ensure a conservative approach to calculating our risk exposures, it is important to note that profits in excess of VaR are only considered when back-testing the accuracy of our models and are not used to calculate the VaR numbers used for risk management or capital purposes.

We back-test our Group VaR at various levels which reflect a full legal entity scope of HSBC, including entities that do not have local permission to use VaR for regulatory purposes.

Stress testing

(Unaudited)

Stress testing is an important tool that is integrated into our market risk management tool to evaluate the potential impact on portfolio values of more extreme, although plausible, events or movements in a set of financial variables. In such abnormal scenarios, losses can be much greater than those predicted by VaR modelling.

Stress testing is implemented at legal entity, regional and overall Group levels. A standard set of scenarios is utilised consistently across all regions within the Group. Scenarios are tailored to capture the relevant events or market movements at each level. The risk appetite around potential stress losses for the Group is set and monitored against referral limits.

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Market risk reverse stress tests are undertaken on the premise that there is a fixed loss. The stress test process identifies which scenarios lead to this loss. The rationale behind the reverse stress test is to understand scenarios which are beyond normal business settings that could have contagion and systemic implications.

Stressed VaR and stress testing, together with reverse stress testing and the management of gap risk, provide management with insights regarding the tail risk beyond VaR for which HSBC s appetite is limited.

Trading portfolios

(Audited)

Gap risk

Certain products are structured in such a way that they give rise to enhanced gap risk, being the risk that loss is incurred upon occurrence of a gap event. A gap event is a significant and sudden change in market price with no accompanying trading opportunity. Such movements may occur, for example, when, in reaction to an adverse event or unexpected news announcement, some parts of the market move far beyond their normal volatility range and become temporarily illiquid. In 2014 gap risk principally arose from non-recourse loan transactions, mostly for corporate clients, where the collateral against the loan is limited to the posted shares. Upon occurrence of a gap event, the value of the equity collateral could fall below the outstanding loan amount.

Given their characteristics, these transactions make little or no contribution to VaR nor to traditional market risk sensitivity measures. We capture their risks within our stress testing scenarios and monitor gap risk on an ongoing basis. We did not incur any notable gap loss in 2014.

De-peg risk

For certain currencies (pegged or managed) the spot exchange rate is pegged at a fixed rate (typically to USD or EUR), or managed within a predefined band around a pegged rate. De-peg risk is the risk of the peg or managed band changing or being abolished, and moving to a floating regime.

HSBC has a lot of experience in managing fixed and managed currency regimes. Using stressed scenarios on spot rates, we are able to analyse how de-peg events would impact the positions held by HSBC. We monitor such scenarios to pegged or managed currencies, such as the Hong Kong dollar, renminbi, Middle Eastern currencies and the Swiss franc with appreciation capped against the euro during 2014, and limit any potential losses that would occur. This complements traditional market risk metrics, such as historical VaR, which may not fully capture the risk involved in holding positions in pegged or managed currencies. Historical VaR relies on past events to determine the likelihood of potential profits or losses. However, pegged or managed currencies may not have experienced a de-peg event during the historical timeframe being considered.

ABS/MBS exposures

The ABS/MBS exposures within the trading portfolios are managed within sensitivity and VaR limits as described on page 176, and are included within the stress testing scenarios described above.

Non-trading portfolios

(Audited)

Most of the Group s non-trading VaR relates to Balance Sheet Management (BSM) or local treasury management functions. Contributions to Group non-trading VaR are driven by interest rates and credit spread risks arising from all global businesses. There is no commodity market risk in the non-trading portfolios.

Non-trading VaR also includes the interest rate risk of non-trading financial instruments held by the global businesses and transferred into portfolios managed by BSM or local treasury functions. In measuring, monitoring and managing risk in our non-trading portfolios, VaR is just one of the tools used. The management of interest rate risk in the banking book is described further in Non-trading interest rate risk below, including the role of BSM.

Non-trading VaR excludes equity risk on available-for-sale securities, structural foreign exchange risk, and interest rate risk on fixed rate securities issued by HSBC Holdings, the scope and management of which are described in the relevant sections below.

Our control of market risk in the non-trading portfolios is based on transferring the assessed market risk of non-trading assets and liabilities created outside BSM or Markets, to the books managed by BSM, provided the market risk can be neutralised. The net exposure is typically managed by BSM through the use of fixed rate government bonds (liquid assets held in available-for-sale books) and interest rate swaps. The interest rate risk arising from fixed rate government bonds held within available-for-sale portfolios is reflected within the Group s non-traded VaR. Interest rate swaps used by BSM are typically classified as either a fair value hedge or a cash flow hedge and are included within the Group s non-traded VaR. Any market risk that cannot be neutralised in the market is managed by local ALCO in segregated ALCO books.

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Credit spread risk for available-for-sale debt instruments

The risk associated with movements in credit spreads is primarily managed through sensitivity limits, stress testing and VaR. The VaR shows the effect on income from a one-day movement in credit spreads over a two-year period, calculated to a 99% confidence interval.

Equity securities classified as available for sale

Potential new commitments are subject to risk appraisal to ensure that industry and geographical concentrations remain within acceptable levels for the portfolio. Regular reviews are performed to substantiate the valuation of the investments within the portfolio and investments held to facilitate ongoing business, such as holdings in government-sponsored enterprises and local stock exchanges.

Structural foreign exchange exposures

(Unaudited)

Structural foreign exchange exposures represent net investments in subsidiaries, branches and associates, the functional currencies of which are currencies other than the US dollar. An entity s functional currency is that of the primary economic environment in which the entity operates.

Exchange differences on structural exposures are recognised in Other comprehensive income . We use the US dollar as our presentation currency in our consolidated financial statements because the US dollar and currencies linked to it form the major currency bloc in which we transact and fund our business. Our consolidated balance sheet is, therefore, affected by exchange differences between the US dollar and all the non-US dollar functional currencies of underlying subsidiaries.

We hedge structural foreign exchange exposures only in limited circumstances. Our structural foreign exchange exposures are managed with the primary objective of ensuring, where practical, that our consolidated capital ratios and the capital ratios of individual banking subsidiaries are largely protected from the effect of changes in exchange rates. This is usually achieved by ensuring that, for each subsidiary bank, the ratio of structural exposures in a given currency to risk-weighted assets denominated in that currency is broadly equal to the capital ratio of the subsidiary in question.

We may also transact hedges where a currency in which we have structural exposures is considered likely to revalue adversely, and it is possible in practice to transact a hedge. Any hedging is undertaken using forward foreign exchange contracts which are accounted for under IFRSs as hedges of a net investment in a foreign operation, or by financing with borrowings in the same currencies as the functional currencies involved.

Non-trading interest rate risk

(Unaudited)

Non-trading interest rate risk in non-trading portfolios arises principally from mismatches between the future yield on assets and their funding cost, as a result of interest rate changes. Analysis of this risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments, and from behavioural assumptions regarding the economic duration of liabilities which are contractually repayable on demand such as current accounts, and the re-pricing behaviour of managed rate products. These assumptions around behavioural features are captured in our interest rate risk behaviouralisation framework, which is described below.

We aim, through our management of market risk in non-trading portfolios, to mitigate the effect of prospective interest rate movements which could reduce future net interest income, while balancing the cost of such hedging activities on the current net revenue stream.

Analysis of interest rate risk is complicated by having to make assumptions on embedded optionality within certain product areas such as the incidence of mortgage prepayments.

Our funds transfer pricing policies give rise to a two stage funds transfer pricing approach. For details see page 219.

Interest rate risk behaviouralisation

Unlike liquidity risk, which is assessed on the basis of a very severe stress scenario, non-trading interest rate risk is assessed and managed according to business-as-usual conditions. In many cases the contractual profile of non-trading assets/liabilities arising from assets/liabilities created outside Markets or BSM does not reflect the behaviour observed.

Behaviouralisation is therefore used to assess the market interest rate risk of non-trading assets/liabilities and this assessed market risk is transferred to BSM, in accordance with the rules governing the transfer of interest rate risk from the global businesses to BSM.

Behaviouralisation is applied in three key areas:

- the assessed re-pricing frequency of managed rate balances;
- the assessed duration of non-interest bearing balances, typically capital and current accounts; and
- the base case expected prepayment behaviour or pipeline take-up rate for fixed rate balances with embedded optionality.

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Interest rate behaviouralisation policies have to be formulated in line with the Group s behaviouralisation policies and approved at least annually by local ALCO, regional ALCM and Group ALCM, in conjunction with local, regional and Group market risk monitoring teams.

The extent to which balances can be behaviouralised is driven by:

- the amount of the current balance that can be assessed as stable under business-as-usual conditions; and
- for managed rate balances, the historic market interest rate re-pricing behaviour observed; or
- for non-interest bearing balances, the duration for which the balance is expected to remain under business-as-usual conditions. This assessment is often driven by the re-investment tenors available to BSM to neutralise the risk through the use of fixed rate government bonds or interest rate derivatives, and for derivatives the availability of cash flow hedging capacity.

Balance Sheet Management

Effective governance across BSM is supported by the dual reporting lines it has to the CEO of GB&M and to the Group Treasurer. In each operating entity, BSM is responsible for managing liquidity and funding under the supervision of the local ALCO (which usually meets on a monthly basis). It also manages the non-trading interest rate positions transferred to it within a Global Markets limit structure.

In executing the management of the liquidity risk on behalf of ALCO, and managing the non-trading interest rate positions transferred to it, BSM invests in highly-rated liquid assets in line with the Group s liquid asset policy. The majority of the liquidity is invested in central bank deposits and government, supranational and agency securities with most of the remainder held in short-term interbank and central bank loans.

Withdrawable central bank deposits are accounted for as cash balances. Interbank loans, statutory central bank reserves and loans to central banks are accounted for as loans and advances to banks. BSM s holdings of securities are accounted for as available-for-sale or, to a lesser extent, held-to-maturity assets.

Statutory central bank reserves are not recognised as liquid assets. The statutory reserves that would be released in line with the Group s stressed customer deposit outflow assumptions are reflected as stressed inflows.

BSM is permitted to use derivatives as part of its mandate to manage interest rate risk. Derivative activity is predominantly through the use of vanilla interest rate swaps which are part of cash flow hedging and fair value hedging relationships.

Credit risk in BSM is predominantly limited to short-term bank exposure created by interbank lending, exposure to central banks and high quality sovereigns, supranationals or agencies which constitute the majority of BSM s liquidity portfolio. BSM does not manage the structural credit risk of any Group entity balance sheets.

BSM is permitted to enter into single name and index credit derivatives activity, but it does so to manage credit risk on the exposure specific to its securities portfolio in limited circumstances only. The risk limits are extremely limited and closely monitored. At 31 December 2014 and 31 December 2013, BSM had no open credit derivative index risk.

VaR is calculated on both trading and non-trading positions held in BSM. It is calculated by applying the same methodology used for the Markets business and utilised as a tool for market risk control purposes.

BSM holds trading portfolio instruments in only very limited circumstances. Positions and the associated VaR were not significant during 2014 and 2013.

Sensitivity of net interest income

(Unaudited)

A principal part of our management of market risk in non-trading portfolios is to monitor the sensitivity of projected net interest income under varying interest rate scenarios (simulation modelling). This monitoring is undertaken at an entity level by local ALCOs.

Entities apply a combination of scenarios and assumptions relevant to their local businesses, and standard scenarios which are required throughout HSBC. The latter are consolidated to illustrate the combined pro forma effect on our consolidated net interest income.

Projected net interest income sensitivity figures represent the effect of the pro forma movements in net interest income based on the projected yield curve scenarios and the Group s current interest rate risk profile. This effect, however, does not incorporate actions which would probably be taken by BSM or in the business units to mitigate the effect of interest rate risk. In reality, BSM seeks proactively to change the interest rate risk profile to minimise losses and optimise net revenues. The net interest income sensitivity calculations assume that interest rates of all maturities move by the same amount in the up-shock scenario. Rates are not assumed to become negative in the down-shock scenario which may, in certain currencies, effectively result in non-parallel shock. In addition, the net interest income sensitivity calculations take account of the effect on net interest income of anticipated differences in changes between interbank interest rates and interest rates over which the entity has discretion in terms of the timing and extent of rate changes.

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Defined benefit pension schemes

(Audited)

Market risk arises within our defined benefit pension schemes to the extent that the obligations of the schemes are not fully matched by assets with determinable cash flows. Pension scheme obligations fluctuate with changes in long-term interest rates, inflation, salary levels and the longevity of scheme members. Pension scheme assets include equities and debt securities, the cash flows of which change as equity prices and interest rates (and credit risk) vary. There is a risk that market movements in equity prices and interest rates could result in asset values which, taken together with regular ongoing contributions, are insufficient over time to cover the level of projected obligations and these, in turn, could increase with a rise in inflation and members living longer. Management and, in certain instances, trustees (who act on behalf of the pension schemes beneficiaries) assess these risks using reports prepared by independent external consultants, take action and, where appropriate, adjust investment strategies and contribution levels accordingly.

HSBC Holdings

(Audited)

As a financial services holding company, HSBC Holdings has limited market risk activity. Its activities predominantly involve maintaining sufficient capital resources to support the Group s diverse activities; allocating these capital resources across our businesses; earning dividend and interest income on its investments in our businesses; providing dividend payments to HSBC Holdings equity shareholders and interest payments to providers of debt capital; and maintaining a supply of short-term capital resources for deployment under extraordinary circumstances. It does not take proprietary trading positions.

The main market risks to which HSBC Holdings is exposed are non-trading interest rate risk and foreign currency risk. Exposure to these risks arises from short-term cash balances, funding positions held, loans to subsidiaries, investments in long-term financial assets and financial liabilities including debt capital issued. The objective of HSBC Holdings market risk management strategy is to reduce exposure to these risks and minimise volatility in capital resources, cash flows and distributable reserves. Market risk for HSBC Holdings is monitored by HSBC Holdings ALCO in accordance with its risk appetite statement.

HSBC Holdings uses interest rate swaps and cross currency interest rate swaps to manage the interest rate risk and foreign currency risk arising from its long-term debt issues.

Operational risk

(Unaudited)

The objective of our operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with our risk appetite, as defined by the GMB.

Operational risk is organised as a specific risk discipline within Global Risk, and a formal governance structure provides oversight over its management. The Global Operational Risk function reports to the Group Chief Risk Officer and supports the Global Operational Risk Committee. It is responsible for establishing and maintaining the operational risk management framework (ORMF) and monitoring the level of operational losses and the effectiveness of the control environment. It is also responsible for operational risk reporting at Group level, including the preparation of reports for consideration by the Risk Management Meeting and Group Risk Committee. The Global Operational Risk Committee meets at least quarterly to discuss key risk issues and review the effective implementation of the ORMF.

The ORMF defines minimum standards and processes and the governance structure for the management of operational risk and internal control in our geographical regions, global businesses and global functions. The ORMF has been codified in a high level standards manual supplemented with detailed policies which describes our approach to identifying, assessing, monitoring and controlling operational risk and gives guidance on mitigating action to be taken when weaknesses are identified.

Business managers throughout the Group are responsible for maintaining an acceptable level of internal control commensurate with the scale and nature of operations, and for identifying and assessing risks, designing controls and monitoring the effectiveness of these controls. The ORMF helps managers to fulfil these responsibilities by defining a standard risk assessment methodology and providing a tool for the systematic reporting of operational loss data.

A centralised database is used to record the results of the operational risk management process. Operational risk and control self-assessments are input and maintained by business units. Business and functional management and Business Risk and Control Managers monitor the progress of documented action plans to address shortcomings. To ensure that operational risk losses are consistently reported and monitored at Group level, all Group companies are required to report individual losses when the net loss is expected to exceed US$10,000, and to aggregate all other operational risk losses under US$10,000. Losses are entered into the Group Operational Risk database and are reported to the Risk Management Meeting on a monthly basis.

For further details, see the *Pillar 3 Disclosures 2014* report.

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Compliance risk

(Unaudited)

Compliance risk falls within the definition of operational risk. All Group companies are required to observe the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice. These rules, regulations, standards and Group policies include those relating to anti-money laundering, anti-bribery and corruption, counter-terrorist and proliferation financing, sanctions compliance, conduct of business, market conduct and other financial regulations.

The two Compliance sub-functions: Financial Crime Compliance (FCC) and Regulatory Compliance (RC), are appropriately supported by shared Compliance Chief Operating Officer, Assurance and Reputational Risk Management teams. The Global Head of Financial Crime Compliance and the Global Head of Regulatory Compliance both report to the Group Chief Risk Officer.

There are compliance teams in each of the countries where we operate and in all global businesses. These compliance teams are principally overseen by Heads of Financial Crime Compliance and Regulatory Compliance located in Europe, the US, Canada, Latin America, Asia and the Middle East and North Africa. The effectiveness of the regional and global business compliance teams are reviewed by the Assurance team.

Global policies and procedures require the prompt identification and escalation to Financial Crime Compliance or Regulatory Compliance of all actual or suspected breaches of any law, rule, regulation, policy or other relevant requirement. These escalation procedures are supplemented by a requirement for the submission of compliance certificates at the half-year and year-end by all Group companies and functions detailing any known breaches as above. The contents of these escalation and certification processes are reported to the Risk Management Meeting, the Group Risk Committee and the Board. They are disclosed in the *Annual Report and Accounts* and *Interim Report*, as appropriate.

Our focus on compliance and conduct issues is further reinforced by 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. In addition, the Conduct & Values Committee reports to the Board on matters relating to the responsible conduct of business and adherence to HSBC s Values.

In 2014, the new enhanced global AML and sanctions policies and a globally consistent approach to the management of conduct were approved by the Board as described in Compliance risk on page 189.

Legal risk

(Unaudited)

Each legal department is required to have processes and procedures in place to manage legal risk that conform to Group standards.

Legal risk falls within the definition of operational risk and includes:

- contractual risk, which is the risk of a member of HSBC suffering financial loss, legal or regulatory action or reputational damage because its rights and/or obligations under a contract to which it is a party are technically defective;

- dispute risk, which is the risk of a member of HSBC suffering financial loss or reputational damage due to an adverse dispute environment or a failure to take appropriate steps to defend, prosecute and/or resolve actual or threatened legal claims brought against or by a Group member;

- legislative risk, which is the risk that an HSBC company fails to adhere to the laws of the jurisdictions in which it operates; and

- non-contractual rights risk, which is the risk that a Group member s assets are not properly owned or protected or are infringed by others or the infringement by a Group member of another party s rights.

Our global legal function assists management in controlling legal risk. There are legal departments in 49 of the countries in which we operate. In addition to the Group Legal function, there are regional legal functions in each of Europe, North America, Latin America, the Middle East and North Africa and Asia headed by regional General Counsels, and a global General Counsel responsible for each of the global businesses.

Global security and fraud risk

(Unaudited)

Security and fraud risk issues are managed at Group level by Global Security and Fraud Risk. This unit, which has responsibility for information, fraud, contingency, financial intelligence, physical and geopolitical risks is fully integrated within the central Group Risk function. This enables management to identify and mitigate the permutations of these and other non-financial risks to its business lines across the jurisdictions in which we operate.

The Information Security Risk function is responsible for defining the strategy and policy by which the organisation protects its information assets and services from compromise, corruption or loss, whether caused deliberately or inadvertently by internal or external parties. It provides independent advice, guidance and oversight to the business about the effectiveness of information security controls and practices in place or being proposed.

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The Fraud Risk function is responsible for ensuring that effective prevention, detection and investigation measures are in place against all forms of fraudulent activity, whether initiated internally or externally, and is available to support any part of the business. To achieve that and to attain the level of integration needed to face the threat, the management of all types of fraud (e.g. card fraud, non-card fraud and internal fraud, including investigations) is established within one management structure and is part of the Global Risk function.

We use technology extensively to prevent and detect fraud. For example, customers credit and debit card spending is monitored continuously and suspicious transactions are highlighted for verification, internet banking sessions are reviewed and transactions monitored in a similar way and all new account applications are screened for fraud. We have a fraud systems strategy which is designed to provide minimum standards and allow easier sharing of best practices to detect fraud and minimise false alerts.

We have developed a holistic and effective anti-fraud strategy which, in addition to the use of advanced technology, includes fraud prevention policies and practices, the implementation of strong internal controls, investigations response teams and liaison with law enforcement where appropriate.

The Contingency Risk function is responsible for ensuring that the group s critical systems, processes and functions have the resilience to maintain continuity in the face of major disruptive events.

Within this wider risk, Business Continuity Management covers the pre-planning for recovery, seeking to minimise the adverse effects of major business disruption, either globally, regionally or within country, against a range of actual or emerging risks. The pre-planning concentrates on the protection of customer services, our staff, revenue generation, the integrity of data and documents and meeting regulatory requirements.

Each business has its own recovery plan, which is developed following the completion of a Business Impact Analysis. This determines how much time the business could sustain an outage before the level of losses becomes unacceptable, i.e. its criticality. These plans are reviewed and tested every year. The planning is undertaken against Group policy and standards and each business confirms in an annual compliance certificate that all have been met. Should there be exceptions, these are raised and their short-term resolution is overseen by Group and regional business continuity teams.

It is important that plans are dynamic and meet all risks, particularly those of an emerging nature such as possible pandemics and cyber-attacks. The ORMF is used to measure our resilience to these risks, and is confirmed to Group and regional risk committees.

Resilience is managed through various risk mitigation measures. These include agreeing with IT acceptable recovery times of systems, ensuring our critical buildings have the correct infrastructure to enable ongoing operations, requiring critical vendors to have their own recovery plans and arranging with Group Insurance appropriate cover for business interruption costs.

The Financial Intelligence Unit is jointly administered by Security and Fraud Risk and Financial Crime Compliance. It uses advanced analytics and subject matter expertise to detect indicators of financial crime in the Group s clients and counter-parties.

The Physical Security function develops practical physical, electronic and operational counter-measures to ensure that the people, property and assets managed by the Group are protected from crime, theft, attack and groups hostile to HSBC s interests.

Geopolitical risk unit provides both regular and ad hoc reporting to business executives and senior Security and Fraud Risk management on geopolitical risk profiles and evolving threats in countries in which the Group operates. This both enhances strategic business planning and provides an early view into developing security risks. Security travel controls and guidance are also maintained.

Systems risk

(Unaudited)

Systems risk is the risk of failure or other deficiency in the automated platforms that support the Group s daily execution (application systems) and the systems infrastructure on which they reside (data centres, networks and distributed computers).

The management of systems risk is overseen globally by the HSBC Technology and Services (HTS) organisation. Oversight is provided through monthly risk management committee meetings that provide a comprehensive overview of existing and emerging top risks.

HTS line management manages the control environment over systems risks using risk and control assessments and scenario analysis. Key risk indicators are used to assure a consistent basis of risk evaluation across geographical and line of business boundaries. Material risks are monitored through the periodic testing of associated key controls.

Business-critical services have been identified through a central, global oversight body. Quantitative scorecards, called risk appetite statements, are used for monitoring performance, and have been established for each of these services.

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Service Resilience and Systems Continuity Planning functions are in place to ensure systems meet agreed target service levels and, in the event of major disruptive events, can be recovered within recovery time objectives agreed with the business.

Vendor risk management

(Unaudited)

Our vendor risk management (VRM) programme is a global framework for managing risk with third party vendors, especially where we are reliant on outsourced agreements to provide critical services to our customers. VRM contains a rigorous process to identify material contracts and their key risks and ensure controls are in place to manage and mitigate these risks. Global and regional governance structures have been implemented to oversee vendor third party service providers.

Risk management of insurance operations

Overview of insurance products

(Audited)

HSBC manufactures the following main classes of contract:

- life insurance contracts with discretionary participation features (DPF);
- credit life insurance business;
- annuities;
- term assurance and critical illness policies;

linked life insurance;

investment contracts with DPF;

unit-linked investment contracts; and

other investment contracts (including pension contracts written in Hong Kong).

We additionally write a small amount of non-life insurance business primarily covering personal and commercial property.

Nature and extent of risks

(Audited)

The majority of the risks in our Insurance business derive from manufacturing activities and can be categorised between financial risks and insurance risk; financial risks include market risk, credit risk and liquidity risk. Operational and sustainability risks are also present and are covered by the Group s respective overall risk management processes.

The following sections describe how financial risks and insurance risk are managed. The assets of insurance manufacturing subsidiaries are included within the consolidated risk disclosures on pages 111 to 203, although separate disclosures in respect of insurance manufacturing subsidiaries are provided in the Risk management of insurance operations section on pages 190 to 198.

Insurance manufacturers establish control procedures complying with the guidelines and requirements issued by Group Insurance and local regulatory requirements. Country level oversight is exercised by local risk management committees. Country Chief Risk Officers have direct reporting lines into local Insurance Chief Executive Officers and functional reporting lines into the Group Insurance Chief Risk Officer, who has overall accountability for risk management in insurance operations globally. The Group Insurance Executive Committee oversees the control framework globally and is accountable to the RBWM Risk Management Committee on risk matters.

In addition, local ALCOs monitor and review the duration and cash flow matching of insurance assets and liabilities.

All insurance products, whether manufactured internally or by a third party, are subjected to a product approval process prior to introduction.

Financial risks

(Audited)

Our insurance businesses are exposed to a range of financial risks, including market risk, credit risk and liquidity risk. Market risk includes interest rate, equity and foreign exchange risks. The nature and management of these risks is described below.

Manufacturing subsidiaries are exposed to financial risks when, for example, the proceeds from financial assets are not sufficient to fund the obligations arising from insurance and investment contracts. In many jurisdictions, local regulatory requirements prescribe the type, quality and concentration of assets that these subsidiaries must maintain to meet insurance liabilities. These requirements complement Group-wide policies.

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Market risk

(Audited)

Description of market risk

The main features of products manufactured by our insurance manufacturing subsidiaries which generate market risk, and the market risk to which these features expose the subsidiaries, are discussed below.

Interest rate risk arises to the extent that yields on the assets are lower than the investment returns implied by the guarantees payable to policyholders by insurance manufacturing subsidiaries. When the asset yields are below guaranteed yields, products may be closed to new business, repriced or restructured. A list of the different types of guarantees within our insurance contracts is outlined below.

Categories of guaranteed benefits

- annuities in payment;
- deferred/immediate annuities: these consist of two phases the savings and investing phase and the retirement income phase;
- annual return: the annual return is guaranteed to be no lower than a specified rate. This may be the return credited to the policyholder every year, or the average annual return credited to the policyholder over the life of the policy, which may occur on the maturity date or the surrender date of the contract; and
- capital: policyholders are guaranteed to receive no less than the premiums paid plus declared bonuses less expenses.

The proceeds from insurance and investment products with DPF are primarily invested in bonds with a proportion allocated to other asset classes in order to provide customers with the potential for enhanced returns. Subsidiaries with portfolios of such products are exposed to the risk of falls in market prices which cannot be fully reflected in the discretionary bonuses. An increase in market volatility could also result in an increase in the value of the guarantee to the policyholder.

Long-term insurance and investment products typically permit the policyholder to surrender the policy or let it lapse at any time. When the surrender value is not linked to the value realised from the sale of the associated supporting assets, the subsidiary is exposed to market risk. In particular, when customers seek to surrender their policies when asset values are falling, assets may have to be sold at a loss to fund redemptions.

A subsidiary holding a portfolio of long-term insurance and investment products, especially with DPF, may attempt to reduce exposure to its local market by investing in assets in countries other than that in which it is based. These assets may be denominated in currencies other than the subsidiary s local currency. Where the foreign exchange exposure associated with these assets is not hedged, for example because it is not cost effective to do so, this exposes the subsidiary to the risk of its local currency strengthening against the currency of the related assets.

For unit-linked contracts, market risk is substantially borne by the policyholder, but market risk exposure typically remains as fees earned for management are related to the market value of the linked assets.

Asset and liability matching

It is not always possible to match asset and liability durations, partly because there is uncertainty over policyholder behaviour which introduces uncertainty over the receipt of all future premiums and the timing of claims, and partly because the forecast payment dates of liabilities may exceed the duration of the longest dated investments available.

We use models to assess the effect of a range of future scenarios on the values of financial assets and associated liabilities, and ALCOs employ the outcomes in determining how to best structure asset holdings to support liabilities. The scenarios include stresses applied to factors which affect insurance risk such as mortality and lapse rates. Of particular importance is assessing the expected pattern of cash inflows against the benefits payable on the underlying contracts, which can extend for many years.

Our current portfolio of assets includes debt securities issued at a time when yields were higher than those observed in the current market. As a result, yields on extant holdings of debt securities exceed those available on current issues. We reduced short-term bonus rates paid to policyholders on certain participating contracts to manage the immediate strain on the business. Should interest rates and yield curves remain low further reductions may be necessary.

How market risk is managed

All our insurance manufacturing subsidiaries have market risk mandates which specify the investment instruments in which they are permitted to invest and the maximum quantum of market risk which they may retain. They manage market risk by using some or all of the techniques listed below, depending on the nature of the contracts they write.

Techniques for managing market risk

for products with DPF, adjusting bonus rates to manage the liabilities to policyholders. The effect is that a significant portion of the market risk is borne by the policyholder;

structuring asset portfolios to support projected liability cash flows;

using derivatives, to a limited extent, to protect against adverse market movements or better match liability cash flows;

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for new products with investment guarantees, considering the cost when determining the level of premiums or the price structure;

periodically reviewing products identified as higher risk, which contain investment guarantees and embedded optionality features linked to savings and investment products;

including features designed to mitigate market risk in new products, such as charging surrender penalties to recoup losses incurred when policyholders surrender their policies;

exiting, to the extent possible, investment portfolios whose risk is considered unacceptable; and

repricing of premiums charged to policyholders.

In the product approval process, the risks embedded in new products are identified and assessed. When, for example, options and guarantees are embedded in new products, the due diligence process ensures that complete and appropriate risk management procedures are in place. For all but the simplest of guaranteed benefits the assessment is undertaken by Group Insurance. Management reviews certain exposures more frequently when markets are more volatile to ensure that any matters arising are dealt with in a timely fashion.

How the exposure to market risk is measured

Our insurance manufacturing subsidiaries monitor exposures against mandated limits regularly and report them to Group Insurance. Exposures are aggregated and reported on a quarterly basis to senior risk management forums in Group Insurance.

In addition, large insurance manufacturing subsidiaries perform a high-level monthly assessment of market risk exposure against risk appetite. This is submitted to Group Insurance and a global assessment presented to the RBWM Risk Management Committee.

Standard measures for quantifying market risks

- for interest rate risk, the sensitivities of the net present values of asset and expected liability cash flows, in total and by currency, to a one basis point parallel shift in the discount curves used to calculate the net present values;

- for equity price risk, the total market value of equity holdings and the market value of equity holdings by region and country; and

- for foreign exchange risk, the total net short foreign exchange position and the net foreign exchange positions by currency.

The standard measures are relatively straightforward to calculate and aggregate, but they have limitations. The most significant one is that a parallel shift in yield curves of one basis point does not capture the non-linear relationships between the values of certain assets and liabilities and interest rates. Non-linearity arises, for example, from investment guarantees and product features which enable policyholders to surrender their policies. We bear the shortfall if the yields on investments held to support contracts with guaranteed benefits are less than the investment returns implied by the guaranteed benefits.

We recognise these limitations and augment our standard measures with stress tests which examine the effect of a range of market rate scenarios on the aggregate annual profits and total equity of our insurance manufacturing subsidiaries, after taking into consideration tax and accounting treatments where material and relevant. The results of these tests are reported to Group Insurance and risk committees every quarter.

The table, Sensitivity of HSBC s insurance manufacturing subsidiaries to market risk factors on page 195, indicates the sensitivity of insurance manufacturers profit and total equity to market risk factors.

Credit risk

(Audited)

Description of credit risk

Credit risk arises in two main areas for our insurance manufacturers:

(i) risk of default by debt security counterparties after investing premiums to generate a return for policyholders and shareholders; and

(ii) risk of default by reinsurance counterparties and non-reimbursement for claims made after ceding insurance risk.

How credit risk is managed

Our insurance manufacturing subsidiaries are responsible for the credit risk, quality and performance of their investment portfolios. Our assessment of the creditworthiness of issuers and counterparties is based primarily upon internationally recognised credit ratings and other publicly available information.

Investment credit exposures are monitored against limits by our local insurance manufacturing subsidiaries, and are aggregated and reported to Group Insurance Credit Risk and Group Credit Risk. Stress testing is performed by Group Insurance on the investment credit exposures using credit spread sensitivities and default probabilities.

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We use a number of tools to manage and monitor credit risk. These include a Credit Watch Report which contains a watch-list of investments with current credit concerns and is circulated fortnightly to senior management in Group Insurance and the individual Country Chief Risk Officers to identify investments which may be at risk of future impairment.

Liquidity risk

(Audited)

Description of liquidity risk

It is an inherent characteristic of almost all insurance contracts that there is uncertainty over the amount of claims liabilities that may arise and the timing of their settlement, and this creates liquidity risk.

There are three aspects to liquidity risk. The first arises in normal market conditions and is referred to as funding liquidity risk; specifically, the capacity to raise sufficient cash when needed to meet payment obligations. Secondly, market liquidity risk arises when the size of a particular holding may be so large that a sale cannot be completed around the market price. Finally, standby liquidity risk refers to the capacity to meet payment terms in abnormal conditions.

How liquidity risk is managed

Our insurance manufacturing subsidiaries primarily fund cash outflows arising from claim liabilities from the following sources of cash inflows:

- premiums from new business, policy renewals and recurring premium products;
- interest and dividends on investments and principal repayments of maturing debt investments;
- cash resources; and
- the sale of investments.

They manage liquidity risk by utilising some or all of the following techniques:

matching cash inflows with expected cash outflows using specific cash flow projections or more general asset and liability matching techniques such as duration matching;

maintaining sufficient cash resources;

investing in good credit-quality investments with deep and liquid markets to the degree to which they exist;

monitoring investment concentrations and restricting them where appropriate, for example, by debt issues or issuers; and

establishing committed contingency borrowing facilities.

Each of these techniques contributes to mitigating the three types of liquidity risk described above.

Every quarter, our insurance manufacturing subsidiaries are required to complete and submit liquidity risk reports to Group Insurance for collation and review. Liquidity risk is assessed in these reports by measuring changes in expected cumulative net cash flows under a series of stress scenarios designed to determine the effect of reducing expected available liquidity and accelerating cash outflows. This is achieved, for example, by assuming new business or renewals are lower, and surrenders or lapses are greater, than expected.

Insurance risk

(Audited)

Insurance risk is the risk, other than financial risk, of loss transferred from the holder of the insurance contract to the issuer (HSBC). The principal risk we face in manufacturing insurance contracts is that, over time, the cost of acquiring and administering a contract, claims and benefits may exceed the aggregate amount of premiums received and investment income.

The cost of claims and benefits can be influenced by many factors, including mortality and morbidity experience, lapse and surrender rates and, if the policy has a savings element, the performance of the assets held to support the liabilities.

Insurance risks are controlled by high-level policies and procedures set both centrally and locally, taking into account where appropriate local market conditions and regulatory requirements. Formal underwriting, reinsurance and claims-handling procedures designed to ensure compliance with regulations are applied, supplemented with stress testing.

As well as exercising underwriting controls, we use reinsurance as a means of mitigating exposure to insurance risk. Where we manage our exposure to insurance risk through the use of third-party reinsurers, the associated revenue and manufacturing profit is ceded to the reinsurers. Although reinsurance provides a means of managing insurance risk, such contracts expose us to credit risk, the risk of default by the reinsurer.

The principal drivers of our insurance risk are described below. The liabilities for long-term contracts are set by reference to a range of assumptions around these drivers. These typically reflect the issuers own experiences. The type and quantum of insurance risk arising from life insurance depends on the type of business, and varies considerably.

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mortality and morbidity: the main contracts which generate exposure to these risks are term assurance, whole life products, critical illness and income protection contracts and annuities. The risks are monitored on a regular basis, and are primarily mitigated by underwriting controls and reinsurance and by retaining the ability in certain cases to amend premiums in the light of experience;

lapses and surrenders: the risks associated with this are generally mitigated by product design, the application of surrender charges and management actions, for example, managing the level of bonus payments to policyholders. A detailed persistency analysis at a product level is carried out at least on an annual basis; and

expense risk is mitigated by pricing, for example, retaining the ability in certain cases to amend premiums and/or policyholder charges based on experience, and cost management discipline.

Liabilities are affected by changes in assumptions (see Sensitivity analysis on page 198).

Reputational risk

(Unaudited)

We regularly review our policies and procedures for safeguarding against reputational risk. This is an evolutionary process which takes account of relevant developments, industry guidance, best practice and societal expectations.

We have always aspired to the highest standards of conduct and, as a matter of routine, take account of reputational risks to our business. Reputational risks can arise from a wide variety of causes. As a banking group, our good reputation depends not only upon the way in which we conduct our business, but also by the way in which clients to whom we provide financial services, and our vendors, conduct themselves.

The Global Head of Financial Crime Compliance and the Global Head of Regulatory Compliance are the risk stewards for reputational risk. The development of policies, and an effective control environment for the identification, assessment, management and mitigation of reputational risk, is co-ordinated through the Group Reputational Risk Policy Committee (GRRPC), which is chaired by the Group Chairman. The primary role of the GRRPC is to consider areas and activities presenting significant reputational risk and, where appropriate, to make recommendations to the Group Risk Management Meeting for policy or procedural changes to mitigate such risk. Each of the Group s geographical regions is required to ensure that reputational risks are also considered at a regional level, either through a special section of their respective Regional Risk Management Committee meetings, or a Regional Reputational Risk Policy Committee. A summary of the minutes from the regional meetings is tabled at GRRPC. Significant issues posing reputational risk are reported to Group Risk Committee and the Holdings Board and, where appropriate, to the Conduct & Values Committee.

In July 2014, the new Reputational Risk and Customer Selection policies were issued which define a consistent and structured approach to managing these risks. For further details, see Reputational risk on page 199. Each of the global businesses and functions is required to have a procedure to assess and address reputational risks potentially arising from proposed business transactions and client activity. These are supported by a central team which ensures that issues are directed to the appropriate forum, that decisions taken are implemented and that management information is collated and actions reported to senior management. In 2014, the combined Reputational Risk and Client Selection committees were created within the global businesses with a clear process to escalate and address matters at the appropriate level. The global functions manage and escalate reputational risks within established operational risk frameworks.

Standards on all major aspects of business are set for HSBC and for individual subsidiaries, businesses and functions. Reputational risks, including environmental, social and governance matters, are considered and assessed by the Board, the GMB, the Risk Management Meeting, the Global Standards Steering Meeting, subsidiary company boards, Board committees and senior management during the formulation of policy and the establishment of our standards. These policies, which form an integral part of the internal control system (see page 288), are communicated through manuals and statements of policy and are promulgated through internal communications and training. The policies set out our risk appetite and operational procedures in all areas of reputational risk, including money laundering deterrence, counter-terrorist financing, environmental impact, anti-bribery and corruption measures and employee relations. The policy manuals address risk issues in detail and co-operation between Group departments and businesses is required to ensure a strong adherence to our risk management system and our sustainability practices.

Fiduciary risk

(Unaudited)

Business activities in which fiduciary risk is inherent are only permitted within designated lines of business. Fiduciary risk is managed within the designated businesses via a comprehensive policy framework and monitoring of key indicators. The Group s principal fiduciary businesses and activities (designated businesses and activities) are:

- HSBC Securities Services, which is exposed to fiduciary risk via its Funds Services and Corporate Trust and loan agency activities;

- HSBC Global Asset Management, which is exposed to fiduciary risks via its investment management activities on behalf of clients;

- HSBC Global Private Banking, which is exposed to fiduciary risks via its private trust division and discretionary investment management;

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HSBC Insurance, which is exposed to fiduciary risks via the investment management activities it undertakes when providing insurance products and services;

RBWM Trust Investment Wrappers, required by regulation for the provision of normal RBWM Wealth Management products and services; and

HSBC Employee Pension Scheme activities, where fiduciary duties may arise as part of carrying out a function of discretion or control over an HSBC employee pension scheme s operations.

The Group s requirements for the management of fiduciary risk are laid down in the fiduciary section of the Global Risk Functional Instruction Manual, which is owned by Global Operational Risk. No business other than the designated businesses may undertake fiduciary activities without notifying Global Operational Risk and receiving specific dispensations from the relevant fiduciary policy requirements.

Other policies around the provision of advice, including investment advice and corporate advisory, and the management of potential conflicts of interest, also mitigate our fiduciary risks.

Pension risk

(Audited)

We operate a number of pension plans throughout the world, as described in the Pension risk section on page 200 and below.

In order to fund the benefits associated with defined benefit plans, sponsoring Group companies (and, in some instances, employees) make regular contributions in accordance with advice from actuaries and in consultation with the scheme s trustees (where relevant). The defined benefit plans invest these contributions in a range of investments designed to meet their long-term liabilities.

The level of these contributions has a direct impact on HSBC s cash flow and would normally be set to ensure that there are sufficient funds to meet the cost of the accruing benefits for the future service of active members. However, higher contributions will be required when plan assets are considered insufficient to cover the existing pension liabilities. Contribution rates are typically revised annually or triennially, depending on the plan. The agreed contributions to the principal plan are revised triennially.

A deficit in a defined benefit plan may arise from a number of factors, including:

- investments delivering a return below that required to provide the projected plan benefits. This could arise, for example, when there is a fall in the market value of equities, or when increases in long-term interest rates cause a fall in the value of fixed income securities held;

- the prevailing economic environment leading to corporate failures, thus triggering write-downs in asset values (both equity and debt);

- a change in either interest rates or inflation which causes an increase in the value of the scheme liabilities; and

- scheme members living longer than expected (known as longevity risk).

A plan s investment strategy is determined after taking into consideration the market risk inherent in the investments and its consequential impact on potential future contributions. The long-term investment objectives of both HSBC and, where relevant and appropriate, the trustees are:

- to limit the risk of the assets failing to meet the liabilities of the plans over the long-term; and
- to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of the defined benefit plans.

In pursuit of these long-term objectives, a benchmark is established for the allocation of the defined benefit plan assets between asset classes. In addition, each permitted asset class has its own benchmarks, such as stock market or property valuation indices and, where relevant, desired levels of out-performance. The benchmarks are reviewed at least triennially within 18 months of the date at which an actuarial valuation is made, or more frequently if required by local legislation or circumstances. The process generally involves an extensive asset and liability review.

Ultimate responsibility for investment strategy rests with either the trustees or, in certain circumstances, a management committee. The degree of independence of the trustees from HSBC varies in different jurisdictions.

Defined contribution plans result in far less exposure to market risk for the bank, but remain exposed to operational and reputational risks as they place the responsibility and flexibility more directly with employees. To manage these risks, the performance of defined contribution investment funds are monitored and local engagement with employees is actively promoted to ensure they are provided with sufficient information about the options available to them.

Pension plans in the UK

The HSBC Bank (UK) Pension Scheme (the principal plan) has both defined benefit and defined contribution sections. The defined benefit section accounts for approximately 72% of our total defined benefit obligations around the world. The defined benefit section was closed to new entrants in 1996 and from 1 July 2015 it will be closed to further accrual for

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current employees who are in that section, who will join the defined contribution section for future pensions. All new employees have joined the defined contribution section since 1996. The principal plan is overseen by an independent corporate trustee who has a fiduciary responsibility for the operation of the pension plan. The trustee is responsible for monitoring and managing the investment strategy and administration of scheme benefits. The principal plan holds a diversified portfolio of investments to meet future cash flow liabilities arising from accrued benefits as they fall due to be paid. The trustee of the principal plan is required to produce a written Statement of Investment Principles which governs decision-making about how investments are made and the need for adequate diversification is taken into account in the choice of asset allocation and manager structure in the defined benefit section. Longevity risk in the principal plan is assessed as part of the measurement of the pension liability and managed through the funding process of the plan.

Sustainability risk

(Unaudited)

Sustainability risks arise from the provision of financial services to companies or projects which run counter to the needs of sustainable development; in effect, this risk arises when the environmental and social effects outweigh economic benefits. Within Group Head Office, a separate function, Global Corporate Sustainability, is mandated to manage these risks globally working through local offices as appropriate. Sustainability Risk Managers have regional or national responsibilities for advising on and managing environmental and social risks. Global Corporate Sustainability s risk management responsibilities include:

- formulating sustainability risk policies. This includes overseeing our sustainability risk standards, our application of the Equator Principles and our sustainability policies (covering agricultural commodities, chemicals, defence, energy, forestry, freshwater infrastructure, mining and metals, and World Heritage Sites and Ramsar Wetlands); undertaking an independent review of transactions where sustainability risks are assessed to be high; and supporting our operating companies to assess similar risks of a lower magnitude;

- building and implementing systems-based processes to ensure consistent application of policies, reduce the costs of sustainability risk reviews and capture management information to measure and report on the effect of our lending and investment activities on sustainable development; and

- providing training and capacity building within our operating companies to ensure sustainability risks are identified and mitigated consistently to either our own standards, international standards or local regulations, whichever is higher.

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1 *Appendix to Capital.*

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Our objective in the management of Group capital is to maintain appropriate levels of capital to support our business strategy and meet our regulatory and stress testing related requirements.

Capital highlights

The transitional CET1 ratio of 10.9% was up from 10.8% at the end of 2013 as a result of continued capital generation and management initiatives offset by RWA growth, foreign exchange movements and regulatory changes.

The end point CET1 ratio of 11.1% was up from 10.9% at the end of 2013 as a result of similar drivers.

Capital overview

(Unaudited)

Capital ratios

(Unaudited)

	At 31 December	
	2014	2013
	%	%
CRD IV transitional		
Common equity tier 1 ratio	**10.9**	10.8
Tier 1 ratio	**12.5**	12.0
Total capital ratio	**15.6**	14.9
CRD IV end point		
Common equity tier 1 ratio	**11.1**	10.9
Basel 2.5		
Core tier 1 ratio	**n/a**	13.6
Tier 1 ratio	**n/a**	14.5
Total capital ratio	**n/a**	17.8

Total regulatory capital and risk-weighted assets

(Unaudited)

	CRD IV transitional at 31 Dec 2014 US$m	CRD IV transitional estimated at 31 Dec 2013 US$m	Basel 2.5 at 31 Dec 2013 US$m
Common equity tier 1 capital	**133,200**	131,233	
Core tier 1 capital			149,051
Additional tier 1 capital	**19,539**	14,408	9,104
Tier 2 capital	**37,991**	35,538	35,854
Total regulatory capital	**190,730**	181,179	194,009
Risk-weighted assets	**1,219,765**	1,214,939	1,092,653

On 1 January 2014, CRD IV came into force and capital and RWAs at 31 December 2014 are calculated and presented on the Group s interpretation of final CRD IV legislation and final rules issued by the PRA. Prior to 1 January 2014, RWAs and capital were calculated and presented in accordance with the previous regime under CRD III, also referred to as Basel 2.5 . As a result, unless otherwise stated, comparatives for capital and RWAs at 31 December 2013 are on a Basel 2.5 basis.

The capital and RWAs on a CRD IV basis incorporate the effect of the PRA s final rules as set out in the PRA Rulebook. This transposed various areas of national discretion within the final CRD IV legislation into UK law. In its final rules, the PRA did not adopt most of the CRD IV transitional provisions available, instead opting for an acceleration of the CRD IV end point definition of common equity tier 1 (CET1) capital. However, CRD IV

transitional provisions for unrealised gains were applied, such that unrealised gains on investment property and available-for-sale securities are not recognised for capital until 1 January 2015. As a result, our transitional capital ratio in 2014 is slightly lower than the comparable end point capital ratio.

In April 2014, the PRA published its rules and supervisory statements implementing some of the CRD IV provisions relating to capital buffers, further details of which are provided in the Regulatory capital buffers section on page 252.

In June 2014, the PRA published its revised expectations in relation to capital ratios for major UK banks and building societies, namely that from 1 July 2014 we are expected to meet a 7% CET1 ratio using the CRD IV end point definition. This applies alongside CRD IV requirements.

Despite the rules published to date, there remains continued uncertainty around the amount of capital that UK banks will be required to hold. This relates specifically to the quantification and interaction of capital buffers and Pillar 2. The PRA is currently consulting on their revised approach to Pillar 2, the PRA buffer and its interaction with the CRD IV buffers. Furthermore, there are a significant number of draft and unpublished EBA technical and implementation standards due in 2015.

Our approach to managing Group capital is designed to ensure that we exceed current regulatory requirements and that we respect the payment priority of our capital providers. Throughout 2014, we complied with the PRA s regulatory capital adequacy requirements, including those relating to stress testing. We are also well placed to meet our expected future capital requirements.

During 2014, we managed our capital position to meet an internal target CET1 ratio on an end point basis of greater than 10%. This has since been reviewed, and in 2015 we expect to manage Group capital to meet a medium-term target for return on equity of more than 10%. This is modelled on a CET1 ratio on an end point basis in the range of 12% to 13%.

A summary of our policies and practices regarding capital management, measurement and allocation is provided in the Appendix to Capital on page 257.

Risk-weighted assets

(Unaudited)

CRD IV contributed to an increased capital requirement. The key changes introduced were:

- securitisation positions which were previously deducted 50% from core tier 1 and 50% from total capital, are now included in RWAs at 1,250%;

- an additional capital charge to cover the risk of mark-to-market losses on expected counterparty risk referred to as credit valuation adjustment (CVA) risk;

- deferred tax assets and significant investments, subject to thresholds, are now risk weighted at 250%;

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increased risk weights on exposures to financial institutions, referred to as asset value correlation (AVC); and

new requirements for exposures to central counterparties (CCP). There are enhanced incentives for clearing OTC derivative transactions through CCP.

RWAs by risk type

(Unaudited)

	CRD IV transitional and end point		Basel 2.5 basis
	2014	2013	2013
	US$bn	US$bn	US$bn
Credit risk	**955.3**	936.5	864.3
Standardised approach	**356.9**	358.6	329.5
IRB foundation approach	**16.8**	13.5	13.6
IRB advanced approach	**581.6**	564.4	521.2
Counterparty credit risk	**90.7**	95.8	45.8
Standardised approach	**25.2**	36.6	3.6
Advanced approach	**65.5**	59.2	42.2
Market risk	**56.0**	63.4	63.4
Operational risk	**117.8**	119.2	119.2
At 31 December	**1,219.8**	1,214.9	1,092.7
Of which:			
US run-off portfolios	**99.2**	142.3	104.9
Legacy credit in GB&M	**44.1**	63.7	26.4
US CML and Other	**55.1**	78.6	78.5
Card and Retail Services[1]		1.1	1.1

For footnotes, see page 256.

RWAs by global businesses

(Unaudited)

	CRD IV	Basel 2.5

	transitional and end point 2014 US$bn	basis 2013 US$bn
Retail Banking and Wealth Management	**205.1**	233.5
Commercial Banking	**432.4**	391.7
Global Banking and Markets	**516.1**	422.3
Global Private Banking	**20.8**	21.7
Other	**45.4**	23.5
At 31 December	**1,219.8**	1,092.7

RWAs by geographical regions[2]

(Unaudited)

	CRD IV transitional and end point 2014 US$bn	Basel 2.5 basis 2013 US$bn
Europe	**375.4**	300.1
Asia	**499.8**	430.7
Middle East and North Africa	**63.0**	62.5
North America	**221.4**	223.8
Latin America	**88.8**	89.5
At 31 December	**1,219.8**	1,092.7

For footnote, see page 256.

Credit risk RWAs

(Unaudited)

Credit risk exposure *RWAs by geographical region*

	Europe US$bn	Asia[3] US$bn	MENA US$bn	North America US$bn	Latin America US$bn	Total US$bn
CRD IV basis						
IRB approach	**216.1**	**213.1**	**15.6**	**142.0**	**11.6**	**598.4**

IRB advanced approach	**203.3**	**213.1**	**11.6**	**142.0**	**11.6**	**581.6**
IRB foundation approach	**12.8**		**4.0**			**16.8**
Standardised approach	**47.1**	**186.0**	**39.0**	**29.6**	**55.2**	**356.9**
RWAs at 31 December 2014	**263.2**	**399.1**	**54.6**	**171.6**	**66.8**	