HSBC HOLDINGS PLC
Form 20-F
March 15, 2010

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As filed with the Securities and Exchange Commission on March 15, 2010.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20-F

o **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, 2009

Or

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

Or

o **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: 1-14930
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)

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London E14 5HQ
United Kingdom
(Address of principal executive offices)
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(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, each representing one-fortieth of a Share of 6.20% Non-Cumulative Dollar Preference Shares, Series A	New York Stock Exchange
5.25% Subordinated Notes 2012	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
8.125% Perpetual Subordinated Capital Securities Exchangeable at the Issuer s Option into Non-Cumulative Dollar Preference Shares	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 period covered by the annual report:

Ordinary Shares, nominal value US$0.50 each 17,408,206,768

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

þ Yes o 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.

o 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 o 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 o Non-accelerated filer o
(Do not check if a smaller reporting company)

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

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

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.

o Item 17 o 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).

o 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 2009

Headquartered in London, HSBC is one of the largest banking and financial services organisations in the world. Its international network comprises some 8,000 properties in 88 countries and territories in Europe; Hong Kong; Rest of Asia-Pacific; the Middle East; North America and Latin America.

With listings on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares in HSBC Holdings plc are held by over 220,000 shareholders in 121 countries and territories. The shares are traded on the New York Stock Exchange in the form of American Depositary Shares.

HSBC provides a comprehensive range of financial services to more than 100 million customers through four customer groups and global businesses: Personal Financial Services (including consumer finance); Commercial Banking; Global Banking and Markets; and Private Banking.

Certain defined terms

Unless the context requires otherwise, HSBC Holdings means HSBC Holdings plc and HSBC or the Group means HSBC Holdings together with its subsidiaries. Within this document the Hong Kong Special Administrative Region of the People s Republic of China is referred to as Hong Kong . When used in the terms shareholders equity and total shareholders equity , shareholders means holders of HSBC Holdings ordinary shares and those preference shares classified as equity.

HSBC HOLDINGS PLC
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1 *Detailed contents are provided on the referenced pages.*

HSBC HOLDINGS PLC

Financial Highlights

Highlights / Ratios

For the year

Total operating income down by 11 per cent to US$78,631 million (2008: US$88,571 million).

Net operating income before loan impairment charges and other credit risk provisions down by 19 per cent to US$66,181 million (2008: US$81,682 million).

Underlying group pre-tax profit up by US$15,308 million to US$13,286 million.

Group pre-tax profit down by 24 per cent to US$7,079 million (2008: US$9,307 million).

Profit attributable to shareholders of the parent company up by 2 per cent to US$5,834 million (2008: US$5,728).

Return on average shareholders equity of 5.1 per cent (2008: 4.7 per cent).

Earnings per ordinary share down by 17 per cent to US$0.34 (2008: US$0.41).

At the year-end

Total equity up by 35 per cent to US$135,661 million (2008: US$100,229 million).

Loans and advances to customers down by 4 per cent to US$896,231 million (2008: US$932,868 million).

Customer accounts up by 4 per cent to US$1,159 billion (2008: US$1,115 billion).

Ratio of customer advances to customer accounts 77.3 per cent (2008: 83.6 per cent).

Risk-weighted assets down by 1 per cent to US$1,133 billion (2008: US$1,148 billion).

Dividends and capital position

Total dividends declared in respect of 2009 of US$0.34 per ordinary share, a decrease of 47 per cent on dividends for 2008; fourth interim dividend for 2009 of US$0.10 per ordinary share, no change from 2008.

Core tier 1 ratio of 9.4 per cent and tier 1 ratio of 10.8 per cent.

Rights issue

In April 2009, HSBC Holdings raised £12.5 billion (US$17.8 billion), net of expenses, by way of a fully underwritten rights issue, offering its shareholders 5 new ordinary shares for every 12 ordinary shares at a price of 254 pence per new ordinary share.

Dividends per ordinary share[1]
(US dollars)

Earnings per ordinary share
(US dollars)

For footnotes, see page 5.

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Capital and performance ratios

	2009	2008
	%	%
Capital ratios		
Core tier 1 ratio	**9.4**	7.0
Tier 1 ratio	**10.8**	8.3
Total capital ratio	**13.7**	11.4
Performance ratios		
Return on average invested capital[2]	**4.1**	4.0
Return on average total shareholders equity[3]	**5.1**	4.7
Post-tax return on average total assets	**0.27**	0.26
Post-tax return on average risk-weighted assets	**0.58**	0.55
Credit coverage ratios		
Loan impairment charges as a percentage of total operating income	**31.72**	27.24
Loan impairment charges as a percentage of average gross customer advances	**2.82**	2.45
Total impairment allowances outstanding as a percentage of impaired loans at the year-end	**83.2**	94.3
Efficiency and revenue mix ratios		
Cost efficiency ratio[4]	**52.0**	60.1
As a percentage of total operating income:		
net interest income	**51.8**	48.1
net fee income	**22.5**	22.6
net trading income	**12.5**	7.4
Financial ratios		
Loans and advances to customers as a percentage of customer accounts	**77.3**	83.6
Average total shareholders equity to average total assets	**4.72**	4.87

Share information at the year-end

	2009	2008
US$0.50 ordinary shares in issue (million)	**17,408**	12,105
Market capitalisation (billion)	**US$199**	US$114
Closing market price per ordinary share:[6]		
London	**£7.09**	£5.77
Hong Kong	**HK$89.40**	HK$67.81
Closing market price per American Depositary Share[7]	**US$57.09**	US$44.15

	Over 1 year	**Over 3 years**	**Over 5 years**
HSBC total shareholder return to 31 December 2009[8]	**128.3**	**103.6**	**120.6**
Benchmarks:			
FTSE 100[9]	127.3	98.0	135.4

MSCI World[10]	116.7	103.6	134.9
MSCI Banks[11]	125.2	70.6	92.3

Return on average invested capital
(per cent)

Cost efficiency ratio
(per cent)

For footnotes, see page 5.

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HSBC HOLDINGS PLC
Financial Highlights (continued)

5-year comparison / Footnotes

Five-year comparison

	2009	2008	2007	2006	2005
	US$m	US$m	US$m	US$m	US$m
For the year					
Net interest income	**40,730**	42,563	37,795	34,486	31,334
Other operating income	**37,901**	46,008	49,806	35,584	30,370
Loan impairment charges and other credit risk provisions	**(26,488)**	(24,937)	(17,242)	(10,573)	(7,801)
Total operating expenses	**(34,395)**	(49,099)	(39,042)	(33,553)	(29,514)
Profit before tax	**7,079**	9,307	24,212	22,086	20,966
Profit attributable to shareholders of the parent company	**5,834**	5,728	19,133	15,789	15,081
Dividends[1]	**5,639**	11,301	10,241	8,769	7,750
At the year-end					
Called up share capital	**8,705**	6,053	5,915	5,786	5,667
Total shareholders equity	**128,299**	93,591	128,160	108,352	92,432
Capital resources[12,13]	**155,729**	131,460	152,640	127,074	105,449
Customer accounts	**1,159,034**	1,115,327	1,096,140	896,834	739,419
Undated subordinated loan capital	**2,785**	2,843	2,922	3,219	3,474
Preferred securities and dated subordinated loan capital[14]	**52,126**	50,307	49,472	42,642	35,856
Loans and advances to customers[15]	**896,231**	932,868	981,548	868,133	740,002
Total assets	**2,364,452**	2,527,465	2,354,266	1,860,758	1,501,970

	US$	US$	US$	US$	US$
Per ordinary share					
Basic earnings[16]	**0.34**	0.41	1.44	1.22	1.18
Diluted earnings[16]	**0.34**	0.41	1.42	1.21	1.17
Dividends	**0.34**	0.93	0.87	0.76	0.69
Net asset value at year-end[17]	**7.17**	7.44	10.72	9.24	8.03
Share information					
US$0.50 ordinary shares in issue (millions)	**17,408**	12,105	11,829	11,572	11,334

	%	%	%	%	%
Financial ratios					
Dividend payout ratio[18]	**100.0**	226.8	60.4	62.3	58.5
Post-tax return on average total assets	**0.27**	0.26	0.97	1.00	1.06

Return on average total shareholders equity	**5.1**	4.7	15.9	15.7	16.8
Loans and advances to customers as a percentage of customer accounts	**77.3**	83.6	89.5	96.8	100.1
Average total shareholders equity to average total assets	**4.72**	4.87	5.69	5.97	5.96
Capital ratios[12]					
Tier 1 ratio	**10.8**	8.3	9.3	9.4	9.0
Total capital ratio	**13.7**	11.4	13.6	13.5	12.8
Foreign exchange translation rates to US$					
Closing £:US$1	**0.616**	0.686	0.498	0.509	0.581
:US$1	**0.694**	0.717	0.679	0.759	0.847
Average £:US$1	**0.641**	0.545	0.500	0.543	0.550
:US$1	**0.719**	0.684	0.731	0.797	0.805

For footnotes, see page 5.

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Consolidated 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 may differ from IFRSs as issued by the IASB if, at any point in time, new or amended IFRSs have not been endorsed by the EU.

At 31 December 2009, there were no unendorsed standards effective for the year ended 31 December 2009 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 2009 are prepared in accordance with IFRSs as issued by the IASB.

HSBC uses the US dollar as its presentation currency because the US dollar and currencies linked to it form the major currency bloc in which HSBC transacts and funds its business. Unless otherwise stated, the information presented in this document has been prepared in accordance with IFRSs.

When reference to underlying or underlying basis is made in tables or commentaries, comparative information has been expressed at constant currency (see page 21), eliminating the impact of fair value movements in respect of credit spread changes on HSBC s own debt and adjusting for the effects of acquisitions and disposals. A reconciliation of reported and underlying profit before tax is presented on page 22.

Footnotes to Financial Highlights

1 *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 2008 of US$0.18 was paid on 14 January 2009. The fourth interim dividend for 2008 of US$0.10 was paid on 6 May 2009. First, second and third interim dividends for 2009, each of US$0.08 per ordinary share, were paid on 8 July 2009, 7 October 2009 and 13 January 2010, respectively. Note 12 on the Financial Statements provides more information on the dividends*

declared in 2009. On 1 March 2010 the Directors declared a fourth interim dividend for 2009 of US$0.10 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 5 May 2010 in cash in US dollars, or in pounds sterling or Hong Kong dollars at exchange rates to be determined on 26 April 2010, with a scrip dividend alternative. The reserves available for distribution at 31 December 2009 were US$34,460 million.

Quarterly dividends of US$15.50 per 6.20 per cent non-cumulative Series A US dollar preference share, equivalent to a dividend of US$0.3875 per Series A ADS, each of which represents one-fortieth of a Series A dollar preference share, were paid on 16 March 2009, 15 June 2009, 15 September 2009 and 15 December 2009.

Quarterly coupons of 8.125 per cent capital securities of

US$0.508 were paid on 15 January 2009, 15 April 2009, 15 July 2009 and 15 October 2009.

2 *The definition of return on average invested capital and a reconciliation to the equivalent GAAP measures are set out on page 19.*

3 *The return on average total shareholders equity is defined as profit attributable to shareholders of the parent company divided by average total shareholders equity.*

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

5 *This footnote is intentionally left blank.*

6 *The prices of HSBC Holdings ordinary shares and American Depositary Shares (ADS) have been adjusted for the 5-for-12 rights issue completed in April 2009.*

7 *Each ADS represents five ordinary shares.*

8 *Total shareholder return is defined on page 19.*

9 *The Financial Times Stock Exchange 100 Index.*

10 *The Morgan Stanley Capital International World Index.*

11 *The Morgan Stanley Capital International World Bank Index*

12 *The calculation of capital resources, capital ratios and risk-weighted assets for 2009 and 2008 is on a Basel II basis. 2005 to 2007 comparatives are on a Basel I basis.*

13 *Capital resources are total regulatory capital, the calculation of which is set out on page 289.*

14 *Includes perpetual preferred securities, details of which can be found in Note 32 on the Financial Statements.*

15 *Net of impairment allowances.*

16 *The effect of the bonus element of the rights issue (Note 13 on the Financial Statements) has been included within the basic and diluted earnings per share.*

17 *The definition of net asset value per share is total shareholders equity, less non-cumulative preference shares and capital securities, divided by the number of ordinary shares in issue.*

18 *Dividends per ordinary share expressed as a percentage of earnings per ordinary share.*

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HSBC HOLDINGS PLC

Cautionary Statement Regarding Forward-Looking Statements

Cautionary statement

The *Annual Report and Accounts 2009* contains certain forward-looking statements with respect to the financial condition, results of operations and business of HSBC.

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, and it should not be assumed that they have been revised or updated in the light of new information or future events.

Written and/or oral forward-looking statements may also be made in the periodic reports to the United States 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 factors include, among others:

- changes in general economic conditions in the markets in which HSBC operates, such as:
  - continuing or deepening recessions and fluctuations in employment beyond those factored into consensus forecasts;
  - changes in foreign exchange rates, in both market exchange rates (for example, between the US dollar and pound sterling) and government-established exchange rates (for example, between the Hong Kong dollar and US dollar);
  - the timing of interest rate rises in countries which have reduced policy rates to close to zero and more general volatility in interest rates;
  - volatility in equity markets, including in the smaller and less liquid trading markets in Asia and Latin America;
  - lack of liquidity in wholesale funding markets;
  - illiquidity and downward price pressure in national real estate markets, particularly consumer-owned real estate markets;
  - the ease with which central banks which have provided liquidity support to financial markets through quantitative easing and extended liquidity schemes are able to withdraw such support and the timing of any withdrawal;
  - heightened market concerns over sovereign creditworthiness in over-indebted countries;
  - the impact of lower than expected investment returns on the funding of private and public sector defined benefit pensions;
  - the effect of unexpected changes in actuarial assumptions on longevity which would influence the funding of private and public sector defined benefit pensions; and

consumer perception as to the continuing availability of credit, and price competition in the market segments served by HSBC.

changes in government policy and regulation, including:

the monetary, interest rate and other policies of central banks and other regulatory authorities, including the UK Financial Services Authority, the Bank of England, the Hong Kong Monetary Authority, the US Federal Reserve, the US Securities and Exchange Commission, the US Office of the Comptroller of the Currency, the European Central Bank, the People s Bank of China and the central banks of other leading economies and markets where HSBC operates;

initiatives to change the size, scope of activities and interconnectedness of financial institutions following consideration of the regulatory consultations currently under way;

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 HSBC operates and the consequences thereof;

- general changes in government policy that may significantly influence investor decisions, in particular in markets in which HSBC operates, including financial institutions newly taken into state ownership on a full or partial basis;

- 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 HSBC s 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 HSBC operates including increased competition from non-bank financial services companies, including securities firms.

factors specific to HSBC:

- the success of HSBC in adequately identifying the risks it faces, 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, HSBC s ability through stress testing and other techniques to prepare for events that cannot be captured by the statistical models it uses; and

- the success of HSBC in addressing operational, legal and regulatory, and litigation challenges.

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HSBC HOLDINGS PLC
Group Chairman s Statement

Group Chairman s Statement

2009: a year of transition

In a number of important respects, 2009 was a year of transition.

It began with further turbulence in global financial markets but, during the year, the markets pulled back from uncertainty and progressively stabilised as a consequence of the continued, extraordinary and timely actions by governments and central banks.

2009 also saw the deepest contraction in the real economy in any year since the Second World War. However, it was apparent by year end that the worst was over even if confidence remained fragile and recovery would be uneven.

The global macro-economic transition from West to East gathered pace during 2009. At HSBC we have long been convinced that the world s economic centre of gravity is shifting, and the financial crisis has only accelerated this trend.

Nevertheless, huge challenges and risks remain for all of us.

While emerging markets are leading global recovery and seem certain to drive the majority of the world s growth in the generation ahead, recovery in developed markets has been slow to start, and unemployment remains high.

Furthermore, the global rebalancing of demand has barely begun. The financial crisis brought into stark relief the extent of the imbalances, especially between over-consuming Western economies and high-saving emerging markets. Rebalancing requires structural change and international co-operation, and it will take time.

There are also important lessons to learn as we seek to reform the financial system. Few of these lessons are quick or simple, but the need for urgent change is clearer than ever.

Supporting customers and delivering results throughout the cycle

Throughout the crisis, HSBC has remained profitable, financially strong and independently owned by our shareholders.

It is testimony to the quality and strength of HSBC s management team that, in 2009, our underlying performance was significantly ahead of 2008. On an underlying basis, and excluding the impact of the goodwill impairment recorded in 2008, pre-tax profit was US$13.3 billion, 56 per cent higher. On a reported basis, profit before tax was US$7.1 billion, down 24 per cent, in part due to the reversal of fair value accounting gains on our own debt.

That HSBC has reported a pre-tax profit in all three years since the onset of the crisis should be a source of great confidence to our shareholders, our depositors and all of our customers. Our track record of delivering results through adversity, and at all stages of the economic cycle, remains intact.

We continued to enhance our financial strength during 2009. We strengthened our capital base by US$10.2 billion through underlying profit generation. This comfortably covers our dividends declared, which total US$5.9 billion in respect of 2009. The directors have announced a fourth interim dividend of 10 cents per ordinary share, payable on 5 May 2010, and we remain one of the leading payers of dividends in financial services, declaring dividends in respect of the last three years of over US$24 billion in total.

The successful completion of our rights issue in April added US$17.8 billion to shareholders equity and helped to set the tenor for market recovery. Its success demonstrated the strong confidence which you, our shareholders, have in our future and we are profoundly thankful for your support.

We indicated at the time of the rights issue our expectation that, if successful, it would increase our tier 1 ratio by around 150 basis points. I am pleased to report that our tier 1 ratio increased by some 250 basis points to 10.8 per cent at 31 December 2009, largely as a result of the rights issue and internal capital generation. The core tier 1 ratio was 9.4 per cent at the same date, increasing by some 240 basis points.

Throughout the crisis, our strategy has remained clear: to build on our position as the leading

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international and emerging markets bank. We have also never forgotten that it is our responsibility to make a real contribution to economic and social development, and that our ability to do so is fundamental to our success in delivering sustainable value to our shareholders.

Meeting our commitments to the communities we serve around the world is not some optional extra or by-product of our business it is part of our *raison d être*. In Argentina, which was in the midst of the peso crisis ten years ago, we did not abandon our customers and have remained committed to the market ever since. In 2009, our operations there reported their best-ever underlying performance and resumed paying cash dividends to the Group in January 2010. In mainland China, we are proud of our position as the leading international bank, and we continued to build our strong rural presence during the year. In Indonesia, we nearly doubled our network to support the growing financial needs of personal and business banking customers, and we launched our SME fund in the United Arab Emirates in January 2010. These are just a few examples which illustrate our commitment to helping people prepare for the future, building prosperity and security for their families and communities.

Robust corporate governance and unrivalled management experience

In 2009 we announced that, as Group Chief Executive, Michael Geoghegan would take responsibility for developing strategy as part of his overall responsibilities for the performance of the Group s business. We relocated the principal office of the Group Chief Executive to Hong Kong and, on 1 February 2010, he succeeded Vincent Cheng as Chairman of The Hongkong and Shanghai Banking Corporation Limited. This underscores our commitment to our emerging markets businesses and reflects the historic shift now taking place in the global economy.

HSBC s corporate headquarters remain in the UK, where we continue to benefit from being at the heart of one of the world s pre-eminent financial centres. From this base, as Chairman, I spend an increasing amount of my time engaging with policymakers and regulators throughout the world on behalf of the Group, on the growing number of policy issues which are crucial for the banking industry in general and for HSBC in particular.

At HSBC, we have an extremely strong, diverse and engaged Board and the international experience and expertise of our management team is something which sets us apart. We are committed to delivering effective supervision and to compliance with the principles set out in the Walker Review in the UK. During 2009, we also took further steps to strengthen our top management team. Sandy Flockhart was appointed Chairman, Personal and Commercial Banking, with responsibility for Personal Financial Services, Commercial Banking and Insurance, HSBC s Latin American and African businesses, and most Group functions. Stuart Gulliver was appointed Chairman, Europe, Middle East and Global Businesses and assumed responsibility for Private Banking, adding to his responsibilities for Global Banking and Markets. Douglas Flint assumed additional responsibilities for Regulation and Compliance in an expanded role as Chief Financial Officer, Executive Director, Risk and Regulation. Peter Wong was appointed Chief Executive of The Hongkong and Shanghai Banking Corporation Limited, succeeding Sandy Flockhart.

I would like to thank Vincent Cheng for his tremendous contribution over the past five years as Chairman of The Hongkong and Shanghai Banking Corporation Limited, and look forward to continuing to work with him as a main Board member and Chairman of HSBC Bank (China) Company Limited.

I would also like to say thank you on behalf of the Board to three of our directors, José Luis Durán, William Fung and Sir Mark Moody-Stuart, who will retire by rotation at the 2010 Annual General Meeting and will not seek re-election. It has been a privilege to work with each of them and all of us on the Board are extremely grateful for their counsel and support.

Learning the lessons from the crisis

In 2009, the G20 set out its clear belief that sustainable globalisation and rising prosperity will require an open world economy based on market principles, effective regulation, and strong global institutions. At HSBC, we agree that these principles are critical for the common good. It is vital that the industry should engage constructively in the debate about how this should work in practice and HSBC is participating fully in these discussions. In our view, the overall objective must be to deliver three effective market mechanisms.

Competitive product provision is fundamental to economic and social development. In the recent past, attempts to drive ever greater profits from the same source resulted in distorted products, lack of transparency and over-complexity. The industry needs to learn the lessons from this and deliver a market which provides financial services that are competitive, transparent and responsive to genuine customer needs.

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HSBC HOLDINGS PLC
Group Chairman s Statement (continued)

Group Chairman s Statement

The market for capital has also suffered from clear distortions in recent years. There has been too great an emphasis on short-term gains, often accompanied by shareholder pressure to increase leverage in order to boost returns, and a dangerous underpricing of risk. This resulted in unsustainable returns, which in some cases proved to be illusory. Banks must be appropriately capitalised, sufficiently liquid and not overstretched, and getting this right will be crucial in delivering the sustainable financial system we need for the future.

Partly because of these problems in other areas of the marketplace, the third area requiring urgent reform is the market for talent. There is understandable public anger in some countries as a result of the practices at certain banks and, in particular, because of the egregious reward of management failure. We have witnessed unacceptable distortions from rewards linked to unsustainable or illusory day-one revenues which encouraged excessive risk-taking; to multi-year guaranteed bonuses with no performance criteria. Over the last three years I have spoken publicly about my concerns regarding remuneration and I will set out our principles at HSBC.

Rewarding sustainable performance

First, for any bank to be sustainable it must strike the right balance in serving the long-term interests of its stakeholders. It must deliver sustainable returns to shareholders on their investment; it must maintain the capital strength needed to support the customers and economies it serves; and it must reward its employees appropriately. My own experience is that colleagues want to know that their job makes a difference and contributes to social and economic development; reward is simply not the only motivating factor. Nonetheless it is important, and companies have a clear responsibility to treat their employees appropriately.

It therefore follows that remuneration must be firmly tied to sustainable performance and must not reward failure. It should be properly aligned with risk which remains on the balance sheet, and subject to deferral and to clawback in case performance later proves to be unsatisfactory.

Second, in order to maintain long-term competitive advantage, remuneration must be market-based. Underpaying ultimately results in a company losing some of its best people. HSBC is domiciled in the UK but we have around 300,000 employees in 88 countries and territories. We have to think internationally, and remuneration policy is no exception. Similarly, if pre-eminent financial centres like London are to remain home to firms like HSBC, those of us who care for its future must reflect the reality of the global marketplace in our thinking and approach.

Third, an independent Remuneration Committee should conduct rigorous international benchmarking on compensation and consult appropriately on its conclusions. These are the principles we have followed in determining HSBC s rewards this year.

Our executive Directors have a combined 178 years of service a track record almost without parallel in the industry. I believe there is no better management team in banking and it is no coincidence that HSBC has remained profitable throughout the financial crisis and paid dividends when few other banks did. Indeed, for 2009, our total dividends to shareholders once again comfortably exceed total bonus awards. We have not needed taxpayers money; on the contrary, HSBC has contributed nearly £5 billion in tax to the UK economy over the past five years.

At HSBC, we firmly believe that bonuses are a legitimate and proper element of reward providing, of course, awards fully satisfy the principles set out above. The G20 has set out clear guidance which HSBC wholly supports, and we comply with the Financial Services Authority s remuneration code of practice. Indeed, our decision to defer 100 per cent of executive Director bonuses in respect of 2009 over three years exceeds these guidelines.

Proper pay for proper performance includes ensuring market-based pay for employees over time. The Board expects fixed pay in banking to increase as a proportion of total compensation, especially for important risk and supervisory functions. This is a process we intend to see through at HSBC, and our management team is no exception.

The Board fully appreciates that, in these extraordinary times, remuneration is enormously sensitive and particularly so when the absolute numbers involved are large by any standards, even if they are not in comparison with some other companies of HSBC s standing. Our practice is clear and transparent and this year s executive awards are set out in the Directors Remuneration Report published today. We absolutely believe that the decisions we have taken on this year s remuneration awards are right for all of our stakeholders.

Building a sustainable financial system for the future

As policymakers and industry participants take the

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necessary steps to improve the way our markets work, there are also some important over-arching challenges which we must address.

It is imperative to strike the right balance between strengthening the financial system and supporting economic growth. De-risking the banking system, if taken too far, will throttle recovery and drive risk into other, unregulated parts of the capital markets. It is in the collective public interest to get this balance right. We must not rush to implement hastily conceived responses and policy must be co-ordinated internationally if we are to manage risk better in a truly global industry.

Policymakers also need to evolve new macroeconomic tools which will assist them to manage the supply of credit, as well as the cost of credit, in the economy. I believe a key element of this involves managing bank capital on a countercyclical basis which strikes the right balance between financial system stability and the prospects for economic growth. We cannot deliver a sustainable financial system without improving the wider framework for macroeconomic management too.

Finally, in the context of a wide-ranging discussion on the appropriate size and shape of banks, we must recognise that corporate structure and liquidity management are at least as important as size *per se*. This debate has sometimes been given the unhelpful shorthand too big to fail , but the reality is more complex than the headlines suggest. We believe that the financial system needs banks which are big enough to cope by having a diversified business portfolio, helping to reduce risk and to generate consistent returns. There has likewise not been enough consideration given to the need for banks to be broad enough to serve those global customers who have increasingly diverse financial needs. In short, it is undesirable and impractical to prescribe some ideal model for a bank. The crisis clearly demonstrated that systemic importance is not a function of size or business focus.

HSBC has always believed in having a transparent structure based on separately capitalised subsidiaries, takes a conservative approach to liquidity management, and has built a business with the scale to provide broad, diversified services to its global customers. While the detail and timing of regulatory change remain uncertain, we are confident that our focus on these fundamentals positions us strongly and competitively to respond to the challenges ahead.

S K Green, *Group Chairman*
1 March 2010

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review

Principal activities / Strategic direction / Challenges and uncertainties

Principal activities

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US$199 billion at 31 December 2009.

Through its subsidiaries and associates, HSBC provides a comprehensive range of banking and related financial services. Headquartered in London, HSBC operates through long-established businesses and has an international network of some 8,000 properties in 88 countries and territories in six geographical regions: Europe; Hong Kong; Rest of Asia-Pacific; the Middle East; North America and Latin America. Previously, the Middle East was reported as part of Rest of Asia-Pacific. Within these regions, a comprehensive range of financial services is offered to personal, commercial, corporate, institutional, investment and private banking clients. Services are delivered primarily by domestic banks, typically with large retail deposit bases, and by consumer finance operations.

Taken together, the five largest customers of HSBC do not account for more than one per cent of HSBC s income.

The Group has contractual and other arrangements with numerous third parties in support of its business activities. None of the arrangements is individually considered to be essential to the business of the Group.

There were no significant acquisitions during the year (for details of acquisitions see page 444).

Strategic direction

HSBC s strategic direction reflects its position as The world s local bank , combining the largest global emerging markets banking business and a uniquely cosmopolitan customer base with an extensive international network and substantial financial strength.

The Group s strategy is aligned with the key trends which are shaping the global economy. In particular, HSBC recognises that, over the long term, developing markets are growing faster than the mature economies, world trade is expanding at a greater rate than gross domestic product and life expectancy is lengthening virtually everywhere. HSBC s strategy is focused on delivering superior growth and earnings over time by building on the Group s heritage and skills. Its origins in trade in Asia have had a considerable influence over the development of the Group and, as a consequence, HSBC has an established and longstanding presence in many countries. The combination of local knowledge and international breadth is supported by a substantial financial capability founded on balance sheet strength, largely attributable to the scale of the Group s retail deposit bases.

HSBC is, therefore, continuing to direct incremental investment primarily to the faster growing markets and, in the more developed markets, is focusing on businesses and customer segments which have international connectivity. A policy of maintaining HSBC s capital strength and strong liquidity position remains complementary to these activities and is the foundation of decisions about the pace and direction of investment.

The Group has identified three main business models for its customer groups and global businesses that embody HSBC s areas of natural advantage:

- businesses with international customers for whom connections with developing markets are crucial Global Banking and Markets, Private Banking, the large business segment of Commercial Banking and the mass affluent segment of Personal Financial Services;

- businesses with local customers where service efficiencies can be enhanced through global scale the small business segment of Commercial Banking and the mass market segment of Personal Financial Services; and

- products where global scale is possible by applying the Group s efficiency, expertise and brand product platforms such as global transaction banking.

The means of executing the strategy and making greater use of the linkages within the Group are clear:

the HSBC brand and global networks will be leveraged to reach new customers and offer further services to existing clients;

efficiency will be enhanced by taking full advantage of local, regional and global economies of scale, in particular by adopting a common systems architecture wherever possible; and

objectives and incentives will be aligned to motivate and reward staff for being fully engaged in delivering the strategy.

Challenges and uncertainties

Current economic and market conditions may adversely affect HSBC s results

HSBC s earnings are affected by global and local economic and market conditions. The dislocation in

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financial markets which began in August 2007 put financial institutions under considerable pressure. Market turbulence was accompanied by recessionary conditions in developed economies and a slowdown in emerging countries, with serious adverse consequences for asset values, employment, consumer confidence and levels of economic activity. The global economy entered the most severe downturn for 80 years in 2008.

Governments and central banks took concerted action to make substantial funds and deposit guarantees available to boost liquidity and confidence in their financial systems, stimulate lending and support institutions which were judged to be at risk of failing. In addition, governments extended fiscal stimulus programmes and central banks reduced interest rates. As a consequence, conditions eased in 2009 and most leading developed economies began to emerge from recession, although the pace and depth of recovery was uneven across economies and asset markets. The financial services industry continued to face an unusually high degree of uncertainty.

Despite some evidence of stabilisation in housing market conditions during 2009, the dramatic declines of the previous two years, particularly in the US and the UK, continued to affect adversely the credit performance of real estate-related exposures. Higher unemployment undermined consumer confidence and this, coupled with the deterioration in house prices, led to lower spending which weakened economies. This resulted in significant write-downs of related asset values by financial institutions, including HSBC. These write-downs, both of direct lending exposures and of asset-backed securities, caused many financial institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger competitors and, in some cases, to fail.

Economic conditions remain fragile, and the risk exists that major economies may suffer a double dip recession in which the improvements seen in a number of important markets reverse. This could have an adverse effect on HSBC s operating results. In particular, the Group may face the following challenges in connection with these events:

- HSBC s ability to assess the creditworthiness of its customers or to estimate the values of its assets may be impaired if the models and techniques it uses become less accurate in their predictions of future behaviour, valuations or estimates. The process HSBC uses to estimate losses inherent in its credit exposure or assess the value of certain assets requires difficult, subjective and complex judgements. These include forecasts of economic conditions and how predicted economic scenarios may impair the ability of HSBC s borrowers to repay their loans or affect the value of assets. As a consequence, this process may be less capable of making accurate estimates which, in turn, may undermine the reliability of the process;

- the demand for borrowing from creditworthy customers may diminish should economic activity slow;

- a prolonged period of low interest rates will constrain net interest income earned by HSBC on its excess deposits;

- HSBC s ability to borrow from other financial institutions or to engage in funding transactions on favourable terms, or at all, could be adversely affected by any renewed disruption in the capital markets or deteriorating investor sentiment;

- market developments may continue to depress consumer confidence and may cause further declines in credit card usage and adverse changes in payment patterns, leading to increases in delinquencies and default rates, write-offs and loan impairment charges beyond HSBC s expectations;

- loan impairment allowances and write-offs would be likely to rise in the event of a double dip recession as consumer confidence weakened and business failures increased;

- HSBC expects to face increased regulation and supervision of the financial services industry, following new proposed regulatory measures in countries in which it operates;

- trade and capital flows may contract as a result of protectionist measures being introduced in certain markets; and increased government ownership and control over financial institutions and further consolidation in the financial industry which could significantly alter the competitive landscape.

As a global financial institution, HSBC is exposed to these developments across all its businesses, both directly and through their impact on its customers and clients. Local variations exist, however, reflecting regional circumstances and presenting challenges to HSBC which are specific to those areas. HSBC s strong balance sheet and capital position, its roots in emerging markets and

Challenges and uncertainties

its links with the developed world provide it with the platform to continue to grow, taking opportunities to expand its operations in existing markets and connect local customers internationally.

Europe

In the UK, the contraction in economic output appears to have ceased with the country emerging slowly from recession in the last quarter of 2009. However, economic indicators remain weak and the risk of the country slipping back into recession in 2010 remains, thus delaying the recovery. Government measures to tackle the record levels of national debt, including taxation increases and public spending cuts, are also likely to result in a slower recovery than from other recessions. Political involvement in the regulatory environment and the major financial institutions in which the state has a direct financial interest will continue. Government demands for increased credit to support the economic recovery coupled with regulatory actions to diminish the banking sector s reliance on short-term wholesale funding will increase competition for deposits, narrowing margins. The combination of slow economic recovery, government intervention and increased competition for deposits will maintain pressure on profitability within HSBC s retail business model. Credit quality is expected to improve in some sectors, however, as the economy returns to growth but could suffer a reversal should there be any further increase in unemployment in 2010.

In France, following government stimulus measures, the economy has started recovering with gross domestic product (GDP) growing slightly from the second quarter of 2009 and the number of companies in default stabilising. Although unemployment is rising and there are concerns about the public deficit, household consumption remains robust and continues to drive the economy. HSBC s retail business model depends on banking fees and a consolidation of the recovery observed in the financial markets in 2009 will help sustain profitability. Credit quality is expected to remain stable for personal customers due to the quality of the client base, though the outlook for commercial credit remains less certain.

Outside the UK and France, conditions are likely to remain difficult in some of the countries in which HSBC currently operates in Europe and volatility is expected to continue, in particular as markets focus on potential sovereign credit deterioration.

Hong Kong and Rest of Asia-Pacific

In Asia-Pacific, Hong Kong remains HSBC s key market, and through the financial crisis has continued to generate relatively high returns on capital. HSBC will invest to maintain its competitive position in Hong Kong while continuing to support its growing franchises in other markets in the region. The slowdown in commercial activity, which precipitated the coordinated government stimulus packages, affected fee-based businesses, and continuing low interest rates have left deposit spreads compressed. However, HSBC is now seeing more lending demand as regional economies emerge from recession and equity markets and cross-border trade flows improve. HSBC attracted higher deposits in 2009 despite intensified competition for liquidity, and this added to the challenges of finding opportunities to deploy the deposits where credit demand remained muted. A recent increase in lending has started to ease some of these pressures. Emerging markets in Asia-Pacific currently offer the brightest prospects, with GDP growth in mainland China and India, in particular, expected to be strong in 2010.

As the world s fastest growing region, Asia is expected to drive incremental growth in the global recovery. Inflation triggered by rising output prices and increased demand remains a concern which has prompted regulatory interventions in the form of cooling measures to manage asset growth and prevent, as far as possible, asset bubbles emerging. Mainland China has been prominent in taking a lead in this area. HSBC s strong liquidity position in the region remains key to the Group s ability to expand as well as increase margins when interest rates begin to rise again, the timing of which remains uncertain. Regional markets are likely to remain competitive due to the growing presence of large domestic and regional banks, for example, the mainland Chinese banks in Hong Kong.

Middle East

After a very difficult year, there are signs that the conditions for a recovery in Middle East economic activity have begun to emerge. Assuming an average oil price in excess of US$70 a barrel, public finances in the key oil producing states such as Saudi Arabia, Qatar and the United Arab Emirates (UAE) should improve, allowing governments to maintain and even accelerate fiscal stimulus programmes.

Investment spending is also likely to pick up after last year s slowdown, although ongoing difficulty accessing funding will impede the pace of capital spending growth for the public and private sector alike. Tight financing conditions as well as a sharp fall in asset prices in some parts of the region will also weigh on an expected increase in private consumption levels.

Provided the external environment continues to strengthen, regional non-commodity exporters such as Egypt should see the recent downturn in demand for tourism and trade services slowly reverse, offering additional support for growth.

With most regional economies basing their monetary regimes around a US dollar-peg, interest rates are expected to remain at historically low levels across much of the region in 2010. Coupled with growth in government spending and gains in global commodity prices, this may result in a rise in inflation. After the sharp economic downturn of 2009, however, the increase in price pressure is unlikely to be pronounced.

North America

In 2009, the economic backdrop in the US continued to be characterised by tight credit conditions, reduced economic growth and a weak housing market. Against this, market confidence began to increase, beginning in the second quarter of the year, stemming largely from government initiatives to restore faith in the capital markets, and the benefits to borrowers of the prolonged period of low Federal funds rates. The latter put pressure on spreads earned on HSBC s deposit base, however. As the disruption to financial markets eased, evidence emerged of contracting credit spreads and improved liquidity during 2009, beginning in the second quarter of the year, enabling many companies to issue debt and raise new capital.

The reduction in uncertainty helped capital markets to recover and stock markets to rise. Signs of stabilisation in house prices, most notably in the lower price ranges, began to emerge in the third quarter of the year. An improvement in unemployment and a sustained recovery in the housing market continue to remain critical to consumer confidence and a broader US economic recovery. Although consumer confidence has improved, it remains depressed on a historical basis, driven by declines in household income and wealth and the job market remaining difficult. It is likely that these conditions will continue to constrain the Group s results into 2010, although the degree to which this happens remains uncertain.

On 14 January 2010, the US Administration announced its intention to propose a Financial Crisis Responsibility Fee to be assessed against financial institutions with more than US$50 billion on consolidated assets for at least 10 years. It is not possible to assess the financial impact of this proposal, however, until final legislation has been enacted.

Latin America

Economic activity in Latin America was affected by the global economic recession in 2009. The region s weighted average GDP is expected to fall by 2.7 per cent in the year, though growth may resume in 2010 given the outlook for world trade and a rebound in economic activity. Unemployment rates in the region rose in 2009 and it is probable that this trend will continue, albeit at a slower pace as economies begin to recover. Inflation fell due to falling commodity prices and lower demand. These effects will begin to reverse in 2010 and consequently inflation may rise.

HSBC is positioning itself to grow in select customer markets, though challenges remain to expanding business volumes. Margin pressures are expected to continue throughout the region due to fierce competition for prime customers and lower interest rates than the historical averages. Any further reduction in GDP and increase in unemployment will negatively affect business activity, compounded by uncertainty surrounding presidential elections in Costa Rica, Colombia and Brazil in 2010 and in Peru and Argentina in 2011.

Liquidity and funding risks are inherent in HSBC s business

HSBC s business model is founded upon having ready access to financial resources whenever required to meet its obligations and grow its business. To this end, HSBC entities seek to maintain a diversified and stable funding base comprising core retail and corporate customer deposits and institutional balances, and certain entities augment this with modest amounts of long-term wholesale funding. In addition, HSBC holds portfolios of highly liquid assets diversified by currency and maturity to enable it to respond to unusual liquidity requirements.

Where markets become illiquid, the value at which financial instruments can be realised is highly uncertain, and although processes are available to estimate fair values, they require substantial elements of judgement, assumptions and estimates (which may change over time). The risk of illiquidity, therefore, may reduce capital resources as valuations decline. Actions or the threat of actions by third parties and independent market participants, such as rating agency downgrades of instruments to which HSBC has exposure, can result in reduced

Challenges and uncertainties

liquidity and valuations of those instruments. The liquidity of those HSBC entities that utilise long-term wholesale markets could be constrained by an inability to access them due to a variety of unforeseen market dislocations or interruptions. Rating agencies which determine HSBC s credit ratings and thereby influence the Group s cost of funds, take into consideration the effectiveness of HSBC s liquidity risk management framework.

The market conditions that the financial services industry experienced during the height of the crisis were reflected in decreased liquidity, reduced availability of long-term wholesale market funding, pressure on capital and extreme price volatility across a wide range of asset classes. Illiquidity prevented the realisation of some asset positions and constrained risk distribution in ongoing banking activities. The market conditions also highlighted the significant benefits of a diversified core deposit base, leading to increased competition for such deposits and the greater risk of deposit migration between competitors.

HSBC s Global Banking and Markets business operates in many markets affected by illiquidity and is subject to the threat of extreme price volatility, either directly or indirectly, through exposures to securities, loans, derivatives and other commitments. At the height of the financial crisis, HSBC made substantial write-downs and recognised impairments on illiquid legacy credit and structured credit positions. Although during 2009 there was some moderation in market conditions, it is difficult to predict if this trend will continue and, if conditions worsen, which of HSBC s markets, products and other businesses will be affected. Any repeat of these factors could have an adverse effect on the Group s results.

Reform of the regulatory environment presents risks to HSBC

There are potential strategic and structural risks to the organisation, nature and scope of the Group s business activities and opportunities posed by many of the proposals for regulatory reform being debated both internationally and domestically in response to the recent financial crisis. A consensus has emerged among the G-20 nations that institutions that would pose a systemic risk if they were to fail should be subject to enhanced regulation in markets in which they have a substantial presence. HSBC is likely to be considered a systemically significant institution in its key markets. The Basel Committee on Banking Supervision (The Committee) has issued a comprehensive reform package to address the lessons of the crisis which includes proposals on strengthening global capital and liquidity regulations and the resolution of systemically significant cross-border banks. The Committee s paper entitled Strengthening the Resilience of the Banking Sector proposes changes to both the composition of capital and the risk coverage of the capital framework, as well as the introduction of a leverage ratio and measures to promote the build up of capital buffers. The stated intention of these proposals is to promote a more resilient banking sector, to improve the banking sector s ability to absorb shocks, to improve risk management and to strengthen bank transparency and disclosure. The proposals on liquidity aim to elevate the resilience of internationally active banks to liquidity stresses, as well as increasing international harmonisation of liquidity risk supervision. A study of the impact of all these proposals on individual banks, and the financial services industry as a whole, is taking place in the first half of 2010 in parallel with a consultation process. The Committee is then seeking to agree proposals by the end of 2010 for implementation by the end of 2012.

At the same time, the European Commission, the UK Tripartite Authorities (HM Treasury, the Bank of England and the Financial Services Authority (FSA)), the US Government and others have made a number of proposals for adjustments in their regulatory regimes which could affect entities in the HSBC Group. HSBC is engaged actively in discussions with its regulators, both directly and through industry bodies, on the appropriate regime to be applied to various activities and entities, taking into account the interaction of global and local regulations. The precise nature, extent, form and timing of any regulatory changes, as well as the degree to which there will be effective consultation among the various jurisdictions involved, are highly uncertain and thus it is not possible to determine or estimate the likely actual impact on the Group s business and activities. Major areas where reform is being actively discussed, all of which could affect HSBC s business and activities, are possible capital surcharges for systemically important banks, greater emphasis on standalone national subsidiaries, reduced interconnectedness within the system, changes to capital regulations affecting both capital and capital requirements, changes in compensation practices, restrictions on certain types of financial products, and greater separation of retail and wholesale activities.

HSBC Bank, like all authorised institutions in the UK, is subject to a Special Resolutions Regime under the Banking Act 2009 which gives wide powers in respect of UK banks and their parent companies to HM Treasury, the Bank of England and the FSA in circumstances where any such UK bank has encountered or is likely to encounter financial difficulties.

HSBC is subject to political and economic risks in the countries in which it operates

HSBC operates through an international network of subsidiaries and affiliates in 88 countries and territories around the world. Its 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 it operates. These factors may also negatively affect revenues from the trading of securities and investment in securities, and credit quality in lending portfolios. The ability of HSBC s subsidiaries and affiliates to pay dividends could be restricted by changes in official banking measures, exchange controls and other requirements. HSBC prepares its accounts in US dollars, but because a substantial portion of its assets, liabilities, assets under management, revenues and expenses are denominated in other currencies, changes in foreign exchange rates have an effect on its reported income, cash flows and shareholders equity.

HSBC has significant exposure to counterparty risk both within the financial sector and to other risk concentrations

HSBC has exposure to virtually all major industries and counterparties, and it routinely executes transactions with counterparties in financial services, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose HSBC to credit risk in the event of default by its counterparty or client. HSBC s ability to engage in routine transactions to fund its operations and manage its risks could be 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. Where counterparty risk has been mitigated by taking collateral, HSBC s credit risk may remain high if the collateral it holds cannot be realised or has to be liquidated at prices
which are insufficient to recover the full amount of its loan or derivative exposure.

HSBC operates in a highly competitive environment, and competition could intensify as a result of current global market conditions and possible changes thereto

The financial crisis has begun to re-shape the banking landscape globally and those institutions which have emerged the strongest have reinforced both the importance of a core retail and commercial deposit funding base and strong capitalisation.

At the height of the crisis, financial institutions requiring support from governments in a variety of ways were characterised broadly as being dependent on short-term wholesale funding which failed to roll over due to market concerns about the quality of the assets being funded. As a consequence, financial firms have sought to reduce the proportion of their balance sheets funded in the wholesale markets. As a result, competition for retail deposits and tighter balance sheet control have resulted in re-pricing of loans and advances. Although the financial industry s renewed focus on building retail deposit bases has resulted in greater price competition in terms of interest rates offered, the strength of HSBC s brand and its longstanding conservative balance sheet structure and its relationship-based approach have enabled the Group to increase deposits in the current environment.

Further consolidation is expected to take place through portfolio disposals, the sale of banks and financial institutions weakened by the crisis, or the consolidation of smaller institutions which lack the scale to compete in a world of higher capital and liquidity requirements.

In addition, the crisis has reinforced a global economic shift towards emerging markets. It is now expected that much of the growth in financial services will be in emerging markets as their economies continue to grow and the relative penetration of banking activities increases.

HSBC is subject to legal and compliance risks, which could have an adverse effect on the Group

Legal and compliance risks arise from a variety of sources with the potential to cause harm to HSBC and its ability to operate. These issues require the Group to deal appropriately with potential conflicts of interest; regulatory requirements; ethical issues; anti-money laundering laws and regulations; privacy laws; information security policies;

sales and trading

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HSBC HOLDINGS PLC

Report of the Directors: Operating and Financial Review (continued)

Challenges and uncertainties / KPIs

practices; and the conduct of companies with which it is associated. Failure to address these issues appropriately may give rise to additional legal and compliance risk to HSBC, with an increase in the number of litigation claims and the amount of damages asserted against HSBC, or subject HSBC to regulatory enforcement actions, fines or penalties or reputational damage.

Operational risks are inherent in HSBC s business

HSBC is exposed to many types of operational risk, including fraudulent and other criminal activities (both internal and external), breakdowns in processes or procedures and systems failure or non availability. HSBC is also subject to the risk of disruption of its business arising from events that are wholly or partially beyond its control (for example natural disasters, acts of terrorism, epidemics and transport or utility failures) which may give rise to losses in service to customers and/or economic loss to HSBC. All of these risks are also applicable where HSBC relies on outside suppliers or vendors to provide services to it and its customers.

The reliability and security of HSBC s information and technology infrastructure and its customer databases are crucial to maintaining the service availability of banking applications and processes and to protecting the HSBC brand. 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 the Group s ability to service its clients, could breach regulations under which HSBC operates and could cause long-term damage to its business and brand.

HSBC is subject to tax-related risks in the countries in which it operates, which could have an adverse effect on its operating results

HSBC is subject to the substance and interpretation of tax laws in all countries in which it operates. Tax risk is the risk associated with changes in tax law or the interpretation of tax law. It also includes the risk of changes in tax rates and the risk of consequences arising from failure to comply with procedures required by tax authorities. Failure to manage tax risks could lead to increased tax charges, including financial or operating penalties.

Key performance indicators

The Board of Directors and the Group Management Board monitor HSBC s progress against its strategic objectives. Progress is assessed by comparison with the Group s strategy, its operating plan targets and its historical performance using both financial and non-financial measures.

As a prerequisite for the vesting of Performance Shares, the Remuneration Committee must satisfy itself that HSBC Holdings financial performance has shown a sustained improvement in the period since the award date. In determining this, the Remuneration Committee will take account of all relevant factors but, in particular, will compare HSBC s financial key performance indicators (KPI s) with the equivalent measures within the total shareholder return (TSR) comparator group.

Financial KPIs

In assessing progress in delivering the Group s strategy and monitoring HSBC s performance, management reviews the financial KPIs described below. These KPIs are complemented by a range of secondary benchmarks which are relevant to reviewing performance against plan and at the business level.

HSBC has published a number of key targets against which performance is measured. Financial targets have been set as follows: a return on average total shareholders equity over the medium term of between 15 per cent and 19 per cent; the cost efficiency ratio to be between 48 per cent and 52 per cent; and HSBC s TSR to be in the top half of that achieved by the comparator group. The cost efficiency ratio has been set as a range within which the business is expected to remain in order to accommodate both returns to stakeholders and the need for continued investment in support of future business growth.

In the light of market conditions and proposed changes to capital requirements currently being considered by various governmental and regulatory bodies, HSBC believes return on average total shareholders equity over the medium term is more likely to be around the lower end of the target range. Once regulatory proposals are in definitive form HSBC intends to publish a revised target range.

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Financial KPIs trend analysis

	2009	2008	2007	2006	2005
	%	%	%	%	%
Revenue growth[1]	**(19.0)**	3.4	20.8	13.4	12.2
Revenue mix[2]					
Net interest income	**61.5**	52.1	47.8	52.8	54.4
Net fee income	**26.7**	24.5	27.9	26.3	25.1
Other income[3]	**11.8**	23.4	24.3	20.9	20.5
Cost efficiency[4]	**52.0**	60.1	49.4	51.3	51.2
Credit performance as measured by risk adjusted margin[5]	**3.5**	4.8	6.0	6.3	6.3
Return on average invested capital[6]	**4.1**	4.0	15.3	14.9	15.9
Return on average total shareholders equity[7]	**5.1**	4.7	15.9	15.7	16.8
Dividends per share growth[8]	**(46.9)**	(28.9)	11.1	11.0	10.6
	US$	US$	US$	US$	US$
Basic earnings per ordinary share[9]	**0.34**	0.41	1.44	1.22	1.18

For footnotes, see page 149.

	Over 1 year	**Over 3 years**	**Over 5 years**
Total shareholder return			
HSBC TSR	**128.3**	**103.6**	**120.6**
Benchmarks:			
FTSE 100	127.3	98.0	135.4
MSCI World	116.7	103.6	134.9
MSCI Banks	125.2	70.6	92.3

Revenue growth provides an important guide to the Group s success in generating business. In 2009, total revenue declined by 19 per cent to US$66.2 billion. On an underlying basis, revenue grew by 8 per cent, reflecting the resilience of HSBC s income generating capabilities in these difficult economic circumstances.

Revenue mix represents the relative distribution of revenue streams between net interest income, net fee income and other revenue. It is used to understand how changing economic factors affect the Group, to highlight dependence on balance sheet utilisation for income generation and to indicate success in cross-selling fee-based services to customers with deposit and loan facilities. This understanding assists management in making business investment decisions.

Cost efficiency is a relative measure that indicates the consumption of resources in generating revenue. Management uses this to assess the success of technology utilisation and, more generally, the productivity of the Group s distribution platforms and sales forces.

Credit performance as measured by risk-adjusted margin is an important gauge for assessing whether credit is correctly priced so that the returns available after recognising impairment charges meet the Group s required return parameters.

Return on average invested capital measures the return on the capital investment made in the business, enabling management to benchmark HSBC against competitors.

Return on average total shareholders equity measures the return on average shareholders investment in the business. This enables management to benchmark Group performance against competitors and its own targets. In 2009, the ratio was 5.1 per cent or 0.4 percentage points higher than in 2008.

HSBC aims to deliver sustained **dividend per share growth** for its shareholders. The total dividend for 2009, based on the year to which the dividends relate (rather than when they were paid), amounts to US$0.34 per ordinary share, a reduction of 47 per cent on 2008.

Basic earnings per share (EPS) is a ratio that shows the level of earnings generated per ordinary share. EPS is one of two KPIs used in rewarding employees and is discussed in more detail in the Director s Remuneration Report on page 334. EPS for 2009 was US$0.34, a decline of 17 per cent on 2008.

Total shareholder return is used as a method of assessing the overall return to shareholders on their investment in HSBC, and is defined as the growth in share value and declared dividend income during the relevant period. TSR is a key performance measure in rewarding employees. In calculating TSR, dividend income is assumed to be invested in the underlying shares. The TSR benchmark is an index set at 100 and measured over one, three and five years for the purpose of comparison with the performance of a group of competitor banks which

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Report of the Directors: Operating and Financial Review (continued)

KPIs / Reconciliation of reported and underlying profit before tax
reflect HSBC s range and breadth of activities. As the comparator group includes companies listed on overseas markets, a common currency is used to ensure that TSR is measured on a consistent basis. The TSR levels at the end of 2009 were 128.3, 103.6 and 120.6 over one, three and five years respectively. HSBC s performance did not meet the target of being in the top half of the comparator group over any of the required time periods.

Management believes that financial KPIs must remain relevant to the business so they may be changed over time to reflect changes in the Group s composition and the strategies employed.

Non-financial KPIs

HSBC has chosen four non-financial KPIs which are important to the future success of the Group in delivering its strategic objectives. These non-financial KPIs are reported within HSBC on a local basis.

Employee engagement

Employee engagement is a measure of employees emotional and rational attachment to HSBC. It is critical to the long-term success of the Group and, as such, an employee engagement target was included in the 2009 objectives for Group executives (see Directors Remuneration Report, page 334).

In 2009, HSBC conducted the third Global People Survey of its workforce worldwide. The 2009 participation rate of 91 per cent was one of the highest in the industry.

The Group s employee engagement score rose from 67 per cent in 2008 to 71 per cent in 2009. In achieving 71 per cent, HSBC exceeded its target for 2009 of 69 per cent and the external global and sector averages. HSBC aspires to progressively improve its engagement score to best in class levels by 2011.

The 2009 survey covered 14 aspects. Employees rated HSBC above the external global average across all aspects.

Brand perception

In order to manage the HSBC brand most effectively, the Group tracks brand health among Personal Financial Services and Business Banking customers in each of HSBC s major markets. The survey is conducted on a consistent basis by accredited independent third-party organisations. A weighted scorecard of brand measures produces an overall score for each market on a 100-point scale, which is then benchmarked against HSBC s main competitors. The scores from each market are then weighted according to the risk-adjusted revenues in that market to obtain the overall Group score.

In 2009, Personal Financial Services customers judged HSBC s brand to be 6 points stronger than its competitors, up from 4 points in 2008 and above the target. Business Banking customers also judged the brand to be 6 points higher than HSBC s competitors, the same as in 2008.

Customer recommendation

Customer recommendation is an important driver of business growth for HSBC. HSBC uses a consistent measure of customer recommendation around the world to continue to improve the services provided by the Group to customers of Personal Financial Services and Business Banking. This measurement is carried out by accredited independent third-party organisations and the resulting recommendation scores are benchmarked against competitors. A 100 point scale is used to measure the score.

The 2009 customer recommendation score for Personal Financial Services increased from +1 to +2 compared with a target of +3.

Business Banking customer recommendation was also +2 points ahead of HSBC s competitors but below the target of +4.

IT performance and systems reliability

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

Number of customer transactions processed

The number of customer transactions processed reflects the dependency on IT of the delivery channels that customers use to interact with HSBC. Monitoring the volumes by channel enables the Group to allocate resources appropriately. Despite a fall in total volumes, the transition of customer transactions from labour intensive channels (branch/call centre) to automated channels (credit card, internet, self-service and other e-channels) continued in 2009. The following chart shows the 2005 to 2009 volumes per delivery channel:

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Number of customer transactions (millions)

Percentage of IT services meeting or exceeding targets

HSBC s IT function establishes with its end-users service levels for systems performance, such as systems running 99.9 per cent of the time or credit card authorisations within two seconds, and monitors the achievement of each of these commitments. The following chart shows the percentage of IT services meeting or exceeding the agreed service targets by region. All regions continue to show sustained improvement over the period.

Percentage of IT services meeting or exceeding targets

Reconciliation of reported and underlying profit before tax

HSBC measures its performance internally on a like-for-like basis by eliminating the effects of foreign currency translation differences; acquisitions and disposals of subsidiaries and businesses; fair value movements on own debt attributable to credit spread where the net result of such movements will be zero upon maturity of the debt; and, in 2007, gains from the dilution of the Group s interests in associates, all of which distort year-on-year comparisons. HSBC refers to this as its underlying performance.

Reported results include the effects of the above items. They are excluded when monitoring progress against operating plans and past results because management believes that the underlying basis more accurately reflects operating performance.

Constant currency

Constant currency comparatives for 2008 and 2007 used in the 2009 and 2008 commentaries, respectively, are computed by retranslating into US dollars for non-US dollar branches, subsidiaries, joint ventures and associates:

- the income statements for 2008 and 2007 at the average rates of exchange for 2009 and 2008, respectively; and
- the balance sheets at 31 December 2008 and 2007 at the prevailing rates of exchange on 31 December 2009 and 2008, respectively.

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 period on the basis described above.

Underlying performance

The tables below compare HSBC s underlying performance in 2009 with 2008, and 2008 with 2007. Equivalent tables are provided for each of HSBC s customer groups and geographical segments in their respective sections below.

The foreign currency translation differences were mainly due to the relative strengthening of the US dollar compared with its value in 2008, and were most significant in Europe due to the size of HSBC s operations in the UK.

The following acquisitions and disposals affected both comparisons:

- the gain on sale of HSBC s UK merchant acquiring business to a joint venture 49 per cent owned by the Group in June 2008 and the gain on sale of the residual stake in June 2009;
- the disposal of seven French regional banking subsidiaries in July 2008;
- the disposal of the stake in Financiera Independencia S.A.B. de C.VB (Financiera Independencia) in Mexico in November 2008; and
- the acquisition of PT Bank Ekonomi Raharja Tbk (Bank Ekonomi) in May 2009.

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Report of the Directors: Operating and Financial Review (continued)

Reconciliation of profit / Financial summary > Income statement
Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
HSBC	**2008 as reported US$m**	**2008 adjust-ments[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjust-ments[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**42,563**	**(65)**	**(2,062)**	**40,436**	**53**	**241**	**40,730**	**(4)**	**1**
Net fee income	**20,024**	**(58)**	**(1,315)**	**18,651**	**6**	**(993)**	**17,664**	**(12)**	**(5)**
Changes in fair value[14]	**6,570**	**(6,570)**			**(6,533)**		**(6,533)**	**(199)**	
Gains on disposal of French regional banks	**2,445**	**(2,445)**						**(100)**	
Other income[15]	**10,080**	**(680)**	**(1,597)**	**7,803**	**298**	**6,219**	**14,320**	**42**	**80**
Net operating income[16]	**81,682**	**(9,818)**	**(4,974)**	**66,890**	**(6,176)**	**5,467**	**66,181**	**(19)**	**8**
Loan impairment charges and other credit risk provisions	**(24,937)**	**6**	**709**	**(24,222)**		**(2,266)**	**(26,488)**	**(6)**	**(9)**
Net operating income	**56,745**	**(9,812)**	**(4,265)**	**42,668**	**(6,176)**	**3,201**	**39,693**	**(30)**	**8**
Operating expenses (excluding goodwill impairment)	**(38,535)**	**68**	**2,655**	**(35,812)**	**(31)**	**1,448**	**(34,395)**	**11**	**4**
Goodwill impairment	**(10,564)**			**(10,564)**		**10,564**		**100**	**100**
Operating profit	**7,646**	**(9,744)**	**(1,610)**	**(3,708)**	**(6,207)**	**15,213**	**5,298**	**(31)**	**410**

Income from associates	**1,661**		**25**	**1,686**		**95**	**1,781**	**7**	**6**
Profit before tax	**9,307**	**(9,744)**	**(1,585)**	**(2,022)**	**(6,207)**	**15,308**	**7,079**	**(24)**	**757**

2008 compared with 2007

HSBC	2007 as reported US$m	2007 adjustments & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjust-ments[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	37,795	(389)	(4)	37,402	250	4,911	42,563	13	13
Net fee income	22,002	(239)	(152)	21,611	18	(1,605)	20,024	(9)	(7)
Changes in fair value[14]	3,055	(3,055)			6,570		6,570	115	
Gains on disposal of French regional banks					2,445		2,445		
Other income[15]	16,141	(1,232)	(269)	14,640	703	(5,263)	10,080	(38)	(36)
Net operating income[16]	78,993	(4,915)	(425)	73,653	9,986	(1,957)	81,682	3	(3)
Loan impairment charges and other credit risk provisions	(17,242)	31	113	(17,098)	(6)	(7,833)	(24,937)	(45)	(46)
Net operating income	61,751	(4,884)	(312)	56,555	9,980	(9,790)	56,745	(8)	(17)
Operating expenses (excluding goodwill impairment)	(39,042)	514	301	(38,227)	(198)	(110)	(38,535)	1	
Goodwill impairment						(10,564)	(10,564)		

Operating profit	22,709	(4,370)	(11)	18,328	9,782	(20,464)	7,646	(66)	(112)
Income from associates	1,503	(12)	107	1,598		63	1,661	11	4
Profit before tax	24,212	(4,382)	96	19,926	9,782	(20,401)	9,307	(62)	(102)

For footnotes, see page 149.

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Financial summary

Consolidated income statement

2009 compared with 2008

Reported pre-tax profits in 2009 fell by 24 per cent to US$7.1 billion and earnings per share declined to US$0.34. Return on average shareholders equity remained broadly at 2008 levels at 5.1 per cent (2008: 4.7 per cent).

On an underlying basis, profit before tax increased by US$15.3 billion compared with 2008. The difference between reported and underlying results is explained on page 21. Except where otherwise stated, the commentaries in the Financial Summary are on an underlying basis.

Profit before tax on an underlying basis and excluding the goodwill impairment charge of US$10.6 billion in 2008, was 56 per cent or US$4.7 billion higher.

The increase in profit before tax was driven by strong growth in net operating income in Global Banking and Markets, in part reflecting the absence of significant write-downs in securities and structured credit positions which had affected results in 2008. More significantly, the business benefited from market share gains in core activities and the effect of early positioning by Balance Sheet Management, in anticipation of the low interest rate environment. Results in 2009 also reflected lower loan impairment charges in North America, partly offset by an increase in loan impairment charges and other credit risk provisions elsewhere.

Although HSBC s business in North America continued to record a loss, performance improved as write-downs in Global Banking and Markets reduced and loan impairment charges in Personal Financial Services decreased. This resulted from steps taken to curtail origination in 2007 and 2008 which culminated in the closure of the Consumer Lending branch network in the second quarter of 2009, and from the decision to place all consumer finance portfolios other than credit cards into run-off. The closure of the branch network fed through to lower operating expenses during the remainder of the year.

In Hong Kong, economic performance remained robust despite continuing challenges, with HSBC s results underpinned by a market-leading share in deposits, residential mortgages, cards and insurance. Overall profitability declined, however, as revenue was driven lower by compressed deposit spreads in the low interest rate environment. Loan impairment charges improved on 2008, remaining low, and operating expenses reflected a disciplined approach to cost management.

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Income statement
Consolidated income statement

	2009 US$m	2008 US$m	2007 US$m
Interest income	**62,096**	91,301	92,359
Interest expense	**(21,366)**	(48,738)	(54,564)
Net interest income	**40,730**	42,563	37,795
Fee income	**21,403**	24,764	26,337
Fee expense	**(3,739)**	(4,740)	(4,335)
Net fee income	**17,664**	20,024	22,002
Trading income excluding net interest income	**6,236**	847	4,458
Net interest income on trading activities	**3,627**	5,713	5,376
Net trading income	**9,863**	6,560	9,834
Changes in fair value of long-term debt issued and related derivatives[18]	**(6,247)**	6,679	2,812
Net income/(expense) from other financial instruments designated at fair value	**2,716**	(2,827)	1,271
Net income/(expense) from financial instruments designated at fair value	**(3,531)**	3,852	4,083
Gains less losses from financial investments	**520**	197	1,956
Gains arising from dilution of interests in associates			1,092
Dividend income	**126**	272	324
Net earned insurance premiums	**10,471**	10,850	9,076
Gains on disposal of French regional banks		2,445	
Other operating income	**2,788**	1,808	1,439
Total operating income	**78,631**	88,571	87,601
Net insurance claims incurred and movement in liabilities to policyholders	**(12,450)**	(6,889)	(8,608)
Net operating income before loan impairment charges and other credit risk provisions	**66,181**	81,682	78,993

Loan impairment charges and other credit risk provisions	**(26,488)**	(24,937)	(17,242)
Net operating income	**39,693**	56,745	61,751
Employee compensation and benefits	**(18,468)**	(20,792)	(21,334)
General and administrative expenses	**(13,392)**	(15,260)	(15,294)
Depreciation and impairment of property, plant and equipment	**(1,725)**	(1,750)	(1,714)
Goodwill impairment		(10,564)	
Amortisation and impairment of intangible assets	**(810)**	(733)	(700)
Total operating expenses	**(34,395)**	(49,099)	(39,042)
Operating profit	**5,298**	7,646	22,709
Share of profit in associates and joint ventures	**1,781**	1,661	1,503
Profit before tax	**7,079**	9,307	24,212
Tax expense	**(385)**	(2,809)	(3,757)
Profit for the year	**6,694**	6,498	20,455
Profit attributable to shareholders of the parent company	**5,834**	5,728	19,133
Profit attributable to minority interests	**860**	770	1,322

For footnote, see page 149.

In the Rest of Asia-Pacific region, the economic challenges faced were similar to those in Hong Kong and their impact was reflected in lower income and higher loan impairment charges. Income from associates, primarily in mainland China, made a significant positive contribution to the region s performance. HSBC continued to expand its presence in Rest of Asia-Pacific through organic growth and strategic investment.

HSBC s Middle East operations suffered from a combination of factors: a severe contraction in the economy of Dubai, a fall in oil revenues for much of the year and investment losses incurred by many regional investors. This led to a decline in profit before tax of 74 per cent, primarily due to a significant increase in loan impairment charges. The regional economic downturn and continuing uncertainty affected both retail and corporate customers, particularly in the United Arab Emirates (UAE) where the downturn was most pronounced.

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In Europe, HSBC reported an increase in profit before tax on an underlying basis, driven by Global Banking and Markets in London and Paris. This resulted from a strong performance in Rates and Balance Sheet Management, coupled with the benefit of stabilisation of asset prices and general tightening of credit spreads and lower write-downs in the credit trading business. This was partly offset by a reduction in deposit spreads in Personal Financial Services and Commercial Banking as interest rates fell, and an increase in loan impairment charges in Global Banking reflecting a deterioration in the credit position of a small number of clients.
The increase in profit before tax was driven by strong growth in Global Banking and Markets.

In Latin America, the decline in pre-tax profits was driven by an increase in loan impairment charges in Personal Financial Services and Commercial Banking and lower revenues in Personal Financial Services, partly offset by a strong performance in trading and Balance Sheet Management in Global Banking and Markets. The lower revenues in Personal Financial Services were in part due to the continued curtailment of personal unsecured credit exposures, following the Group s adverse experience in 2008, with net interest income also adversely affected by declining interest rates and narrowing spreads.

With the exception of Personal Financial Services, which continued to be heavily affected by the consumer finance losses in North America, all customer groups remained profitable.

The following items are significant to a comparison of reported results with 2008:

- the non-recurrence of the US$10.6 billion goodwill impairment charge in North America recorded in 2008;
- the non-recurrence of a US$2.4 billion gain on the sale of French regional banks in 2008;
- fair value losses relating to own credit spreads of US$6.5 billion in 2009 compared with gains of US$6.6 billion in 2008;
- a US$72 million fraud loss relating to Bernard L Madoff Investment Securities LLC (Madoff Securities) in 2009, which was in addition to the US$984 million charge reported in 2008;
- loss from write-downs in legacy securities and structured credit positions amounting to US$0.3 billion in 2009 compared with US$5.4 billion in 2008;
- the acquisition in 2008 of the subsidiary, Project Maple II B.V., which owned the Group s headquarters at 8 Canada Square, and the subsequent sale of the company and leaseback of the property in 2009, resulting in gains of US$0.6 billion in 2009 and US$0.4 billion in 2008;
- the sale of the card merchant-acquiring business in the UK, resulting in gains of US$0.3 billion in 2009 and US$0.4 billion in 2008;
- the change in the basis of delivering long-term employee benefits in the UK, which generated a one-off accounting gain of US$0.5 billion in 2009; and
- the tax expense of US$0.3 billion in 2009, which was lower than in previous years as a result of the geographic distribution of income. The Group generated profits in low tax rate jurisdictions, principally Asia, and incurred losses in high tax rate jurisdictions, principally the US, which when mixed produced a low overall rate.

2008 compared with 2007

Reported pre-tax profits in 2008 fell by 62 per cent to US$9.3 billion and earnings per share declined to US$0.47. In a year characterised by a significant deterioration in the credit markets and by unprecedented illiquidity in most asset classes, return on average total shareholders equity fell to 4.7 per cent.

The fall in profit before tax was exacerbated by recognition of a US$10.6 billion impairment charge which wrote off in full the goodwill carried on the balance sheet in respect of the Group s investment in its North America Personal Financial Services business. This non-cash charge arose substantially in the second half of 2008 as heightened risk premia in the market increased discount rates and cash flows estimated from ongoing activities fell as the US economy continued to decline and the outlook for the business deteriorated.

On an underlying basis, profit before tax declined by 102 per cent compared with 2007. The difference between the reported and underlying results is explained on page 21. Except where stated otherwise, the commentaries in the Financial Summary are on an underlying basis.

Performance in Asia was strong, generating profit before tax of US$11.9 billion, broadly in line with results excluding the dilution gains which arose

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Financial summary > Group performance > Net interest income / Net fee income

in 2007 when HSBC did not participate in share offerings by its mainland China associates. Within Asia, Global Banking and Markets results were strongly ahead, driven by foreign exchange, Rates and securities services. Balance Sheet Management revenues rose significantly from positioning ahead of interest rate cuts, and were especially strong in Europe despite losses from the defaults of certain financial sector companies. With the exception of Personal Financial Services, which incurred significant losses in North America, all customer groups remained profitable. Commercial Banking and Private Banking delivered results broadly in line with 2007, while Global Banking and Markets profits declined.

Performance was overshadowed by a US$7.8 billion rise in loan impairment charges and other credit risk provisions, largely from the US consumer finance business, and a further US$5.4 billion in trading write-downs on illiquid legacy positions in credit trading, leveraged and acquisition finance and monoline credit exposure in Global Banking and Markets. Increases in loan impairment charges and other credit risk provisions in Personal Financial Services and Commercial Banking, the latter rising rapidly in the second half of 2008 from a low base, occurred as the global economy slowed. Global Banking and Markets also experienced a rise in loan impairment charges and other credit risk provisions as refinancing options dried up for a number of companies as the market for long-term asset financing became increasingly illiquid. The market turmoil also led to impairments on equity securities in the available-for-sale portfolio.

The following items were significant:

- the non-recurrence of US$1.1 billion of gains which arose in 2007 on the dilution of the Group s stakes in various associates;
- a US$3.6 billion increase (from US$3.0 billion in 2007 to US$6.6 billion) in fair value gains from wider credit spreads recorded predominantly on HSBC s own long-term debt designated at fair value. These gains reported in the Other segment, are not allocated to customer groups and are not included within regulatory capital calculations;
- the gain of US$2.4 billion on the sale of the French regional banks; and
- a charge against trading income of US$984 million following the fraud in December 2008 relating to Madoff Securities.

Group performance by income and expense item

Net interest income

	2009	2008	2007
Net interest income[19] (US$m)	**40,730**	42,563	37,795
Average interest-earning assets (US$m)	**1,384,705**	1,466,622	1,296,701
Gross interest yield[20] (per cent)	**4.48**	6.23	7.12
Net interest spread[21] (per cent)	**2.90**	2.87	2.86
Net interest margin[22] (per cent)	**2.94**	2.90	2.91

For footnotes, see page 149.

2009 compared with 2008

Reported net interest income of US$40.7 billion fell by 4 per cent compared with 2008, but was marginally higher on an underlying basis.

Reported net interest income includes the expense of the internal funding of trading assets, while related revenue is reported in trading income. The cost of internally funding these assets declined significantly as a result of the low interest rate environment. In HSBC s customer group reporting, this cost is included within trading income.

Deposit spreads were squeezed by the exceptionally low interest rates, although this was partly offset by the reduced cost of funding trading activities. Strong revenues in Balance Sheet Management reflected positions taken in 2008 ahead of the reduction in major currency interest rates. As these positions began to mature, the revenue from Balance Sheet Management s activities reduced but remained strong in the second half of 2009.

Average interest-earning assets fell slightly due to a decline in term lending, mainly from the run-off portfolios in North America and the decline in consumer credit appetite globally.

Average interest-bearing liabilities also decreased, due to a decline in debt securities in issue as funding requirements for HSBC Finance Corporation (HSBC Finance) fell as certain portfolios were managed down. This was largely offset by a rise in current account balances, driven by growth in customer demand for more liquid assets. The very low interest rates led to clients

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holding an increasing proportion of funds in liquid current accounts rather than in savings and deposit accounts as they positioned for rising interest rates or prospective investment opportunities.
Competition for deposits and exceptionally low interest rates squeezed deposit margins.

The net interest spread rose slightly. As a result of continuing deposit inflows, the Group sourced an increasing proportion of its funding from customer accounts, and consequently reduced its reliance on relatively more expensive debt securities. The benefit of this was largely offset, however, by a decline in customer lending, particularly higher yielding personal lending, which reduced the average yield on assets.

2008 compared with 2007

Reported net interest income of US$42.6 billion rose by 13 per cent compared with 2007, 13 per cent on an underlying basis.

Growth in net interest income was driven by significantly higher revenues in Balance Sheet Management, in part reflecting favourable positioning to take advantage of falling interest rates. Lending and deposit balances also grew strongly, while progressive reductions in central bank reference rates led to a decline in both asset yields and the cost of funds. Overall, spreads narrowed on an underlying basis.

Average interest-earning assets increased to US$1,467 billion, led by growth in average loans and advances to customers. This was mainly due to an increase in average term lending balances in Europe and Asia.

An increase in average interest-bearing liabilities was driven by growth in average customer accounts, notably in Europe. HSBC attracted substantial deposits from customers who valued HSBC s perceived strength at a time of global financial market turmoil and customers also expressed a preference for security and liquidity following declines in equity markets.

Interest rates were cut aggressively in many countries during 2008, as central banks reduced their reference rates as part of stimulus programmes introduced in response to deteriorating economic conditions. This contributed to a decline in asset yields. The cost of funds also fell, but this was less significant than the decline in yields as spreads narrowed overall on an underlying basis.

In North America, net interest income was also adversely affected by rises in loan modifications designed to reduce the payment burden on the Group s customers, and impaired loans.

Net fee income

	2009	2008	2007
	US$m	US$m	US$m
Cards	**4,625**	5,844	6,496
Account services	**3,592**	4,353	4,359
Funds under management	**2,172**	2,757	2,975
Broking income	**1,617**	1,738	2,012
Credit facilities	**1,479**	1,313	1,138
Insurance	**1,421**	1,771	1,836
Global custody	**988**	1,311	1,404
Imports/exports	**897**	1,014	866
Underwriting	**746**	325	367
Remittances	**613**	610	556
Corporate finance	**396**	381	409
Unit trusts	**363**	502	875
Trust income	**278**	325	299
Mortgage servicing	**124**	120	109
Maintenance income on operating leases	**111**	130	139
Taxpayer financial services	**87**	168	252

Other	**1,894**	2,102	2,245
Total fee income	**21,403**	24,764	26,337
Less: fee expense	**(3,739)**	(4,740)	(4,335)
Net fee income	**17,664**	20,024	22,002

Financial summary > Group performance > Net fee income / Net trading income

2009 compared with 2008

Reported net fee income decreased by 12 per cent to US$17.7 billion, 5 per cent lower on an underlying basis. Lower credit card fees and weaker equity markets led to a decline in net fee income.

Credit card fees fell significantly, mainly in North America, reflecting lower transaction volumes, a reduction in cards in issue and changes in customer behaviour which led to lower cash advance, interchange, late and overlimit fees. In the UK, the decrease primarily arose from the disposal of the card-acquiring business to a joint venture in June 2008.

Weaker equity markets and subdued investor sentiment for higher risk products led to a reduction in both the volume and the value of equity-related products. This resulted in a decrease in fees generated from funds under management, global custody and unit trusts, though fees grew from equity capital markets products in Global Banking and Markets. The impact was particularly marked in the first half of 2009, though market-related fees recovered somewhat in the second half of the year as market values rose and investor appetite for equity products increased.

Account services fees fell, predominantly in North America as the result of a decline in credit card volumes and changes in customer behaviour, and in Private Banking due to a decrease in fiduciary deposit commissions as lower interest rates drove down balances.

Insurance broking fees also fell, mainly due to lower origination volumes of credit-related products, principally in the US consumer finance business, and reduced payment protection business in the UK.

Corporate credit facility and underwriting fees increased strongly on the back of higher debt originations in Europe and North America which accompanied the considerable reconstruction and refinancing of corporate balance sheets in 2009.

2008 compared with 2007

Reported net fee income declined by 9 per cent to US$20 billion, 7 per cent lower on an underlying basis.

Lower equity market-related revenues, notably in Hong Kong, were driven by weakened investor sentiment, and reflected in the fall in the aggregate of broking income, global custody and unit trust income. Similarly, fund management fees declined as equity markets retreated and lower performance fees were earned.

HSBC announced revisions to its credit card fee charging policies in the US in 2007, and this fed through as expected in the form of a substantial decline in overlimit fees, further compounded by lower cash advance and interchange fee income as a result of reduced volumes. In the UK, the divestment in 2008 of the card acquiring business resulted in reduced card acquiring fees. Offsetting these factors were rises in card fees in Hong Kong, the Middle East, India and Turkey.

Fee income from credit facilities rose, notably in the Middle East, in line with customer volumes. Growth in fee income from trade and supply chain products reflected higher volumes and customer acquisition in India and, to a greater extent in the Middle East, increased activity driven by commodity price inflation.

Net trading income

	2009	2008	2007
	US$m	US$m	US$m
Trading activities	**5,240**	2,988	4,521
Net interest income on trading activities	**3,627**	5,713	5,376
Other trading income hedge ineffectiveness:			
on cash flow hedges	**90**	(40)	(77)

on fair value hedges	**(45)**	5	19
Non-qualifying hedges	**951**	(1,122)	(5)
Losses on Madoff Securities fraud		(984)	
Net trading income[23,24]	**9,863**	6,560	9,834

For footnotes, see page 149.

2009 compared with 2008

Reported net trading income increased by 50 per cent to US$9.9 billion, 83 per cent higher on an underlying basis.

Reported trading income excludes the interest expense of the internal funding of trading assets. As noted in Net interest income , the cost of internally funding these assets declined significantly as a result of the low interest rate environment.

The Credit business benefited from a general tightening of credit spreads following a return of liquidity to much of the market, and the write-downs on legacy positions in Credit trading declined significantly following the stabilisation of asset prices.

Net trading income rose by 83 per cent on an underlying basis.

An increase in Rates revenues, particularly in the first half of the year, reflected increased market share and client trading volumes, wider bid-offer spreads and early positioning for interest rate movements. Partly offsetting these gains, fair value losses were recorded on HSBC structured liabilities as a result of credit spreads tightening, compared with gains in this area in 2008.

Equities benefited from the non-recurrence of the US$984 million charge reported in 2008 in respect of Madoff Securities. The core Equities business also took advantage of a changed competitive landscape to capture a greater share of business in strategic markets from key institutional clients.

Foreign exchange trading revenues were well ahead of 2007, but fell short of the record year in 2008. This reflected a combination of reduced customer volumes from lower trade flows and investment activity, and relatively lower market volatility.

Tightening credit spreads led to losses of US$429 million on credit default swap transactions in parts of the Global Banking portfolio. In 2008, gains of US$912 million were reported on these credit default swaps as a result of widening credit spreads.

A reduction in net interest income on trading activities reflected the sharp fall in interest rates at the end of 2008 but was partly compensated for by a reduction in the internal funding cost of trading activities, which is reported in Net interest income .

Income from non-qualifying hedges related to mark-to-market gains on cross-currency swaps as the US dollar depreciated against sterling, and on interest rate swaps as US dollar long and medium term interest rates increased over the year. In 2008, appreciation of the US dollar and a fall in interest rates led to mark-to-market losses on these instruments.

During the second half of 2008, HSBC reclassified US$17.9 billion of assets from held for trading to loans and receivables and available for sale following the IASB s amendment to International Accounting Standard (IAS) 39. Had these reclassifications not taken place and the assets had continued to be accounted for on a fair value basis, additional gains of US$1.5 billion would have been recorded in 2009 (2008: losses of US$3.5 billion). See Impact of Market Turmoil , pages 151 to 195.

2008 compared with 2007

Reported net trading income fell by 33 per cent to US$6.6 billion, 32 per cent lower on an underlying basis.

Net income from trading activities declined by 81 per cent, driven by the continuing effect of the market turmoil which led to US$5.4 billion of write-downs on legacy monoline credit exposures, credit trading and leveraged and acquisition finance loans. More information about the losses, the associated assets and residual exposure is provided in Impact of Market Turmoil on pages 151 to 195.

Record foreign exchange trading income was due to increased customer volumes and market volatility across all regions, as investors sought to reduce risk in the second half of 2008, driving growth in global foreign exchange trading as demand for assets denominated in US dollars and Japanese Yen increased.

Rates trading income rose substantially, with record revenues in the first half of 2008 due to favourable positioning against movements in interest rate yield curves as central banks responded to the market turmoil by lowering short-term interest rates. Revenues were also boosted by an increased number of deals, widening spreads and increased customer demand for trading and hedging products.

The decline in equities trading income reflected weaker equity markets, particularly in Hong Kong, where demand for structured equity products fell. In addition, following the alleged fraud at Madoff Securities, HSBC wrote off the value of units it held in funds that had invested with the company and took a US$984 million charge. The units had been acquired in connection with various financing

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transactions HSBC had entered into with institutional clients.

The decline in non-qualifying hedges related to mark-to-market losses on cross-currency swaps as the US dollar appreciated and on interest rate swaps as interest rates fell in late 2008.

Widening credit spreads led to further gains on credit default swap transactions in parts of the Global Banking portfolio.

Net income from financial instruments designated at fair value

	2009	2008	2007
	US$m	US$m	US$m
Net income/(expense) arising from:			
financial assets held to meet liabilities under insurance and investment contracts	**3,793**	(5,064)	2,056
liabilities to customers under investment contracts	**(1,329)**	1,751	(940)
HSBC s long-term debt issued and related derivatives	**(6,247)**	6,679	2,812
Change in own credit spread on long-term debt	**(6,533)**	6,570	3,055
Other changes in fair value[25]	**286**	109	(243)
other instruments designated at fair value and related derivatives	**252**	486	155
Net income/(expense) from financial instruments designated at fair value	**(3,531)**	3,852	4,083
Financial assets designated at fair value at 31 December	**37,181**	28,533	41,564
Financial liabilities designated at fair value at 31 December	**80,092**	74,587	89,939

For footnote, see page 149.

HSBC designates certain financial instruments at fair value to remove or reduce accounting mismatches in measurement or recognition, or where financial instruments are managed and their performance is evaluated together on a fair value basis. All income and expense from financial instruments designated at fair value are included in this line except for interest arising from HSBC s issued debt securities and related derivatives managed in conjunction with those debt securities, which is recognised in Interest expense .

HSBC principally uses the fair value designation in the following instances (for which all numbers are reported):

for certain fixed-rate long-term debt issues whose rate profile has been changed to floating through interest rate swaps as part of a documented interest rate management strategy. Approximately US$63 billion (2008: US$59 billion) of the Group s debt issues have been accounted for using the fair value option.

The movement in fair value of these debt issues includes the effect of own 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 accounting consequences of changes in own credit spread and ineffectiveness can be volatile from year to year, but do not alter the cash flows envisaged
as part of the documented interest rate management strategy. As a consequence, gains and losses arising from changes in own credit spread on long-term debt are not regarded internally as part of managed performance and are excluded from underlying results. Similarly, such gains and losses are ignored in the calculation of regulatory capital;

for US$15 billion (2008: US$11 billion) of financial assets held to meet liabilities under insurance contracts, and certain liabilities under investment contracts with discretionary participation features; and

for US$8 billion (2008: US$7 billion) of financial assets held to meet liabilities under unit-linked and other investment contracts, as well as the associated liabilities.

2009 compared with 2008

A net expense from financial instruments designated at fair value of US$3.5 billion was reported compared with income of US$3.9 billion in 2008.

A significant change in credit spread on HSBC s own debt in 2009 reversed the movement in 2008.

On an underlying basis, HSBC reported income of US$3.0 billion in 2009 compared with an expense of US$2.6 billion in 2008. The large difference between the reported and underlying results is due to the exclusion of the effect of credit spread-related

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movements in the fair value of HSBC s own long-term debt from underlying performance.

Income of US$3.8 billion was recorded due to a fair value movement on assets held to back insurance and investment contracts, compared with an expense of US$4.8 billion in 2008. This reflected investment gains in the current year driven by improved market performance, predominantly affecting the value of assets held in unit-linked and participating funds in Hong Kong, the UK and France.

To the extent that the investment gains related to assets held to back investment contracts, the expense associated with the corresponding increase in liabilities to customers was also recorded under net income from financial instruments designated at fair value. This expense amounted to US$1.3 billion in 2009 compared with an income of US$1.5 billion in 2008 when liabilities fell in line with declining asset markets.

To the extent that the investment gains related to assets held to back insurance contracts, they were offset by a corresponding increase in Net insurance claims and movement in liabilities to policyholders to reflect the extent to which unit-linked policyholders, in particular, participate in the investment performance experienced in the associated asset portfolios.

2008 compared with 2007

Reported net income from financial instruments designated at fair value decreased by US$231 million to US$3.9 billion in 2008.

On an underlying basis, in particular excluding a large income from movements in the fair value of the Group s own long-term debt, a net expense of US$2.7 billion was recorded, compared with income of US$1.1 billion in 2007.

A negative movement of US$5.1 billion was recorded in the fair value of assets held to back insurance and investment contracts, compared with a positive reported movement of US$2.1 billion in 2007. This reflected investment losses driven by falling equity and bond markets, predominantly affecting the value of assets held in unit-linked and participating funds in Hong Kong, France and the UK. The negative movement in fair value is partially offset by a corresponding reduction in Net insurance claims and movement in liabilities to policyholders , where unit-linked policyholders in particular participate in the investment performance experienced on the investment portfolios held to support the liabilities.

For assets held to meet liabilities under investment contracts the corresponding reduction in the liability to customers is also reported within net income from financial instruments designated at fair value. A reduction of US$1.8 billion in the fair value of liabilities held under investment contracts compared with a reported increase in the fair value of liabilities of US$940 million in 2007.

Gains less losses from financial investments

	2009	2008	2007
	US$m	US$m	US$m
Net gain from disposal of:			
debt securities	**463**	19	120
equity securities	**407**	1,216	1,864
other financial investments	**8**	4	14
	878	1,239	1,998
Impairment of available-for-sale equity securities	**(358)**	(1,042)	(42)
Gains less losses from financial investments	**520**	197	1,956

2009 compared with 2008

Reported gains less losses from financial investments increased by US$323 million to US$520 million. On an underlying basis, they increased by US$546 million.

Net gains on the disposal of debt securities increased significantly, due to gains recorded on the sale of mortgage-backed securities in North America. They were supplemented by smaller gains, principally on the disposal of available-for-sale bonds in Latin America and the UK.

Sales of Visa shares contributed significant gains during 2008, with additional gains from further sales in 2009. Other gains recognised during 2008, including those recorded on the sale of MasterCard shares, were not repeated in 2009.

A significantly lower level of impairments on equity investments was recognised in 2009 than in

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2008 in Asia, Europe and North America, reflecting the improvement in the economic situation and equity markets. Of the investments on which material impairments were recognised in 2008, a significant amount reversed during 2009 due to share price appreciation, notably in India and, to a lesser extent, Vietnam; however, under IFRSs all subsequent increases in the fair value are treated as a revaluation and are recognised in other comprehensive income rather than the income statement.

2008 compared with 2007

Reported gains less losses of US$197 million from financial investments during 2008 were 90 per cent lower than in 2007, 93 per cent lower on an underlying basis. A reduction in net gains from disposals was compounded by significant impairments recognised on equity securities held in the available-for-sale portfolio as certain investments were marked down to reflect the prevailing market conditions.

The redemption of Visa shares following its initial public offering (IPO) resulted in significant gains, and there were further gains from the sale of MasterCard shares. These were more than offset by losses in Principal Investments and the non-recurrence of various significant gains in 2007, mostly in respect of Euronext, the European stock exchange, and a credit bureau in Brazil.

Declining equity markets caused impairments to be recognised against a number of strategic investments in Asia, held in the available-for-sale portfolio and on private equity investments, mainly in Europe. The market turmoil in the US also led to impairments against investments in various US financial institutions.

Net earned insurance premiums

	2009	2008	2007
	US$m	US$m	US$m
Gross insurance premium income	**10,991**	12,547	11,001
Reinsurance premiums	**(520)**	(1,697)	(1,925)
Net earned insurance premiums	**10,471**	10,850	9,076

2009 compared with 2008

Reported net earned insurance premiums amounted to US$10.5 billion, a decrease of 3 per cent compared with 2008. On an underlying basis, net earned insurance premiums increased by 3 per cent. Growth was recorded in Asia, Brazil and France, but this was largely offset by significant declines in the UK and the US.

Net earned insurance premiums continued to grow in Asia, mainly from the launch of new products including a life insurance product designed for high net worth individuals and a guaranteed savings product. In Hong Kong, HSBC retained its position as the leading bancassurer and net earned insurance premiums increased as a result of higher sales of unit-linked and whole life products.

Growth in insurance premiums in Asia, Brazil and France was largely offset by declines in the UK and US.

In Latin America, premium growth was driven by higher sales of pension and life products in Brazil, partly due to a number of customers switching their personal pension annuities to HSBC.

In France, growth was significantly influenced by a large one-off reinsurance transaction in June 2008, which passed insurance premiums to a third party reinsurance provider. Adjusting for this, net earned insurance premiums were ahead of 2008 despite a significant reduction in the distribution network following the disposal of the French regional banks in July 2008.

In the UK, demand for the Guaranteed Income Bond savings product declined as HSBC offered more favourable rates on an alternative deposit product. As the deposit product was a savings bond rather than an insurance contract, its income was recorded under net interest income, while the associated fall in sales of insurance products led to a US$1.1 billion reduction in insurance premium income with an equivalent decrease in Net insurance claims incurred and movement in liabilities to policyholders , as described below.

The reduction in origination volumes in the consumer finance business in North America also led to correspondingly lower sales of credit protection insurance as the consumer finance business was closed.

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2008 compared with 2007
Reported net earned insurance premiums amounted to US$10.9 billion, 20 per cent higher than in 2007. HSBC acquired the remaining interest in HSBC Assurances in France in March 2007 and, in October 2007, sold the Hamilton Insurance Company Limited and Hamilton Life Assurance Company Limited in the UK. On an underlying basis, net earned insurance premiums increased by 14 per cent.

Growth in net earned insurance premiums was driven by a continued strong performance from the UK life assurance business, mainly as a result of higher sales of the Guaranteed Income Bond, a non-linked product that was launched in June 2007. The introduction of enhanced life assurance benefits to certain pension products, which led to these products being reclassified as insurance contracts, also resulted in higher premiums.

The Hong Kong insurance business also performed well with respect to premium growth, due to stronger sales of products with DPF and an increase in regular premiums partly offset by a reduction in unit-linked premiums.

In France, HSBC Assurances performed well in a declining market, as three promotional campaigns during the year contributed to growth in sales of policies with DPF. However, a significant one-off reinsurance transaction undertaken during 2008 caused net earned insurance premiums to decrease compared with 2007.

Other operating income

	2009	2008	2007
	US$m	US$m	US$m
Rent received	**547**	606	630
Gains/(losses) recognised on assets held for sale	**(115)**	(130)	5
Valuation gains/(losses) on investment properties	**(24)**	(92)	152
Gain on disposal of property, plant and equipment, intangible assets and non-financial investments	**1,033**	881	213
Change in present value of in-force long-term insurance business	**605**	286	(145)
Other	**742**	257	584
Other operating income	**2,788**	1,808	1,439

2009 compared with 2008
Reported other operating income of US$2.8 billion was 54 per cent higher than in 2008. This included a US$280 million gain related to the sale of the remaining stake in the card merchant-acquiring business in the UK, compared with a US$425 million gain in 2008 from the sale of the first tranche. In 2008 results also included gains of US$71 million related to the sale of HSBC s stake in Financiera Independencia. On an underlying basis, other operating income rose by 163 per cent, driven mainly by an increase in insurance-related income in Hong Kong, a rise in gains on property disposals and lower losses on foreclosed properties.
Increased insurance income in Hong Kong, higher gains on property disposals and lower losses on foreclosed properties in the US helped drive an underlying US$1.5 billion rise in other operating income.

Losses recognised on assets held for sale declined as losses on foreclosed properties in HSBC Finance decreased, partly due to lower inventory levels following delays in the foreclosure process and partly due to some stabilisation in real estate prices.

Property gains of US$576 million were recognised in respect of the sale and leaseback of 8 Canada Square, London which was effected through the disposal of HSBC s entire shareholding in Project Maple II B.V. (PMII) to the

National Pension Service of Korea. In 2008, HSBC reported a gain of US$416 million in respect of the purchase of PMII. See Note 23 on the Financial Statements.

An increase in insurance sales to new customers in Hong Kong resulted in positive movements in the present value of in-force (PVIF) long-term insurance business. Further positive movements arose from refining the income recognition methodology used in respect of long-term insurance contracts in HSBC Finance. In 2008, a similar refinement in Brazil and HSBC s introduction of enhanced benefits to existing pension products in the UK, resulted in favourable movements in PVIF.

In Hong Kong, a gain of US$110 million was recognised in respect of a property disposal, and in Argentina a gain was realised on the sale of the head office building.

Other operating income includes higher gains on the sale of prime residential mortgage portfolios in

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the US, gains from the extinguishment of certain debt issued by HSBC s mortgage securitisation vehicles in the UK and lower costs associated with the provision of support to certain money market funds.

2008 compared with 2007

Reported other operating income of US$1.8 billion was 26 per cent higher than in 2007. This included gains of US$425 million on the sale of the card merchant acquiring business in the UK and US$71 million on the sale of HSBC s entire stake in Financiera Independencia, a Mexican consumer lending company. On an underlying basis, other operating income fell by 23 per cent.

The difficult property market conditions in the UK led to a loss in value of a property fund, lower income from the sale of property fund assets and a reduction in Group real estate disposals in 2008.
Similarly, in Hong Kong revaluation gains on investment properties did not recur.

Life assurance enhancements to pension products resulted in increased present value of inforce long-term insurance (PVIF) business, which also benefited from the non-recurrence of regulatory changes in 2007 in the UK.

During 2008, HSBC recognised a gain of US$416 million in respect of the purchase of the subsidiary of Metrovacesa which owned the property and long leasehold comprising 8 Canada Square, London.

Other operating income declined, driven by losses on sale of the Canadian vehicle finance business and other loan portfolios in 2008, in addition to the non-recurrence of gains on disposal of fixed assets and private equity investments in 2007.

Net insurance claims incurred and movement in liabilities to policyholders

	2009	2008	2007
	US$m	US$m	US$m
Insurance claims incurred and movement in liabilities to policyholders:			
gross	**12,560**	9,206	9,550
reinsurers share	**(110)**	(2,317)	(942)
net[26]	**12,450**	6,889	8,608

For footnote, see page 149.

2009 compared with 2008

Reported net insurance claims incurred and movement in liabilities to policyholders increased by 81 per cent to US$12.5 billion. On an underlying basis, they increased by 94 per cent.

The increase in net insurance claims incurred and movement in liabilities to policyholders mainly reflected the improvement in investment market performance compared with 2008 described above under Financial instruments designated at fair value . Higher investment gains were broadly matched by movement in liabilities to policyholders on unit-linked and, to a certain extent, participating policies whose policyholders share in the investment performance of the supporting assets. The gains generated on the assets held to support insurance contract liabilities are reported in Net income from financial instruments designated at fair value .

New business growth in a number of regions during 2009, particularly Hong Kong and Singapore, also contributed to an increase in the movement in liabilities to policyholders, as did the non-recurrence of a large one-off reinsurance transaction in France in 2008. The decline in sales of a Guaranteed Income
Bond noted above had a corresponding effect on movement in liabilities to policyholders in the UK.

As a consequence of a rising incidence and severity of claims, aggregate charges of US$310 million were made to strengthen reserves in the UK motor book and the Irish reinsurance business during 2009. The UK motor insurance business was placed into run-off in September 2009.

2008 compared with 2007

Reported net insurance claims incurred and movement in liabilities to policyholders decreased by 20 per cent to US$6.9 billion. HSBC acquired the remaining interest in HSBC Assurances in France in March 2007 and, in October 2007, sold Hamilton Insurance Company Limited and Hamilton Life Assurance Company Limited in the UK. On an underlying basis, net insurance claims incurred and movement in liabilities to policyholders fell by 22 per cent.

The reduction in net insurance claims incurred and movement in liabilities to policyholders primarily reflected the impact of markedly weaker investment markets worldwide. This led to a

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reduction in liabilities to policyholders on unit-linked and, to a certain extent, participating policies.

The decline arising from market value movements was partially offset by an increase in claims incurred and movement in liabilities to policyholders driven by new business growth, most significantly in France, the UK and Hong Kong. In addition, 2007 was affected by the implementation of an FSA regulatory change, which led to lower gross liability valuations in that year, along with a reduction in the corresponding reinsurers share.

A significant increase in the reinsurers share of claims incurred and movement in liabilities to policyholders was primarily driven by the above regulatory change plus an increase in a reserve provision on a unit-linked product in Hong Kong, which was fully reinsured. In addition, a significant one-off reinsurance transaction was undertaken in France during 2008.

Loan impairment charges and other credit risk provisions

	2009	2008	2007
	US$m	US$m	US$m
Loan impairment charges			
New allowances net of allowance releases	**25,832**	24,965	18,182
Recoveries of amounts previously written off	**(890)**	(834)	(1,005)
	24,942	24,131	17,177
Individually assessed allowances	**4,458**	2,064	796
Collectively assessed allowances	**20,484**	22,067	16,381
Impairment of available-for-sale debt securities	**1,474**	737	44
Other credit risk provisions	**72**	69	21
Loan impairment charges and other credit risk provisions	**26,488**	24,937	17,242
	%	%	%
As a percentage of net operating income excluding the effect of fair value movements in respect of credit spread on own debt and before loan impairment charges and other credit risk provisions	**36.4**	33.2	22.7
Impairment charges on loans and advances to customers as a percentage of gross average loans and advances to customers	**2.8**	2.5	2.0
	US$m	US$m	US$m
Customer impaired loans	**30,606**	25,352	19,582
Customer loan impairment allowances	**25,542**	23,909	19,205

2009 compared with 2008

Reported loan impairment charges and other credit risk provisions were US$26.5 billion in 2009, an increase of 6 per cent over 2008, 9 per cent on an underlying basis. Within this, collectively assessed allowances declined while individually assessed impairment allowances continued to increase.

HSBC s aggregate outstanding customer loan impairment allowances at 31 December 2009 of US$25.5 billion represented 3 per cent of gross customer advances (net of reverse repos and settlement accounts), compared with 2.6 per cent at the end of 2008.

Loan impairment charges declined in certain businesses, notably Personal Financial Services in North America and Commercial Banking in Hong Kong, but this was more than offset by increases elsewhere, primarily on individually significant loans within Global Banking and Markets and more broadly on Commercial Banking exposures outside Hong Kong as the global economic downturn
adversely affected the ability of many customers to service their loan commitments. As a consequence, loan impairment charges rose despite an underlying 9 per cent decline in gross loans and advances to customers which was driven mainly by the run-off of the US consumer finance portfolios.

In the US Personal Financial Services business, loan impairment charges declined by 11 per cent to US$14.2 billion, as additional delinquencies due to the continued deterioration in the US economy were more than offset by the effect of lower balances in the run-off portfolios in HSBC Finance.

In HSBC Finance, loan impairment charges decreased by 12 per cent. The reduction arose in most portfolios, but mainly in Mortgage Services as the portfolio continued to run off. In Consumer Lending, loan impairment charges increased, particularly in the unsecured personal lending portfolio, due to a deterioration in the 2006 and 2007 vintages and, to a lesser extent, first lien real estate secured loans, which was partly offset by lower loan impairment charges in the real estate secured portfolio. Loan impairment charges in the Card and Retail Services portfolio decreased despite the state of the US economy and higher levels of unemployment and personal bankruptcy. The main reason was the decline in card balances following actions taken to manage risk beginning in the fourth quarter of 2007 and continuing through 2009, and stable credit conditions.

In HSBC Bank USA, increased loan impairment charges in the personal lending portfolios were due to additional delinquencies which resulted in increased write-offs in the prime first lien mortgage loan portfolios as house prices continued to deteriorate in certain markets.

Loan impairment charges and other credit risk provisions increased significantly in Global Banking and Markets. Loan impairment charges increased, reflecting the impairment of a small number of exposures in the financial and property sectors in Europe and the Middle East. Further impairments were also recognised in respect of certain asset-backed securities held in the available-for-sale portfolio, reflecting mark-to-market losses which HSBC judged to be significantly in excess of the likely ultimate cash losses.

Loan impairment charges declined in Personal Financial Services in the US but rose in Commercial Banking outside Hong Kong and in Global Banking and Markets.

In the UK, loan impairment charges rose in both the Commercial Banking and Personal Financial Services portfolios. However, despite the contraction in the economy, charges remained a low proportion of the portfolio. In Commercial Banking, loan impairment charges largely reflected economic weakness in a broad range of sectors.

In UK Personal Financial Services, loan impairment charges also increased as unemployment rose. This was seen primarily in the credit card and unsecured personal loan portfolios. In the residential mortgage portfolios, delinquency rates decreased as HSBC continued to benefit from very limited exposure to buy-to-let and self-certified mortgages. HSBC s mortgage exposure continued to be well secured, with an average loan-to-value ratio for new UK business in HSBC Bank s mortgage portfolio, excluding First Direct, of under 55 per cent in 2009, compared with 59 per cent in 2008.

In the Middle East, loan impairment charges increased markedly from US$280 million to US$1.3 billion as the region experienced a significant economic contraction in activity,
predominantly in real estate and construction, which particularly affected the UAE. Commercial Banking recorded a number of specific loan impairment charges and a significant increase in collective loan impairment charges. Lower employment in the region, largely driven by the decline in construction activity, led to a rise in loan impairment charges in Personal Financial Services, particularly in the credit card and personal lending portfolios.

In Latin America, portfolios were affected by the weaker economic environment for much of the year. In Personal Financial Services, loan impairment charges rose by 12 per cent to US$2.0 billion, with increased delinquencies in credit cards, mortgages, vehicle finance and payroll loans due to higher unemployment. In the Brazilian Commercial Banking portfolios, higher delinquencies were experienced primarily in the business banking and mid-market segments. In Mexico, action taken in 2008 to curtail originations and increase collection resources held loan impairment charges broadly unchanged notwithstanding the deterioration in the economy and the impact of the H1N1 virus.

In India, as in Mexico, curtailment of origination activity in unsecured personal lending slowed the increase in loan impairment charges in the unsecured credit card and personal lending portfolios in Personal Financial Services. In Commercial Banking, a higher number of corporate failures including a number of fraud-related losses, led to increased loan impairment charges.

Loan impairment charges and other credit risk provisions in Hong Kong decreased by 35 per cent to US$500 million as the economic environment improved in 2009, credit conditions recovered and international trade volumes improved.

In Private Banking, loan impairment charges increased from a very low level, largely attributable to a specific charge relating to a single client relationship in the US.

2008 compared with 2007

Reported loan impairment charges and other credit risk provisions were US$24.9 billion in 2008, an increase of 45 per cent over 2007, 46 per cent on an underlying basis.

A deterioration in credit quality was experienced across all customer groups and geographical regions as the global economy slowed. The rise in Group loan impairment charges and other credit risk provisions also reflected an underlying

8 per cent increase in lending to customers (excluding the financial sector and settlement accounts).

Loan impairment charges rose significantly in the US by 38 per cent to US$16.3 billion, due to credit quality deterioration across all US portfolios in Personal Financial Services.

In the US consumer lending portfolio, loan impairment charges rose as delinquency rates deteriorated sharply and the economy declined markedly in the second half of 2008, most notably in the first lien portfolio. This was particularly apparent in the geographical regions most affected by house price depreciation and rising unemployment rates. In mortgage services, loan impairment charges rose as 2005 and 2006 vintages matured and moved into the later stages of delinquency. This was partly offset by the benefit of lower balances as run-off continued, albeit at a slowing pace as house price depreciation restricted refinancing options for customers. In HSBC USA, loan impairment charges rose as credit quality worsened across the real estate secured portfolio and private label cards. Delinquencies rose in the prime first lien residential mortgage portfolio, Home Equity Line of Credit and Home Equity Loan second lien portfolios. The higher delinquency rate for prime first lien mortgages was in part due to lower balances following US$7.0 billion of portfolio sales during the year.

Loan impairment charges in the US card and retail services portfolios rose, again driven by increasing unemployment, portfolio seasoning, higher levels of personal bankruptcy filings and continued weakness in the US economy which was most apparent in regions with the most significant declines in house prices and rising unemployment.

Loan impairment charges in Commercial Banking in North America more than doubled from a low base in 2007, due to deterioration across the commercial real estate, middle market and corporate banking portfolios in the US and, to a lesser extent, higher loan impairment charges against firms in the manufacturing, export and commercial real estate sectors in Canada.

In the UK, a modest decline in loan impairment charges in Personal Financial Services reflected the non-recurrence of a methodology change at HFC in 2007 which resulted in higher impairment charges. Credit quality in the Personal Financial Services portfolio remained broadly stable, reflecting early risk mitigation through the tightening of lending controls and the sale of non-core credit card portfolios during the year. Credit quality in the unsecured portfolios deteriorated slightly in 2008, particularly in the second half of the year, due to the weakening UK economy. Loan impairment charges in the commercial portfolio rose in 2008 as the weakening property market led to higher impairment charges against construction companies and businesses dependent upon the real estate sector, particularly in the final quarter of the year. Impairment charges against banks rose due to some exposure to the Icelandic banks in 2008. In addition, rising levels of personal indebtedness resulted in lower releases and recoveries of charges than in 2007.

Higher loan impairment and other credit risk provisions within Global Banking and Markets in Europe reflected increased charges against certain corporate accounts and impairment recorded on available-for-sale debt securities.

In Mexico, loan impairment charges rose by US$513 million or 69 per cent, primarily in the credit card portfolio. This was due to a combination of higher lending volumes from organic expansion and higher delinquency rates which were driven by a deterioration in credit quality as the portfolio continued to season and move into the later stages of delinquency. Management took action to enhance collection activity and improve the quality of new business. Impairment charges in the commercial portfolio also rose due to credit quality deterioration among small and medium-sized enterprises as the economy weakened.

In Hong Kong, the rise in loan impairment charges was driven by weakness in parts of the export sector within the commercial portfolio in the second half of 2008. In Global Banking and Markets, credit impairment charges within Balance Sheet Management principally reflected losses on debt securities and paper issued by financial institutions previously rated at investment grade which failed in the year.

In Rest of Asia-Pacific, the growth in loan impairment charges reflected a combination of the expansion of consumer lending and credit quality deterioration in India and the Middle East. In addition, higher impairment charges in Commercial Banking were driven by a deterioration in credit quality in the second half of the year.

For the Group as a whole, the aggregate outstanding customer loan impairment allowances at 31 December 2008 of US$23.9 billion represented 2.6 per cent of gross customer advances (net of reverse repos and settlement accounts), compared with 2 per cent at 31 December 2007.

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Group performance > Operating expenses
Operating expenses

	2009 US$m	2008 US$m	2007 US$m
By expense category			
Employee compensation and benefits	**18,468**	20,792	21,334
Premises and equipment (excluding depreciation and impairment)	**4,099**	4,305	3,966
General and administrative expenses	**9,293**	10,955	11,328
Administrative expenses	**31,860**	36,052	36,628
Depreciation and impairment of property, plant and equipment	**1,725**	1,750	1,714
Amortisation and impairment of intangible assets	**810**	733	700
Goodwill impairment		10,564	
Total operating expenses	**34,395**	49,099	39,042

	At 31 December		
	2009	2008	2007
Staff numbers (full-time equivalent)			
Europe	**76,703**	82,093	82,166
Hong Kong	**27,614**	29,330	27,655
Rest of Asia-Pacific[27]	**87,141**	89,706	80,523
Middle East[27]	**8,281**	8,453	8,050
North America	**35,458**	44,725	52,722
Latin America	**54,288**	58,559	64,404
Total staff numbers	**289,485**	312,866	315,520

For footnote, see page 149.

2009 compared with 2008

Reported operating expenses fell by US$14.7 billion to US$34.4 billion, with the most significant feature being the non-recurrence of the goodwill impairment charge of US$10.6 billion in 2008 to fully write off goodwill in Personal Financial Services in North America. Excluding this and on an underlying basis, operating expenses fell by 4 per cent. Underlying operating expenses excluding goodwill impairment fell by 4 per cent.

Employee compensation and benefits fell by 4 per cent as costs in the US declined following the closure of the branch-based consumer finance business in the first quarter of 2009. Average headcount in most regions was lower and this was reflected in lower costs. In the UK, a change in the basis of delivering death-in-service, ill health and

early retirement benefits for some UK employees generated a one-off accounting gain of US$499 million which was partly offset by increased regular pension costs. There were higher performance-related costs in Global Banking and Markets reflecting its results. The UK and French governments announced one-off taxes in late 2009 in respect of certain bonuses payable by banks and banking groups. In both countries there is uncertainty over the interpretation of the draft proposals, and detailed analysis of individual awards
in the context of the final legislation will be required to determine the precise effect of the taxes. The estimated tax payable under the proposals as currently drafted is US$355 million in the UK and US$45 million in France. The taxes will be payable and accounted for in 2010 once the legislation is enacted. For further details, see page 326.

Premises and equipment costs increased marginally with higher rental costs reflecting the sale and leaseback of a number of properties in 2008. One-off costs incurred due to the closure of the Consumer Lending branch network in the US were partly offset by savings resulting from the closure.

General and administrative expenses fell as HSBC focused on managing costs tightly and increasing efficiency. Marketing and advertising costs fell across the group, most notably in Card and Retail Services in North America, and in the UK. Travel and entertainment costs, and expenditure related to services contracted to third parties, fell, primarily in Europe and North America. Better use of direct channels, increased automation of manual processes, enhanced utilisation of global service centres and elimination of redundant systems continued to be driven through the One HSBC programme. In North America, cost savings also resulted in the Consumer Lending Business from the discontinuation of loan originations and the closure of branches.

2008 compared with 2007

Reported operating expenses increased by US$10.1 billion to US$49.1 billion, due to an impairment charge of US$10.6 billion to fully write off goodwill in Personal Financial Services in North America. Excluding this, operating expenses remained broadly in line on both reported and underlying bases.

Employee compensation and benefits fell marginally. Lower discretionary bonuses reflected weaker performance in the current economic conditions. A review of actuarial assumptions on employees defined benefit pensions resulted in lower service costs in the UK. The restructuring of the consumer finance business in North America led to reduced headcount and lower costs. This was partially offset by higher salaries and increased headcount to support business expansion, mainly in Asia. Restructuring costs were incurred primarily in Latin America and Europe.

Premises and equipment costs increased primarily in the UK and the Rest of Asia-Pacific region, driven by investment in technology and extensions and improvements to the branch and ATM networks. As a consequence, repairs and maintenance costs rose. Commercial property rental costs also increased as a result of higher prices, new rentals and sale and leaseback deals.

General and administrative expenses decreased, primarily due to a one-off recovery of US$110 million of previous years transactional taxes in Brazil and the non-recurrence of a number of one-off items in 2007, most notably (i) ex-gratia payments made in the UK in respect of overdraft fees, (ii) the provision for reimbursement of certain charges on historic will trusts and other related services in the UK, (iii) the indemnification agreement with Visa ahead of Visa s IPO, and (iv) restructuring charges in the US consumer finance business incurred in 2007. These were partly offset by an increase in the Financial Services compensation scheme levy in the UK and an increase in a litigation provision in Asia.

Goodwill impairment amounting to US$10.6 billion was booked following the continued deterioration in economic and credit conditions in North America. For further information see Note 22 on the Financial Statements.

Cost efficiency ratios

	2009	2008	2007
	%	%	%
HSBC	**52.0**	60.1	49.4
Personal Financial Services	**51.7**	76.4	50.3
Europe	**68.7**	62.7	64.8
Hong Kong	**34.9**	32.2	27.2
Rest of Asia-Pacific[27]	**81.2**	81.5	77.9
Middle East[27]	**53.5**	53.2	61.1
North America	**38.1**	106.8	42.3
Latin America	**66.7**	59.7	61.3
Commercial Banking	**46.4**	43.0	44.8
Europe	**47.4**	44.2	49.3
Hong Kong	**33.7**	26.2	24.9
Rest of Asia-Pacific[27]	**47.0**	45.9	47.5
Middle East[27]	**33.8**	32.0	34.5
North America	**47.7**	46.1	45.1
Latin America	**57.0**	55.0	54.3

For footnote, see page 149.

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Group performance > Share of profit in associates and joint ventures / Economic profit
Share of profit in associates and joint ventures

	2009	2008	2007
	US$m	US$m	US$m
Associates			
Bank of Communications Co., Limited	**754**	741	445
Ping An Insurance (Group) Company of China, Limited	**551**	324	518
Industrial Bank Co., Limited	**216**	221	128
The Saudi British Bank	**172**	251	216
Other	**42**	63	159
Share of profit in associates	**1,735**	1,600	1,466
Share of profit in joint ventures	**46**	61	37
Share of profit in associates and joint ventures	**1,781**	1,661	1,503

2009 compared with 2008

The share of profit in associates and joint ventures was US$1.8 billion, an increase of 7 per cent on 2008, and 6 per cent on an underlying basis.

HSBC s share of profits from Ping An Insurance (Group) Company of China, Limited (Ping An Insurance) increased by 62 per cent as a result of the non-recurrence of Ping An Insurance s impairment of its investment in Fortis SA/NV and Fortis N.V. (Fortis) in 2008 and an increase in new business sales and investment returns which were boosted by a recovery in equity markets during 2009. This was partly offset by the non-recurrence of favourable changes to investment assumptions in the first half of 2008.

6 per cent underlying increase in share of profit in associates and joint ventures.

HSBC s share of profits from the Bank of Communications Co., Limited (Bank of Communications) remained in line with 2008 as higher fee and trading income and a lower tax charge were broadly offset by a decline in net interest income and higher loan impairment charges.

Profits from The Saudi British Bank were lower than in 2008 as an increase in loan impairment charges was only partly offset by increased operating income.

The share of profits from joint ventures fell due to a decline in the profitability of HSBC Saudi Arabia Ltd as a result of a slowdown in initial public offerings (IPO s) and a decline in assets under management. This was partly offset by an increase in profits from HSBC Merchant Services UK Ltd in the first half of 2009 compared with the second half of 2008. HSBC Merchant Services UK Ltd was created in June 2008 and sold in June 2009.

2008 compared with 2007

Share of profit in associates and joint ventures was US$1.7 billion, an increase of 11 per cent compared with 2007, and 4 per cent on an underlying basis.

This increase was driven by higher contributions from Bank of Communications, Industrial Bank, and The Saudi British Bank, partly offset by lower profits from Ping An Insurance.

HSBC s share of profits from Bank of Communications rose by 52 per cent to US$741 million, primarily driven by increased margins, as yields rose following higher base rates in mainland China through most of 2008, and balance sheet growth. Growth in revenues from the asset custody business, financial advisory services and bank card transactions also drove higher profits.

HSBC s share of profits from Ping An Insurance decreased by 43 per cent, primarily due to the impairment of its investment in Fortis, following significant declines in its market value.

Profits from The Saudi British Bank were higher by 16 per cent due to strong balance sheet growth, particularly in the lending portfolio, augmented by higher fees from cards, account services and trade.

Profits from Industrial Bank grew by 72 per cent, driven by increased investment income and balance sheet growth.

The share of profits from joint ventures rose due to growth in HSBC Saudi Arabia Ltd and the recognition of profits in HSBC Merchant Services UK Ltd, the new merchant acquiring venture with Global Payments Inc.

An adjustment to the embedded value of HSBC Assurances in 2007 did not recur.

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Gains arising from dilution of interests in associates

In 2007, HSBC s associates, Industrial Bank, Ping An Insurance and Bank of Communications in mainland China, Financiera Independencia in Mexico and Techcombank in Vietnam issued new shares for which HSBC did not subscribe. As a consequence of the new monies raised by the associates, HSBC s share of their underlying assets increased by US$1.1 billion, notwithstanding the reduction in the Group s interests. These gains were presented in the income statement as Gains arising from dilution of interests in associates , and should be regarded as exceptional.

Economic profit

HSBC s internal performance measures include economic profit, a calculation which compares the return on financial capital invested in HSBC by its shareholders with the cost of that capital. HSBC prices its cost of capital internally and the difference between that cost and the post-tax profit attributable to ordinary shareholders represents the amount of economic profit generated. Economic profit generated is used by management as one input in deciding where to allocate capital and other resources.

In seeking to drive long-term sustainable risk-based performance, HSBC emphasises the trend in economic profit ahead of absolute amounts within business units. The Group s long-term cost of equity is reviewed annually and for 2009 remained at 10 per cent. The following commentary on economic profit is on a reported basis.

The economic loss decreased by US$0.2 billion. Profit attributable to shareholders reflected a significant negative fair value movement in own debt of US$6.5 billion as credit spreads tightened, compared with an equivalent gain of US$6.6 billion in 2008, and the non-recurrence of a goodwill impairment charge of US$10.6 billion in 2008.

Average invested capital decreased by 1 per cent. The additional equity raised through the rights issue was offset by the effect of the goodwill impairment charge at the end of 2008 and losses on structural foreign exchange exposures, the result of a stronger US dollar.

Economic spread increased by 0.1 percentage points, the result of an increase in return on invested capital of 2 per cent and a decrease in the cost of capital in dollar terms of 1 per cent compared with 2008.

	2009 US$m	**%**[28]	2008 US$m	%[28]
Average total shareholders equity	**115,431**		122,292	
Adjusted by:				
Goodwill previously amortised or written off	**8,123**		8,152	
Property revaluation reserves	**(799)**		(828)	
Reserves representing unrealised losses on effective cash flow hedges	**385**		997	
Reserves representing unrealised losses on available-for-sale securities	**16,189**		9,163	
Preference shares and other equity instruments	**(3,538)**		(2,685)	
Average invested capital[29]	**135,791**		137,091	
Return on invested capital[30]	**5,565**	**4.1**	5,497	4.0
Benchmark cost of capital	**(13,579)**	**(10.0)**	(13,709)	(10.0)
Economic loss and spread	**(8,014)**	**(5.9)**	(8,212)	(6.0)

For footnotes, see page 149.

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HSBC HOLDINGS PLC

Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > Movement in 2009

Consolidated balance sheet

Consolidated balance sheet as at 31 December 2009

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
ASSETS			
Cash and balances at central banks	**60,655**	52,396	21,765
Trading assets	**421,381**	427,329	445,968
Financial assets designated at fair value	**37,181**	28,533	41,564
Derivatives	**250,886**	494,876	187,854
Loans and advances to banks	**179,781**	153,766	237,366
Loans and advances to customers	**896,231**	932,868	981,548
Financial investments	**369,158**	300,235	283,000
Other assets	**149,179**	137,462	155,201
Total assets	**2,364,452**	2,527,465	2,354,266
LIABILITIES AND EQUITY			
Liabilities			
Deposits by banks	**124,872**	130,084	132,181
Customer accounts	**1,159,034**	1,115,327	1,096,140
Trading liabilities	**268,130**	247,652	314,580
Financial liabilities designated at fair value	**80,092**	74,587	89,939
Derivatives	**247,646**	487,060	183,393
Debt securities in issue	**146,896**	179,693	246,579
Liabilities under insurance contracts	**53,707**	43,683	42,606
Other liabilities	**148,414**	149,150	113,432
Total liabilities	**2,228,791**	2,427,236	2,218,850
Equity			
Total shareholders equity	**128,299**	93,591	128,160
Minority interests	**7,362**	6,638	7,256
Total equity	**135,661**	100,229	135,416

Total equity and liabilities	**2,364,452**	2,527,465	2,354,266

A more detailed consolidated balance sheet is contained in the Financial Statements on page 355.

Movement from 31 December 2008 to 31 December 2009

Total assets amounted to US$2.4 trillion, 6 per cent lower than at 31 December 2008. After excluding the effect of currency movements, underlying total assets declined by 11 per cent, driven by a reduction in the fair value of derivative assets as market conditions stabilised.

The Group s reported tier 1 ratio increased from 8.3 per cent to 10.8 per cent, mainly due to additional equity of US$17.8 billion raised through the rights issue in April 2009, the contribution from profits for the year and a reduction in the underlying level of risk-weighted assets. For more details of capital and risk weighted assets, see pages 285 to 291. The following commentary is on an underlying basis.

Assets

Cash and balances at central banks increased by 12 per cent, consistent with the global liquidity creation by central banks, particularly in Europe and North America.

Trading assets fell by 6 per cent, primarily due to a decrease in the level of reverse repos, particularly in Europe and North America, and a reduction in holdings of short-dated government securities in Hong Kong. There was also a reduction in the collateral required by counterparties to support derivative liabilities as these balances declined. Equity shares held-for-trading grew as activity recovered against a low in the fourth quarter of 2008.

A reduction in the fair values of derivative assets drove an 11 per cent decline in underlying total assets.

Financial assets designated at fair value grew by 19 per cent due to an increase in UK government debt securities in Balance Sheet Management, and an increase in the fair value of equity securities held within the insurance business, particularly in Europe and Hong Kong, as market values recovered.

Derivative assets declined by 52 per cent with reductions across all classes of asset, notably foreign exchange, interest rate and credit derivatives. Lower volatility within the financial markets, steepening yield curves in major currencies and narrowing credit spreads led to a fall in the fair value of outstanding derivative contracts.

Loans and advances to banks increased by 12 per cent, mainly in Hong Kong and Rest of Asia-Pacific, where surplus funds were placed on a short-term basis with financial institutions and central banks as part of Balance Sheet Management activities.

Loans and advances to customers fell by 9 per cent, driven by a reduction in balances in North America due to the run-off of the consumer finance businesses, the sale of selected portfolios, and a reduction in Treasury reverse repo balances and cash collateral as excess liquidity was placed in other investments. These factors were compounded by declines in balances in other regions, particularly in the first half of the year, due to customer deleveraging and lower credit origination in certain segments as risk appetite reduced and customer demand declined. In the UK, there was also a reduction in customer overdraft balances that are managed on a net basis but reported gross under IFRSs. Mortgage balances increased strongly in the UK and Hong Kong as HSBC targeted growth in these markets, although this was largely offset by the run-off of balances in the US, as noted above.

Financial investments rose by 17 per cent, mainly in Hong Kong driven by purchases of Hong Kong government and other highly-rated securities in the year. This increase was partly offset by a fall in financial investments in Europe, as a result of debt securities that matured and were not replaced.

Other assets grew by 7 per cent compared with 31 December 2008.

Liabilities

Deposits by banks decreased by 10 per cent, largely reflecting a decline in central bank and other interbank deposits in Hong Kong, Rest of Asia-Pacific and North America.

Customer account balances decreased by 2 per cent, despite growth in the Personal Financial Services and Commercial Banking segments. This was mainly due to an outflow of deposits in Europe as the economic situation improved and investor risk appetite increased. There was also a fall in deposits from customers whose accounts are managed net but reported gross under IFRSs, (see Loans and advances to customers). These factors were partly offset by an increase in deposits in Hong Kong due to an excess of liquidity in the market.

Trading liabilities were 3 per cent higher, driven by increases in hedged net short positions on equity securities in line with a rise in market activity, and in government debt securities as a result of more active market making activities and an expectation of interest rate rises on certain trading desks. Offsetting this was a reduction in repo contracts, and a decrease in structured deposit accounts in Hong Kong as existing deals matured and customers expressed a preference for vanilla cash instruments in the uncertain economic environment.

Financial liabilities designated at fair value grew by 4 per cent due to new HSBC debt issuances in Europe during the year.

Derivative businesses are managed within market risk limits and, as a consequence, the reduction in the value of *derivative liabilities* broadly matched that of derivative assets.

Debt securities in issue fell by 22 per cent, primarily in North America as the funding requirements reduced in line with the run-off of the consumer finance business.

Liabilities under insurance contracts grew by 18 per cent due to gains recorded on unit-linked products as a result of an improvement in investment market values, and higher insurance sales in Hong Kong following the launch of several new products.

Other liabilities were 4 per cent lower than at 31 December 2008.

Equity

Total shareholders equity increased by 31 per cent, mainly due to the US$17.8 billion of funds raised through the rights issue in April 2009. In addition, the negative balance on the available-for-sale reserve also declined from US$20.6 billion at 31 December 2008 to US$10.0 billion at 31 December 2009, largely reflecting increases in the market value of assets.

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > Reconciliation of assets and liabilities / Loans and advances and customer accounts
Reconciliation of reported and underlying assets and liabilities

	31 December 2009 compared with 31 December 2008						
HSBC	31 Dec 08 as reported US$m	Currency translation[31] US$m	31 Dec 08 at 31 Dec 09 exchange rates US$m	Underlying change US$m	31 Dec 09 as reported US$m	Reported change %	Under-lying change %
Cash and balances at central banks	**52,396**	**1,550**	**53,946**	**6,709**	**60,655**	**16**	**12**
Trading assets	**427,329**	**21,612**	**448,941**	**(27,560)**	**421,381**	**(1)**	**(6)**
Financial assets designated at fair value	**28,533**	**2,636**	**31,169**	**6,012**	**37,181**	**30**	**19**
Derivative assets	**494,876**	**32,379**	**527,255**	**(276,369)**	**250,886**	**(49)**	**(52)**
Loans and advances to banks	**153,766**	**7,406**	**161,172**	**18,609**	**179,781**	**17**	**12**
Loans and advances to customers	**932,868**	**57,163**	**990,031**	**(93,800)**	**896,231**	**(4)**	**(9)**
Financial investments	**300,235**	**14,748**	**314,983**	**54,175**	**369,158**	**23**	**17**
Other assets	**137,462**	**1,807**	**139,269**	**9,910**	**149,179**	**9**	**7**
Total assets	**2,527,465**	**139,301**	**2,666,766**	**(302,314)**	**2,364,452**	**(6)**	**(11)**
Deposits by banks	**130,084**	**8,426**	**138,510**	**(13,638)**	**124,872**	**(4)**	**(10)**
Customer accounts	**1,115,327**	**64,478**	**1,179,805**	**(20,771)**	**1,159,034**	**4**	**(2)**
Trading liabilities	**247,652**	**12,714**	**260,366**	**7,764**	**268,130**	**8**	**3**
Financial liabilities designated at fair value	**74,587**	**2,709**	**77,296**	**2,796**	**80,092**	**7**	**4**
Derivative liabilities	**487,060**	**31,722**	**518,782**	**(271,136)**	**247,646**	**(49)**	**(52)**
Debt securities in issue	**179,693**	**8,005**	**187,698**	**(40,802)**	**146,896**	**(18)**	**(22)**
Liabilities under insurance contracts	**43,683**	**1,763**	**45,446**	**8,261**	**53,707**	**23**	**18**
Other liabilities	**149,150**	**5,144**	**154,294**	**(5,880)**	**148,414**		**(4)**

Total liabilities	**2,427,236**	**134,961**	**2,562,197**	**(333,406)**	**2,228,791**	**(8)**	**(13)**
Total shareholders equity	**93,591**	**4,114**	**97,705**	**30,594**	**128,299**	**37**	**31**
Minority interests	**6,638**	**226**	**6,864**	**498**	**7,362**	**11**	**7**
Total equity	**100,229**	**4,340**	**104,569**	**31,092**	**135,661**	**35**	**30**
Total equity and liabilities	**2,527,465**	**139,301**	**2,666,766**	**(302,314)**	**2,364,452**	**(6)**	**(11)**

For footnote, see page 149.

In 2009, the effect of acquisitions was not material.

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Reconciliation of reported and underlying loans and advances to customers and customer accounts by geographical region

	31 December 2009 compared with 31 December 2008						
	31 Dec 08 as reported US$m	Currency translation[31] US$m	31 Dec 08 at 31 Dec 09 exchange rates US$m	Underlying change US$m	31 Dec 09 as reported US$m	Reported change %	Under-lying change %
Loans and advances to customers (net)							
Europe	**426,191**	**37,773**	**463,964**	**(24,483)**	**439,481**	**3**	**(5)**
Hong Kong	**100,220**	**(54)**	**100,166**	**(785)**	**99,381**	**(1)**	**(1)**
Rest of Asia-Pacific	**80,661**	**5,320**	**85,981**	**(5,938)**	**80,043**	**(1)**	**(7)**
Middle East	**27,295**	**(69)**	**27,226**	**(4,382)**	**22,844**	**(16)**	**(16)**
North America	**256,214**	**7,379**	**263,593**	**(56,740)**	**206,853**	**(19)**	**(22)**
Latin America	**42,287**	**6,814**	**49,101**	**(1,472)**	**47,629**	**13**	**(3)**
	932,868	**57,163**	**990,031**	**(93,800)**	**896,231**	**(4)**	**(9)**
Customer accounts							
Europe	**502,476**	**42,883**	**545,359**	**(50,340)**	**495,019**	**(1)**	**(9)**
Hong Kong	**250,517**	**(119)**	**250,398**	**25,043**	**275,441**	**10**	**10**
Rest of Asia-Pacific	**124,194**	**5,736**	**129,930**	**4,069**	**133,999**	**8**	**3**
Middle East	**35,165**	**(76)**	**35,089**	**(2,560)**	**32,529**	**(7)**	**(7)**
North America	**143,532**	**5,577**	**149,109**	**48**	**149,157**	**4**	
Latin America	**59,443**	**10,477**	**69,920**	**2,969**	**72,889**	**23**	**4**
	1,115,327	**64,478**	**1,179,805**	**(20,771)**	**1,159,034**	**4**	**(2)**

Reconciliation of reported and underlying loans and advances to customers and customer accounts by customer groups and global businesses

	31 December 2009 compared with 31 December 2008						
	31 Dec 08 as reported US$m	Currency translation[31] US$m	31 Dec 08 at 31 Dec 09 exchange rates US$m	Underlying change US$m	31 Dec 09 as reported US$m	Reported change %	Under-lying change %

Loans and advances to customers (net)							
Personal Financial Services	**401,402**	**21,119**	**422,521**	**(23,061)**	**399,460**		**(5)**
Commercial Banking	**203,949**	**14,614**	**218,563**	**(18,889)**	**199,674**	**(2)**	**(9)**
Global Banking and Markets	**287,306**	**19,989**	**307,295**	**(50,339)**	**256,956**	**(11)**	**(16)**
Private Banking	**37,590**	**1,416**	**39,006**	**(1,975)**	**37,031**	**(1)**	**(5)**
Other	**2,621**	**25**	**2,646**	**464**	**3,110**	**19**	**18**
	932,868	**57,163**	**990,031**	**(93,800)**	**896,231**	**(4)**	**(9)**
Customer accounts							
Personal Financial Services	**440,338**	**24,029**	**464,367**	**34,742**	**499,109**	**13**	**7**
Commercial Banking	**235,879**	**13,901**	**249,780**	**17,608**	**267,388**	**13**	**7**
Global Banking and Markets	**320,386**	**24,243**	**344,629**	**(59,902)**	**284,727**	**(11)**	**(17)**
Private Banking	**116,683**	**2,291**	**118,974**	**(12,441)**	**106,533**	**(9)**	**(10)**
Other	**2,041**	**14**	**2,055**	**(778)**	**1,277**	**(37)**	**(38)**
	1,115,327	**64,478**	**1,179,805**	**(20,771)**	**1,159,034**	**4**	**(2)**

For footnote, see page 149.

In 2009, the effect of acquisitions was not material.

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet / Average balance sheet
Average balance sheet and net interest income
Average balances and related interest are shown for the domestic operations of HSBC s principal commercial banks by geographical region. Other operations comprise the operations of the 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 HSBC s 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 within Other interest-earning assets and Other interest-bearing liabilities as appropriate and the elimination entries are included within Other operations in those two categories.

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. Interest income and interest expense arising from trading assets and liabilities and the funding thereof is included within Net trading income in the income statement.

Assets

		2009			2008			2007		
		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										
Total interest-earning assets (itemised below)		**1,384,705**	**62,096**	**4.48**	1,466,622	91,301	6.23	1,296,701	92,359	7.12
Trading assets[32]		**357,504**	**7,614**	**2.13**	428,539	16,742	3.91	374,973	17,562	4.68
Financial assets designated at fair value[33]		**62,143**	**1,032**	**1.66**	37,303	1,108	2.97	14,899	813	5.46
Impairment provisions		**(26,308)**			(20,360)			(15,309)		
Non-interest-earning assets		**667,942**			596,885			440,686		
Total assets and interest income		**2,445,986**	**70,742**	**2.89**	2,508,989	109,151	4.35	2,111,950	110,734	5.24
Short-term funds and loans and advances to banks										
Europe	HSBC Bank	**38,455**	**1,379**	**3.59**	46,703	2,187	4.68	49,910	2,592	5.19
	HSBC Private Banking Holdings (Suisse)	**4,451**	**43**	**0.97**	8,040	333	4.14	5,295	229	4.32
		37,239	**440**	**1.18**	35,801	1,495	4.18	31,591	1,294	4.10

	HSBC France									
Hong Kong	Hang Seng Bank	**16,626**	**202**	**1.21**	17,402	587	3.37	13,054	609	4.67
	The Hongkong and Shanghai Banking Corporation	**27,903**	**182**	**0.65**	47,244	1,344	2.84	50,210	2,352	4.68
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**23,107**	**326**	**1.41**	27,907	881	3.16	19,286	810	4.20
	HSBC Bank Malaysia	**3,776**	**81**	**2.15**	4,659	165	3.54	2,861	103	3.60
Middle East[27]	HSBC Bank Middle East	**4,312**	**52**	**1.21**	6,028	188	3.12	6,328	324	5.12
North America	HSBC Bank USA	**2,338**	**94**	**4.02**	9,595	328	3.42	9,393	477	5.08
	HSBC Bank Canada	**2,934**	**10**	**0.34**	3,354	107	3.19	3,810	174	4.57
Latin America	HSBC Mexico	**3,722**	**149**	**4.00**	3,682	247	6.71	3,555	239	6.72
	Brazilian operations[34]	**10,490**	**1,003**	**9.56**	7,959	951	11.95	5,790	645	11.14
	HSBC Bank Panama	**1,187**	**10**	**0.84**	1,133	30	2.65	897	33	3.68
	HSBC Bank Argentina	**256**	**29**	**11.33**	612	43	7.03	304	16	5.26
Other operations		**15,782**	**199**	**1.26**	19,992	760	3.80	19,087	898	4.70
		192,578	**4,199**	**2.18**	240,111	9,646	4.02	221,371	10,795	4.88

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Assets (continued)

		2009			2008			2007		
		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 %
Loans and advances to customers										
Europe	HSBC Bank	**276,602**	**10,898**	**3.94**	288,214	18,587	6.45	237,231	18,078	7.62
	HSBC Private Banking Holdings (Suisse)	**9,993**	**176**	**1.76**	12,355	494	4.00	9,805	507	5.17
	HSBC France	**71,048**	**1,932**	**2.72**	73,455	3,604	4.91	68,027	3,219	4.73
	HSBC Finance	**3,094**	**319**	**10.31**	4,808	505	10.50	5,492	611	11.13
Hong Kong	Hang Seng Bank	**42,619**	**1,194**	**2.80**	42,304	1,589	3.76	37,827	2,120	5.60
	The Hongkong and Shanghai Banking Corporation	**55,287**	**1,757**	**3.18**	54,628	2,291	4.19	48,134	2,901	6.03
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**66,262**	**3,668**	**5.54**	77,741	5,163	6.64	59,286	4,321	7.29
	HSBC Bank Malaysia	**8,113**	**455**	**5.61**	8,407	553	6.58	7,467	507	6.79
Middle East[27]	HSBC Bank Middle East	**22,612**	**1,593**	**7.04**	23,697	1,549	6.54	15,125	1,200	7.93
North America	HSBC Bank USA	**98,422**	**5,541**	**5.63**	93,088	5,758	6.19	90,091	6,585	7.31
	HSBC Finance	**101,132**	**9,941**	**9.83**	140,957	15,835	11.23	153,658	18,086	11.77
	HSBC Bank Canada	**43,072**	**1,499**	**3.48**	48,331	2,455	5.08	43,570	2,598	5.96
Latin America	HSBC Mexico	**12,185**	**1,708**	**14.02**	17,252	2,565	14.87	16,469	2,187	13.28
	Brazilian operations[34]	**18,704**	**4,494**	**24.03**	19,642	4,879	24.84	13,569	3,895	28.71
	HSBC Bank Panama	**9,302**	**864**	**9.29**	8,620	810	9.40	8,113	778	9.59

	HSBC Bank Argentina	**1,940**	**357**	**18.40**	2,136	378	17.70	1,667	241	14.46
Other operations		**29,670**	**1,905**	**6.42**	28,027	1,707	6.09	21,318	1,790	8.40
		870,057	**48,301**	**5.55**	943,662	68,722	7.28	836,849	69,624	8.32
Financial investments										
Europe	HSBC Bank	**79,763**	**2,321**	**2.91**	83,725	3,840	4.59	45,885	2,431	5.30
	HSBC Private Banking Holdings (Suisse)	**15,602**	**363**	**2.33**	12,018	553	4.60	10,372	511	4.93
	HSBC France	**5,327**	**141**	**2.65**	14,862	795	5.35	10,357	511	4.93
Hong Kong	Hang Seng Bank	**24,594**	**630**	**2.56**	24,031	1,063	4.42	30,791	1,550	5.03
	The Hongkong and Shanghai Banking Corporation	**52,965**	**644**	**1.22**	15,361	563	3.67	20,717	1,017	4.91
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**34,056**	**1,039**	**3.05**	31,992	1,507	4.71	23,739	1,065	4.49
	HSBC Bank Malaysia	**1,218**	**37**	**3.04**	937	36	3.84	1,515	56	3.70
Middle East[27]	HSBC Bank Middle East	**6,996**	**118**	**1.69**	5,671	144	2.54	3,654	174	4.76
North America	HSBC Bank USA	**27,253**	**969**	**3.56**	25,089	1,232	4.91	23,373	1,189	5.09
	HSBC Finance	**2,426**	**120**	**4.95**	2,908	143	4.92	4,072	229	5.62
	HSBC Bank Canada	**10,282**	**205**	**1.99**	7,037	197	2.80	6,068	258	4.25
Latin America	HSBC Mexico	**3,916**	**227**	**5.80**	3,470	244	7.03	3,327	319	9.59
	Brazilian operations[34]	**6,930**	**820**	**11.83**	6,758	853	12.62	5,596	672	12.01
	HSBC Bank Panama	**604**	**39**	**6.46**	618	47	7.61	709	58	8.18
	HSBC Bank Argentina	**181**	**35**	**19.34**	287	47	16.38	563	68	12.08
Other operations		**50,767**	**1,717**	**3.38**	29,632	1,354	4.57	27,252	1,407	5.16
		322,880	**9,425**	**2.92**	264,396	12,618	4.77	217,990	11,515	5.28

For footnotes, see page 149.

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > Average balance sheet
Assets (continued)

		2009			2008			2007		
		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 %
Other interest-earning assets										
Europe	HSBC Bank	**17,406**	**188**	**1.08**	25,885	630	2.43	11,170	652	5.84
	HSBC Private Banking Holdings (Suisse)	**21,450**	**360**	**1.68**	21,189	875	4.13	16,360	882	5.39
	HSBC France	**11,867**	**172**	**1.45**	23,414	630	2.69	12,158	419	3.45
Hong Kong	Hang Seng Bank	**2,618**	**32**	**1.22**	1,629	48	2.95	832	42	5.05
	The Hongkong and Shanghai Banking Corporation	**26,657**	**214**	**0.80**	33,571	949	2.83	27,057	1,237	4.57
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**19,917**	**106**	**0.53**	24,492	352	1.44	11,137	588	5.28
	HSBC Bank Malaysia	**407**	**6**	**1.47**	212	7	3.30	231	12	5.19
Middle East[27]	HSBC Bank Middle East	**541**	**46**	**8.50**	843	63	7.47	758	52	6.86
North America	HSBC Bank USA	**3,327**	**71**	**2.13**	3,091	188	6.08	3,731	231	6.19
	HSBC Finance	**2,995**	**6**	**0.20**	2,638	63	2.39	1,724	89	5.16
	HSBC Bank Canada	**773**	**9**	**1.16**	1,025	25	2.44	960	31	3.23
Latin America	HSBC Mexico	**138**			193	2	1.04			
		1,074	**46**	**4.28**	1,438	147	10.22	840	75	8.93

	Brazilian operations[34]									
	HSBC Bank Panama	**1,372**	**9**	**0.66**	1,807	23	1.27	1,351	40	2.96
	HSBC Bank Argentina	**51**			58	1	1.72	39	1	2.56
Other operations		**(111,403)**	**(1,094)**		(123,032)	(3,688)		(67,857)	(3,926)	
		(810)	**171**	**(21.11)**	18,453	315	1.71	20,491	425	2.07
Total interest-earning assets										
Europe	HSBC Bank	**412,226**	**14,786**	**3.59**	444,527	25,244	5.68	344,196	23,753	6.90
	HSBC Private Banking Holdings (Suisse)	**51,496**	**942**	**1.83**	53,602	2,255	4.21	41,832	2,129	5.09
	HSBC France	**125,481**	**2,685**	**2.14**	147,532	6,524	4.42	122,133	5,443	4.46
	HSBC Finance	**3,094**	**319**	**10.31**	4,808	505	10.50	5,492	611	11.13
Hong Kong	Hang Seng Bank	**86,457**	**2,058**	**2.38**	85,366	3,287	3.85	82,504	4,321	5.24
	The Hongkong and Shanghai Banking Corporation	**162,812**	**2,797**	**1.72**	150,804	5,147	3.41	146,118	7,507	5.14
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**143,342**	**5,139**	**3.59**	162,132	7,903	4.87	113,448	6,784	5.98
	HSBC Bank Malaysia	**13,514**	**579**	**4.28**	14,215	761	5.35	12,074	678	5.62
Middle East[27]	HSBC Bank Middle East	**34,461**	**1,809**	**5.25**	36,239	1,944	5.36	25,865	1,750	6.77
North America	HSBC Bank USA	**131,340**	**6,675**	**5.08**	130,863	7,506	5.74	126,588	8,482	6.70
	HSBC Finance	**106,553**	**10,067**	**9.45**	146,503	16,041	10.95	159,454	18,404	11.54
	HSBC Bank Canada	**57,061**	**1,723**	**3.02**	59,747	2,784	4.66	54,408	3,061	5.63
Latin America	HSBC Mexico	**19,961**	**2,084**	**10.44**	24,597	3,058	12.43	23,351	2,745	11.76
	Brazilian operations[34]	**37,198**	**6,363**	**17.11**	35,797	6,830	19.08	25,795	5,287	20.50
	HSBC Bank Panama	**12,465**	**922**	**7.40**	12,178	910	7.47	11,070	909	8.21

	HSBC Bank Argentina	**2,428**	**421**	**17.34**	3,093	469	15.16	2,573	326	12.67
Other operations		**(15,184)**	**2,727**		(45,381)	133		(200)	169	
		1,384,705	**62,096**	**4.48**	1,466,622	91,301	6.23	1,296,701	92,359	7.12

For footnotes, see page 149.

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Equity and liabilities

		2009			2008			2007		
		Average balance US$m	**Interest expense US$m**	**Cost %**	Average balance US$m	Interest expense US$m	Cost %	Average balance US$m	Interest expense US$m	Cost %
Summary										
Total interest-bearing liabilities (itemised below)		**1,353,283**	**21,366**	**1.58**	1,451,842	48,738	3.36	1,279,460	54,564	4.26
Trading liabilities		**205,670**	**3,987**	**1.94**	277,940	11,029	3.97	250,572	12,186	4.86
Financial liabilities designated at fair value (excluding own debt issued)		**15,688**	**293**	**1.87**	21,266	345	1.62	20,827	224	1.07
Non-interest bearing current accounts		**123,271**			98,193			83,958		
Total equity and other non-interest bearing liabilities		**748,074**			659,747			477,133		
Total equity and liabilities		**2,445,986**	**25,646**	**1.05**	2,508,988	60,112	2.40	2,111,950	66,974	3.17
Deposits by banks[35]										
Europe	HSBC Bank	**35,207**	**553**	**1.57**	48,167	1,875	3.89	44,787	2,148	4.80
	HSBC Private Banking Holdings (Suisse)	**1,063**	**1**	**0.09**	4,493	105	2.34	690	22	3.19
	HSBC France	**43,682**	**536**	**1.23**	37,851	1,672	4.42	30,816	1,358	4.41
Hong Kong	Hang Seng Bank	**1,051**	**5**	**0.48**	1,696	55	3.24	2,993	123	4.11
	The Hongkong and Shanghai Banking Corporation	**6,892**	**9**	**0.13**	3,665	70	1.91	3,634	150	4.13
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**10,710**	**165**	**1.54**	16,232	450	2.77	10,247	445	4.34
	HSBC Bank Malaysia	**110**	**2**	**1.82**	338	10	2.96	375	12	3.20
Middle East[27]	HSBC Bank Middle East	**773**	**9**	**1.16**	1,680	29	1.73	672	32	4.76

North America	HSBC Bank USA	**8,381**	**9**	**0.11**	11,015	220	2.00	6,933	414	5.97
	HSBC Bank Canada	**1,405**	**8**	**0.57**	1,391	41	2.95	1,681	93	5.53
Latin America	HSBC Mexico	**1,462**	**49**	**3.35**	822	32	3.89	983	63	6.41
	Brazilian operations[34]	**3,292**	**241**	**7.32**	2,790	190	6.81	1,549	106	6.84
	HSBC Bank Panama	**908**	**26**	**2.86**	1,016	43	4.23	1,137	66	5.80
	HSBC Bank Argentina	**12**	**1**	**8.33**	27	1	3.70	117	9	7.69
Other operations		**2,899**	**45**	**1.55**	4,564	166	3.64	4,495	291	6.47
		117,847	**1,659**	**1.41**	135,747	4,959	3.65	111,109	5,332	4.80
Financial liabilities designated at fair value own debt issued[36]										
Europe	HSBC Holdings	**17,887**	**369**	**2.06**	18,675	721	3.86	15,142	822	5.43
	HSBC Bank	**7,932**	**196**	**2.47**	8,805	529	6.01	9,907	525	5.30
	HSBC France	**5,108**	**128**	**2.51**	1,515	79	5.21	143	11	7.69
Hong Kong	Hang Seng Bank	**130**	**2**	**1.54**	127	6	4.72	126	6	4.76
North America	HSBC Bank USA	**1,615**	**30**	**1.86**	1,504	67	4.45	1,620	125	7.72
	HSBC Finance	**26,628**	**871**	**3.27**	32,126	1,563	4.87	31,889	2,079	6.52
Other operations		**921**	**(38)**	**(4.13)**	1,083	168	15.51			
		60,221	**1,558**	**2.59**	63,835	3,133	4.91	58,827	3,568	6.07

For footnotes, see page 149.

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > Average balance sheet
Equity and liabilities (continued)

		2009			2008			2007		
		Average balance US$m	**Interest expense US$m**	**Cost %**	Average Balance US$m	Interest expense US$m	Cost %	Average balance US$m	Interest expense US$m	Cost %
Customer accounts[37]										
Europe	HSBC Bank	**274,949**	**2,407**	**0.88**	305,702	10,092	3.30	270,965	10,576	3.90
	HSBC Private Banking Holdings (Suisse)	**27,250**	**256**	**0.94**	37,778	1,349	3.57	30,955	1,485	4.80
	HSBC France	**61,465**	**645**	**1.05**	39,428	1,583	4.01	31,845	1,226	3.85
Hong Kong	Hang Seng Bank	**71,140**	**200**	**0.28**	66,142	914	1.38	61,227	1,900	3.10
	The Hongkong and Shanghai Banking Corporation	**150,520**	**211**	**0.14**	139,169	1,365	0.98	125,478	3,499	2.79
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**92,305**	**1,494**	**1.62**	96,476	2,869	2.97	76,052	2,645	3.48
	HSBC Bank Malaysia	**9,658**	**191**	**1.98**	10,266	295	2.87	8,823	260	2.95
Middle East[27]	HSBC Bank Middle East	**18,726**	**432**	**2.31**	19,922	422	2.12	15,685	578	3.69
North America	HSBC Bank USA	**85,007**	**975**	**1.15**	86,701	2,069	2.39	78,138	3,051	3.90
	HSBC Bank Canada	**35,051**	**385**	**1.10**	34,090	967	2.84	30,060	1,090	3.63
Latin America	HSBC Mexico	**11,636**	**391**	**3.36**	14,612	561	3.84	14,230	548	3.85
	Brazilian operations[34]	**28,605**	**2,946**	**10.30**	26,288	3,110	11.83	19,581	2,163	11.05
		8,592	**353**	**4.11**	7,761	296	3.81	7,604	314	4.13

	HSBC Bank Panama									
	HSBC Bank Argentina	**2,151**	**99**	**4.60**	2,266	145	6.40	1,892	85	4.49
Other operations		**63,863**	**361**	**0.57**	64,253	1,952	3.04	55,351	2,297	4.15
		940,918	**11,346**	**1.21**	950,854	27,989	2.94	827,886	31,717	3.83
Debt securities in issue										
Europe	HSBC Bank	**72,955**	**1,305**	**1.79**	86,216	4,001	4.64	64,168	3,753	5.85
	HSBC France	**25,065**	**330**	**1.32**	30,815	1,447	4.70	28,757	1,207	4.20
	HSBC Finance				215	8	3.72	240	18	7.50
Hong Kong	Hang Seng Bank	**1,220**	**21**	**1.72**	1,685	57	3.38	1,734	80	4.61
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**5,409**	**218**	**4.03**	8,995	640	7.12	8,979	559	6.23
	HSBC Bank Malaysia	**403**	**16**	**3.97**	475	20	4.21	318	13	4.09
Middle East[27]	HSBC Bank Middle East	**2,988**	**62**	**2.07**	2,650	90	3.40	2,086	119	5.70
North America	HSBC Bank USA	**20,968**	**590**	**2.81**	21,922	852	3.89	25,724	1,232	4.79
	HSBC Finance	**63,563**	**2,510**	**3.95**	98,096	3,765	3.84	115,520	5,311	4.60
	HSBC Bank Canada	**12,825**	**322**	**2.51**	16,957	604	3.56	14,771	640	4.33
Latin America	HSBC Mexico	**1,460**	**67**	**4.59**	2,693	243	9.02	1,147	110	9.59
	Brazilian operations[34]	**1,568**	**86**	**5.48**	1,859	156	8.39	1,417	115	8.12
	HSBC Bank Panama	**487**	**34**	**6.98**	556	33	5.94	607	45	7.41
	HSBC Bank Argentina	**1**			2			12		
Other operations		**16,745**	**340**	**2.03**	13,691	66	0.48	6,446	(13)	(0.20)
		225,657	**5,901**	**2.62**	286,827	11,982	4.18	271,926	13,189	4.85

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		2009			2008			2007		
		Average balance US$m	**Interest expense US$m**	**Cost %**	Average balance US$m	Interest expense US$m	Cost %	Average balance US$m	Interest expense US$m	Cost %
Other interest-bearing liabilities										
Europe	HSBC Bank	**50,247**	**655**	**1.30**	38,906	1,134	2.91	22,035	1,302	5.91
	HSBC Private Banking Holdings (Suisse)	**3,892**	**18**	**0.46**	4,203	135	3.21	3,427	163	4.76
	HSBC France	**24,699**	**187**	**0.76**	33,920	1,361	4.01	27,830	979	3.52
	HSBC Finance	**2,363**	**59**	**2.50**	3,712	191	5.15	4,557	227	4.98
Hong Kong	Hang Seng Bank	**789**	**5**	**0.63**	1,258	41	3.26	2,278	114	5.00
	The Hongkong and Shanghai Banking Corporation	**12,815**	**105**	**0.82**	10,557	288	2.73	9,866	535	5.42
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**19,447**	**177**	**0.91**	23,685	466	1.97	12,631	580	4.59
	HSBC Bank Malaysia	**266**	**2**	**0.75**	338	7	2.07	232	6	2.59
Middle East[27]	HSBC Bank Middle East	**1,748**	**68**	**3.89**	1,918	89	4.64	1,168	81	6.93
North America	HSBC Bank USA	**9,754**	**368**	**3.77**	10,490	468	4.46	13,602	587	4.32
	HSBC Finance	**4,051**	**102**	**2.52**	4,670	141	3.02	1,941	113	5.82
	HSBC Bank Canada	**1,149**	**6**	**0.52**	1,306	19	1.45	1,151	27	2.35
		1,716	**36**	**2.10**	10,349	78	0.75	8,889	255	2.87

	HSBC Markets Inc									
Latin America	HSBC Mexico	**301**	**11**	**3.65**	187	20	10.70	207	16	7.73
	Brazilian operations[34]	**1,496**	**130**	**8.69**	2,340	207	8.85	1,103	182	16.50
	HSBC Bank Panama	**192**	**2**	**1.04**	917	3	0.33	574	9	1.57
	HSBC Bank Argentina	**36**	**1**	**2.78**	92	6	6.52	95	4	4.21
Other operations		**(126,321)**	**(1,030)**		(134,269)	(3,979)		(101,874)	(4,422)	
		8,640	**902**	**10.44**	14,579	675	4.63	9,712	758	7.80
Total interest-bearing liabilities										
Europe	HSBC Bank	**441,290**	**5,116**	**1.16**	487,796	17,631	3.61	411,862	18,304	4.44
	HSBC Private Banking Holdings (Suisse)	**32,205**	**275**	**0.85**	46,474	1,589	3.42	35,072	1,670	4.76
	HSBC France	**160,019**	**1,826**	**1.14**	143,529	6,142	4.28	119,391	4,781	4.00
	HSBC Finance	**2,363**	**59**	**2.50**	3,927	199	5.07	4,797	245	5.11
Hong Kong	Hang Seng Bank	**74,330**	**233**	**0.31**	70,908	1,073	1.51	68,358	2,223	3.25
	The Hongkong and Shanghai Banking Corporation	**170,227**	**325**	**0.19**	153,391	1,723	1.12	138,978	4,184	3.01
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**127,871**	**2,054**	**1.61**	145,388	4,425	3.04	107,909	4,229	3.92
	HSBC Bank Malaysia	**10,437**	**211**	**2.02**	11,417	332	2.91	9,748	291	2.99
Middle East[27]		**24,235**	**571**	**2.36**	26,170	630	2.41	19,611	810	4.13

	HSBC Bank Middle East									
North America	HSBC Bank USA	**125,725**	**1,972**	**1.57**	131,632	3,676	2.79	126,017	5,409	4.29
	HSBC Finance	**94,242**	**3,483**	**3.70**	134,892	5,469	4.05	149,350	7,503	5.02
	HSBC Bank Canada	**50,430**	**721**	**1.43**	53,744	1,631	3.03	47,663	1,850	3.88
	HSBC Markets Inc	**1,716**	**36**	**2.10**	10,349	78	0.75	8,889	255	2.87
Latin America	HSBC Mexico	**14,859**	**518**	**3.49**	18,314	856	4.67	16,567	737	4.45
	Brazilian operations[34]	**34,961**	**3,403**	**9.73**	33,277	3,663	11.01	23,650	2,566	10.85
	HSBC Bank Panama	**10,179**	**415**	**4.08**	10,250	375	3.66	9,922	434	4.37
	HSBC Bank Argentina	**2,200**	**101**	**4.59**	2,387	152	6.37	2,116	98	4.63
Other operations		**(24,006)**	**47**		(32,003)	(906)		(20,440)	(1,025)	
		1,353,283	**21,366**	**1.58**	1,451,842	48,738	3.36	1,279,460	54,564	4.26

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Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > Net interest margin / Average asset distribution / Changes in net interest income and expense

Net interest margin[39]

		2009	2008	2007
		%	%	%
Europe	HSBC Bank	**2.35**	1.71	1.58
	HSBC Private Banking Holdings (Suisse)	**1.30**	1.24	1.10
	HSBC France	**0.68**	0.26	0.54
	HSBC Finance	**8.40**	6.36	6.66
Hong Kong	Hang Seng Bank	**2.11**	2.59	2.54
	The Hongkong and Shanghai Banking Corporation	**1.52**	2.27	2.27
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**2.15**	2.15	2.25
	HSBC Bank Malaysia	**2.72**	3.02	3.21
Middle East[27]	HSBC Bank Middle East	**3.59**	3.63	3.63
North America	HSBC Bank USA	**3.58**	2.93	2.43
	HSBC Finance	**6.18**	7.22	6.84
	HSBC Bank Canada	**1.76**	1.93	2.23
Latin America	HSBC Mexico	**7.85**	8.95	8.60
	Brazilian operations[34]	**7.96**	8.85	10.55
	HSBC Bank Panama	**4.07**	4.39	4.29
	HSBC Bank Argentina	**13.18**	10.25	8.86
		2.94	2.90	2.91

Distribution of average total assets

		2009	2008	2007
		%	%	%
Europe	HSBC Bank	**36.7**	36.7	34.6
	HSBC Private Banking Holdings (Suisse)	**2.3**	2.3	2.2
	HSBC France	**15.0**	13.8	12.0
	HSBC Finance	**0.0**	0.2	0.3

Hong Kong	Hang Seng Bank	**4.2**	3.9	4.4
	The Hongkong and Shanghai Banking Corporation	**10.5**	9.5	10.1
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**8.5**	8.8	6.9
	HSBC Bank Malaysia	**0.6**	0.6	0.7
Middle East[27]	HSBC Bank Middle East	**1.6**	1.8	1.4
North America	HSBC Bank USA	**11.0**	11.2	10.1
	HSBC Finance	**4.5**	6.2	8.3
	HSBC Bank Canada	**2.7**	2.9	3.3
Latin America	HSBC Mexico	**1.4**	1.5	2.5
	Brazilian operations[34]	**2.1**	2.1	1.6
	HSBC Bank Panama	**0.6**	0.6	0.7
	HSBC Bank Argentina	**0.2**	0.2	0.2
Other operations (including consolidation adjustments)		**(1.9)**	(2.3)	0.7
		100.0	100.0	100.0

For footnotes, see page 149.

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 2009 compared with 2008, and for 2008 compared with 2007.

Interest income

			Increase/(decrease) in 2009 compared with 2008			Increase/(decrease) in 2008 compared with 2007		
		2009 US$m	**Volume US$m**	**Rate US$m**	2008 US$m	Volume US$m	Rate US$m	2007 US$m
Short-term funds and loans and advances to banks								
Europe	HSBC Bank	**1,379**	**(386)**	**(422)**	2,187	(166)	(239)	2,592
	HSBC Private Banking Holdings (Suisse)	**43**	**(149)**	**(141)**	333	119	(15)	229
	HSBC France	**440**	**60**	**(1,115)**	1,495	173	28	1,294
Hong Kong	Hang Seng Bank	**202**	**(26)**	**(359)**	587	203	(225)	609
	The Hongkong and Shanghai Banking Corporation	**182**	**(549)**	**(613)**	1,344	(139)	(869)	2,352
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**326**	**(152)**	**(403)**	881	362	(291)	810
	HSBC Bank Malaysia	**81**	**(31)**	**(53)**	165	65	(3)	103
Middle East[27]	HSBC Bank Middle East	**52**	**(54)**	**(82)**	188	(15)	(121)	324
North America	HSBC Bank USA	**94**	**(248)**	**14**	328	10	(159)	477
	HSBC Bank Canada	**10**	**(13)**	**(84)**	107	(21)	(46)	174
Latin America	HSBC Mexico	**149**	**3**	**(101)**	247	9	(1)	239
	Brazilian operations[34]	**1,003**	**302**	**(250)**	951	242	64	645
	HSBC Bank Panama	**10**	**1**	**(21)**	30	9	(12)	33
	HSBC Bank Argentina	**29**	**(25)**	**11**	43	16	11	16
Other operations		**199**	**(160)**	**(401)**	760	43	(181)	898
		4,199	**(1,911)**	**(3,536)**	9,646	915	(2,064)	10,795

Loans and advances to customers

Europe	HSBC Bank	**10,898**	**(749)**	**(6,940)**	18,587	3,885	(3,376)	18,078
	HSBC Private Banking Holdings (Suisse)	**176**	**(94)**	**(224)**	494	132	(145)	507
	HSBC France	**1,932**	**(118)**	**(1,554)**	3,604	257	128	3,219
	HSBC Finance	**319**	**(180)**	**(6)**	505	(76)	(30)	611
Hong Kong	Hang Seng Bank	**1,194**	**12**	**(407)**	1,589	251	(782)	2,120
	The Hongkong and Shanghai Banking Corporation	**1,757**	**28**	**(562)**	2,291	392	(1,002)	2,901
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**3,668**	**(762)**	**(733)**	5,163	1,345	(503)	4,321
	HSBC Bank Malaysia	**455**	**(19)**	**(79)**	553	64	(18)	507
Middle East[27]	HSBC Bank Middle East	**1,593**	**(71)**	**115**	1,549	680	(331)	1,200
North America	HSBC Bank USA	**5,541**	**330**	**(547)**	5,758	219	(1,046)	6,585
	HSBC Finance	**9,941**	**(4,472)**	**(1,422)**	15,835	(1,495)	(756)	18,086
	HSBC Bank Canada	**1,499**	**(267)**	**(689)**	2,455	284	(427)	2,598
Latin America	HSBC Mexico	**1,708**	**(753)**	**(104)**	2,565	104	274	2,187
	Brazilian operations[34]	**4,494**	**(233)**	**(152)**	4,879	1,744	(760)	3,895
	HSBC Bank Panama	**864**	**64**	**(10)**	810	49	(17)	778
	HSBC Bank Argentina	**357**	**(35)**	**14**	378	68	69	241
Other operations		**1,905**	**100**	**98**	1,707	564	(647)	1,790
		48,301	**(5,358)**	**(15,063)**	68,722	8,887	(9,789)	69,624

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Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > Changes in net interest income / net interest expense

Interest income (continued)

			Increase/(decrease) in 2009 compared with 2008			Increase/(decrease) in 2008 compared with 2007		
		2009	**Volume**	**Rate**	2008	Volume	Rate	2007
		US$m	**US$m**	**US$m**	US$m	US$m	US$m	US$m
Financial investments								
Europe	HSBC Bank	**2,321**	**(182)**	**(1,337)**	3,840	2,006	(597)	2,431
	HSBC Private Banking Holdings (Suisse)	**363**	**165**	**(355)**	553	81	(39)	511
	HSBC France	**141**	**(510)**	**(144)**	795	222	62	511
Hong Kong	Hang Seng Bank	**630**	**25**	**(458)**	1,063	(340)	(147)	1,550
	The Hongkong and Shanghai Banking Corporation	**644**	**1,380**	**(1,299)**	563	(263)	(191)	1,017
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**1,039**	**97**	**(565)**	1,507	371	71	1,065
	HSBC Bank Malaysia	**37**	**11**	**(10)**	36	(21)	1	56
Middle East[27]	HSBC Bank Middle East	**118**	**34**	**(60)**	144	96	(126)	174
North America	HSBC Bank USA	**969**	**106**	**(369)**	1,232	87	(44)	1,189
	HSBC Finance	**120**	**(24)**	**1**	143	(65)	(21)	229
	HSBC Bank Canada	**205**	**91**	**(83)**	197	41	(102)	258
Latin America	HSBC Mexico	**227**	**31**	**(48)**	244	14	(89)	319
	Brazilian operations[34]	**820**	**22**	**(55)**	853	140	41	672
	HSBC Bank Panama	**39**	**(1)**	**(7)**	47	(7)	(4)	58
	HSBC Bank Argentina	**35**	**(17)**	**5**	47	(33)	12	68
Other operations		**1,717**	**966**	**(603)**	1,354	123	(176)	1,407
		9,425	**2,790**	**(5,983)**	12,618	2,450	(1,347)	11,515

Interest expense

Deposits by banks

Europe	HSBC Bank	**553**	**(504)**	**(818)**	1,875	162	(435)	2,148
	HSBC Private Banking Holdings (Suisse)	**1**	**(80)**	**(24)**	105	121	(38)	22
	HSBC France	**536**	**258**	**(1,394)**	1,672	310	4	1,358
Hong Kong	Hang Seng Bank	**5**	**(21)**	**(29)**	55	(53)	(15)	123
	The Hongkong and Shanghai Banking Corporation	**9**	**62**	**(123)**	70	1	(81)	150
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**165**	**(153)**	**(132)**	450	260	(255)	445
	HSBC Bank Malaysia	**2**	**(7)**	**(1)**	10	(1)	(1)	12
Middle East[27]	HSBC Bank Middle East	**9**	**(16)**	**(4)**	29	48	(51)	32
North America	HSBC Bank USA	**9**	**(53)**	**(158)**	220	244	(438)	414
	HSBC Bank Canada	**8**		**(33)**	41	(16)	(36)	93
Latin America	HSBC Mexico	**49**	**25**	**(8)**	32	(10)	(21)	63
	Brazilian operations[34]	**241**	**34**	**17**	190	85	(1)	106
	HSBC Bank Panama	**26**	**(5)**	**(12)**	43	(7)	(16)	66
	HSBC Bank Argentina	**1**	**(1)**	**1**	1	(7)	(1)	9
Other operations		**45**	**(61)**	**(60)**	166	4	(129)	291
		1,659	**(653)**	**(2,647)**	4,959	1,183	(1,556)	5,332

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Interest expense (continued)

			Increase/(decrease) in 2009 compared with 2008			Increase/(decrease) in 2008 compared with 2007		
		2009	**Volume**	**Rate**	2008	Volume	Rate	2007
		US$m	**US$m**	**US$m**	US$m	US$m	US$m	US$m
Customer accounts								
Europe	HSBC Bank	**2,407**	**(1,015)**	**(6,670)**	10,092	1,355	(1,839)	10,576
	HSBC Private Banking Holdings (Suisse)	**256**	**(376)**	**(717)**	1,349	328	(464)	1,485
	HSBC France	**645**	**884**	**(1,822)**	1,583	292	65	1,226
Hong Kong	Hang Seng Bank	**200**	**69**	**(783)**	914	152	(1,138)	1,900
	The Hongkong and Shanghai Banking Corporation	**211**	**111**	**(1,265)**	1,365	382	(2,516)	3,499
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**1,494**	**(124)**	**(1,251)**	2,869	711	(487)	2,645
	HSBC Bank Malaysia	**191**	**(17)**	**(87)**	295	43	(8)	260
Middle East[27]	HSBC Bank Middle East	**432**	**(25)**	**35**	422	156	(312)	578
North America	HSBC Bank USA	**975**	**(40)**	**(1,054)**	2,069	334	(1,316)	3,051
	HSBC Bank Canada	**385**	**27**	**(609)**	967	146	(269)	1,090
Latin America	HSBC Mexico	**391**	**(114)**	**(56)**	561	15	(2)	548
	Brazilian operations[34]	**2,946**	**274**	**(438)**	3,110	741	206	2,163
	HSBC Bank Panama	**353**	**32**	**25**	296	6	(24)	314
	HSBC Bank Argentina	**99**	**(7)**	**(39)**	145	17	43	85
Other operations		**361**	**(12)**	**(1,579)**	1,952	369	(714)	2,297
		11,346	**(292)**	**(16,351)**	27,989	4,710	(8,438)	31,717
		1,558	**(177)**	**(1,398)**	3,133	304	(739)	3,568

Financial liabilities designated at fair value own debt issued

Debt securities in issue

Europe	HSBC Bank	**1,305**	**(615)**	**(2,081)**	4,001	1,290	(1,042)	3,753
	HSBC France	**330**	**(270)**	**(847)**	1,447	86	154	1,207
	HSBC Finance		**(8)**		8	(2)	(8)	18
Hong Kong	Hang Seng Bank	**21**	**(16)**	**(20)**	57	(2)	(21)	80
Rest of Asia-Pacific[27]	The Hongkong and Shanghai Banking Corporation	**218**	**(255)**	**(167)**	640	1	80	559
	HSBC Bank Malaysia	**16**	**(3)**	**(1)**	20	6	1	13
Middle East[27]	HSBC Bank Middle East	**62**	**11**	**(39)**	90	32	(61)	119
North America	HSBC Bank USA	**590**	**(37)**	**(225)**	852	(182)	(198)	1,232
	HSBC Finance	**2,510**	**(1,326)**	**71**	3,765	(802)	(744)	5,311
	HSBC Bank Canada	**322**	**(147)**	**(135)**	604	95	(131)	640
Latin America	HSBC Mexico	**67**	**(111)**	**(65)**	243	148	(15)	110
	Brazilian operations[34]	**86**	**(24)**	**(46)**	156	36	5	115
	HSBC Bank Panama	**34**	**(4)**	**5**	33	(4)	(8)	45
Other operations		**340**	**15**	**259**	66	(14)	93	(13)
		5,901	**(2,557)**	**(3,524)**	11,982	(723)	(1,930)	13,189

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Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > Short-term borrowings / Contractual obligations / Ratios / Loan maturities

Short-term borrowings
HSBC includes short-term borrowings within customer accounts, deposits by banks and debt securities in issue and does not show short-term borrowings separately on the balance sheet. Short-term borrowings are defined by the US Securities and Exchange Commission (SEC) as
Repos and short-term bonds
Federal funds purchased and securities sold under agreements to repurchase, commercial paper and other short-term borrowings. HSBC s only significant short-term borrowings are securities sold under agreements to repurchase and certain debt securities in issue. Additional information on these is provided in the table below.

	2009	2008	2007
	US$m	US$m	US$m
Securities sold under agreements to repurchase			
Outstanding at 31 December	**152,218**	145,180	140,001
Average amount outstanding during the year	**170,671**	177,256	129,779
Maximum quarter-end balance outstanding during the year.	**157,778**	190,651	148,601
Weighted average interest rate during the year	**0.8%**	3.8%	5.4%
Weighted average interest rate at the year-end	**0.4%**	2.9%	4.8%
Short-term bonds			
Outstanding at 31 December	**38,776**	40,279	51,792
Average amount outstanding during the year	**33,010**	45,330	39,153
Maximum quarter-end balance outstanding during the year.	**38,776**	55,842	51,792
Weighted average interest rate during the year	**3.2%**	5.0%	7.0%
Weighted average interest rate at the year-end	**0.6%**	3.1%	6.5%

Contractual obligations
The table below provides details of HSBC s material contractual obligations as at 31 December 2009.

		Payments due by period		
	Total	**Less than 1 year**	**1 5 years**	**More than 5 years**
	US$m	**US$m**	**US$m**	**US$m**
Long-term debt obligations	**234,297**	**71,482**	**93,778**	**69,037**
Term deposits and certificates of deposit	**211,434**	**198,081**	**13,353**	
Capital (finance) lease obligations	**971**	**103**	**249**	**619**
Operating lease obligations	**5,655**	**857**	**2,264**	**2,534**
Purchase obligations	**1,359**	**1,045**	**314**	

Short positions in debt securities and equity shares.	**90,067**	**73,437**	**5,332**	**11,298**
Current tax liability	**2,141**	**2,141**		
Pension/healthcare obligation	**15,979**	**1,188**	**5,548**	**9,243**
	561,903	**348,334**	**120,838**	**92,731**

Ratios of earnings to combined fixed charges (and preference share dividends)

	2009	2008	2007	2006	2005
	%	%	%	%	%
Ratios of earnings to combined fixed charges and preference share dividends:[38]					
excluding interest on deposits	**2.64**	2.97	6.96	7.22	9.16
including interest on deposits	**1.20**	1.13	1.34	1.40	1.59
Ratios of earnings to combined fixed charges:[38]					
excluding interest on deposits	**2.99**	3.17	7.52	7.93	9.60
including interest on deposits	**1.22**	1.14	1.34	1.41	1.59

For footnote, see page 149.

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Loan maturity and interest sensitivity analysis

At 31 December 2009, the geographical analysis of loan maturity and interest sensitivity by loan type on a contractual repayment basis was as follows:

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[27] US$m	Middle East[27] US$m	North America US$m	Latin America US$m	Total US$m
Maturity of 1 year or less							
Loans and advances to banks	62,840	**35,817**	**35,535**	**8,212**	**15,093**	**15,525**	**173,022**
Commercial loans to customers							
Commercial, industrial and international trade	80,451	12,563	22,085	7,248	4,327	9,576	136,250
Real estate and other property related	18,951	5,678	4,221	1,624	8,690	1,545	40,709
Non-bank financial institutions	67,934	1,201	1,751	959	9,680	1,181	82,706
Governments	1,155	110	172	1,212	161	442	3,252
Other commercial	26,238	2,026	4,173	1,432	6,944	2,665	43,478
	194,729	21,578	32,402	12,475	29,802	15,409	306,395
Hong Kong Government Home Ownership Scheme		385					385
Residential mortgages and other personal loans	29,732	13,083	10,811	2,959	35,352	8,793	100,730
Loans and advances to customers	224,461	35,046	43,213	15,434	65,154	24,202	407,510
	287,301	70,863	78,748	23,646	80,247	39,727	580,532
Maturity after 1 year but within 5 years							
Loans and advances to banks	2,452	380	105	168	221	374	3,700
Commercial loans to customers							
Commercial, industrial and international trade	21,101	4,708	5,427	1,591	6,183	4,591	43,601
Real estate and other property related	13,937	13,125	5,354	957	8,551	988	42,912
Non-bank financial institutions	4,622	535	472	239	1,993	519	8,380
Governments	461	263	257	125	46	731	1,883
Other commercial	13,638	4,375	2,536	1,076	3,029	2,508	27,162

	53,759	23,006	14,046	3,988	19,802	9,337	123,938
Hong Kong Government Home Ownership Scheme		1,276					1,276
Residential mortgages and other personal loans	35,063	9,642	6,782	2,635	47,021	6,364	107,507
Loans and advances to customers	88,822	33,924	20,828	6,623	66,823	15,701	232,721
	91,274	34,304	20,933	6,791	67,044	16,075	236,421
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							
Fixed interest rate	12,159	302	789	925	3,831	2,684	20,690
Variable interest rate	44,052	23,084	13,362	3,231	16,192	7,027	106,948
	56,211	23,386	14,151	4,156	20,023	9,711	127,638
Maturity after 5 years							
Loans and advances to banks	322		8	55	72	2,709	3,166
Commercial loans to customers							
Commercial, industrial and international trade	10,822	457	716	497	1,018	2,767	16,277
Real estate and other property related	7,196	5,041	763	85	2,738	465	16,288
Non-bank financial institutions	669	726	23	8	2,290	435	4,151
Governments	600	68	166	19	1	700	1,554
Other commercial	15,279	1,363	409	745	944	224	18,964
	34,566	7,655	2,077	1,354	6,991	4,591	57,234
Hong Kong Government Home Ownership Scheme		1,795					1,795
Residential mortgages and other personal loans	97,767	21,765	14,921	811	81,561	5,688	222,513
Loans and advances to customers	132,333	31,215	16,998	2,165	88,552	10,279	281,542
	132,655	31,215	17,006	2,220	88,624	12,988	284,708
Interest rate sensitivity of loans and advances to banks and commercial loans to customers							
Fixed interest rate	7,742		150	749	1,436	2,337	12,414

Variable interest rate	27,146	7,655	1,935	660	5,627	4,963	47,986
	34,888	7,655	2,085	1,409	7,063	7,300	60,400

For footnote, see page 149.

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > Deposits

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. The Other category includes securities sold under agreements to repurchase.

Deposits by banks

	2009		2008		2007	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**87,677**		99,228		84,635	
Demand and other non-interest bearing	**6,415**		5,231		6,359	
Demand interest bearing	**14,259**	**1.0**	19,204	3.2	11,036	3.8
Time	**30,367**	**1.6**	43,695	3.9	38,470	4.7
Other	**36,636**	**1.3**	31,098	4.4	28,770	4.8
Hong Kong	**10,725**		5,916		7,269	
Demand and other non-interest bearing	**2,975**		1,375		1,331	
Demand interest bearing	**5,526**	**0.1**	2,780	2.0	2,420	4.3
Time	**1,637**	**0.3**	1,583	2.7	3,267	4.5
Other	**587**	**0.5**	178	3.4	251	0.4
Rest of Asia-Pacific[27]	**12,467**		18,203		12,748	
Demand and other non-interest bearing	**1,605**		1,546		1,356	
Demand interest bearing	**4,097**	**1.2**	4,317	2.3	3,164	2.4
Time	**4,682**	**1.9**	9,103	3.5	5,464	5.2
Other	**2,083**	**1.4**	3,237	3.8	2,764	4.8
Middle East[27]	**1,317**		2,151		1,517	

Demand and other non-interest bearing	**539**		365		541	
Demand interest bearing	**18**		15		3	
Time	**691**	**1.2**	1,239	2.7	969	4.5
Other	**69**	**1.4**	532	0.2	4	
North America	**13,203**		14,835		11,501	
Demand and other non-interest bearing	**1,755**		761		827	
Demand interest bearing	**4,770**	**0.1**	5,684	1.7	3,759	4.8
Time	**5,422**	**0.2**	7,941	2.3	6,746	6.0
Other	**1,256**	**0.7**	449	1.6	169	7.1
Latin America	**5,959**		5,058		4,661	
Demand and other non-interest bearing	**212**		366		808	
Demand interest bearing	**219**	**0.9**	81	2.5	153	5.9
Time	**4,171**	**5.0**	3,357	5.6	2,690	6.5
Other	**1,357**	**8.1**	1,254	7.8	1,010	8.0
Total	**131,348**		145,391		122,331	
Demand and other non-interest bearing	**13,501**		9,644		11,222	
Demand interest bearing	**28,889**	**0.7**	32,081	2.7	20,535	3.8
Time	**46,970**	**1.7**	66,918	3.7	57,606	4.9
Other	**41,988**	**1.6**	36,748	4.5	32,968	5.0

For footnote, see page 149.

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Customer accounts

	2009		2008		2007	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**440,450**		447,982		391,496	
Demand and other non-interest bearing	**55,751**		39,610		34,585	
Demand interest bearing	**212,178**	**0.4**	225,034	2.9	210,692	3.5
Savings	**57,344**	**2.2**	73,479	4.3	62,002	4.6
Time	**67,045**	**1.4**	83,208	3.8	69,476	4.9
Other	**48,132**	**0.8**	26,651	3.9	14,741	4.5
Hong Kong	**261,703**		236,109		212,792	
Demand and other non-interest bearing	**22,056**		15,620		14,214	
Demand interest bearing	**171,846**	**0.1**	126,199	0.4	107,053	2.2
Savings	**45,537**	**0.6**	65,068	2.4	63,649	3.9
Time	**20,901**	**0.6**	27,659	2.3	26,712	3.9
Other	**1,363**	**0.1**	1,563	1.2	1,164	4.3
Rest of Asia-Pacific[27]	**126,144**		128,381		103,235	
Demand and other non-interest bearing	**13,425**		11,872		10,225	
Demand interest bearing	**53,108**	**0.8**	49,329	2.0	37,340	2.5
Savings	**46,137**	**2.5**	52,849	3.8	44,004	4.1
Time	**12,542**	**1.2**	13,342	3.3	10,114	4.7
Other	**932**	**1.8**	989	3.6	1,552	5.2
Middle East[27]	**33,211**		35,546		25,615	
Demand and other non-interest bearing	**9,865**		10,849		6,213	
Demand interest bearing	**6,364**	**1.4**	6,324	1.6	3,749	2.0
Savings	**15,005**	**3.4**	16,119	3.1	13,946	4.6
Time	**1,424**	**2.7**	1,884	2.9	1,424	4.1
Other	**553**	**0.2**	370	0.5	283	1.1

North America	**145,820**		144,982		130,982	
Demand and other non-interest bearing	**18,350**		16,759		15,175	
Demand interest bearing	**25,870**	**0.2**	18,261	1.6	15,389	3.3
Savings	**69,296**	**1.4**	87,001	2.5	79,529	3.3
Time	**25,164**	**1.3**	17,838	3.2	17,655	5.9
Other	**7,140**	**0.8**	5,123	2.4	3,234	3.7
Latin America	**63,635**		65,071		54,708	
Demand and other non-interest bearing	**10,598**		12,507		10,530	
Demand interest bearing	**4,734**	**1.1**	4,994	1.9	5,662	2.1
Savings	**33,091**	**8.5**	31,442	10.3	24,861	8.8
Time	**14,244**	**4.8**	15,179	5.2	12,443	5.9
Other	**968**	**6.4**	949	8.2	1,212	9.5
Total	**1,070,963**		1,058,071		918,828	
Demand and other non-interest bearing	**130,045**		107,217		90,942	
Demand interest bearing	**474,100**	**0.3**	430,141	1.9	379,885	3.0
Savings	**266,410**	**2.6**	325,958	3.9	287,991	4.4
Time	**141,320**	**1.6**	159,110	3.6	137,824	4.9
Other	**59,088**	**0.9**	35,645	3.6	22,186	4.7

For footnote, see page 149.

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Financial summary > Balance sheet > CDs // Critical accounting policies

Certificates of deposit and other money market instruments

	2009		2008		2007	
	Average balance US$m	**Average rate %**	Average balance US$m	Average rate %	Average balance US$m	Average rate %
Europe	**65,151**	**0.9**	74,007	4.5	66,164	5.0
Hong Kong	**278**	**3.6**	745	3.0	941	3.9
Rest of Asia-Pacific[27]	**3,536**	**3.7**	6,966	6.6	7,094	6.0
Middle East[27]	**265**	**6.4**	648	4.6	136	3.7
North America	**14,218**	**1.1**	22,278	3.3	23,735	5.4
Latin America	**1,227**	**3.6**	3,036	7.8	1,526	6.8
	84,675	**1.2**	107,680	4.5	99,596	5.2

For footnote, see page 149.

Certificates of deposit and other time deposits

The maturity analysis of CDs 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 2009				
	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	**97,874**	**11,310**	**19,664**	**7,131**	**135,979**
Certificates of deposit	**18,009**	**3,810**	**3,755**	**1**	**25,575**
Time deposits:					
banks	**25,194**	**2,048**	**9,455**	**3,965**	**40,662**
customers	**54,671**	**5,452**	**6,454**	**3,165**	**69,742**
Hong Kong	**12,031**	**873**	**484**	**500**	**13,888**
Certificates of deposit	**75**	**24**	**151**	**265**	**515**

Time deposits:					
banks	**619**	**1**		**89**	**709**
customers	**11,337**	**848**	**333**	**146**	**12,664**
Rest of Asia-Pacific[27]	**13,890**	**1,784**	**651**	**1,108**	**17,433**
Certificates of deposit	**1,498**	**1,001**	**366**	**183**	**3,048**
Time deposits:					
banks	**2,231**	**252**	**19**	**108**	**2,610**
customers	**10,161**	**531**	**266**	**817**	**11,775**
Middle East[27]	**902**	**486**	**43**	**319**	**1,750**
Certificates of deposit		**136**			**136**
Time deposits:					
banks	**448**	**186**		**24**	**658**
customers	**454**	**164**	**43**	**295**	**956**
North America	**14,235**	**4,221**	**3,314**	**1,293**	**23,063**
Time deposits:					
banks	**2,798**		**7**	**238**	**3,043**
customers	**11,437**	**4,221**	**3,307**	**1,055**	**20,020**
Latin America	**11,980**	**2,626**	**1,713**	**3,002**	**19,321**
Certificates of deposit	**88**			**322**	**410**
Time deposits:					
banks	**1,036**	**1,421**	**747**	**236**	**3,440**
customers	**10,856**	**1,205**	**966**	**2,444**	**15,471**
Total	**150,912**	**21,300**	**25,869**	**13,353**	**211,434**
Certificates of deposit	**19,670**	**4,971**	**4,272**	**771**	**29,684**
Time deposits:					
banks	**32,326**	**3,908**	**10,228**	**4,660**	**51,122**
customers	**98,916**	**12,421**	**11,369**	**7,922**	**130,628**

For footnote, see page 149.

Critical accounting policies

(Audited)

Introduction

The results of HSBC are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its consolidated financial statements. The significant accounting policies used in the preparation of the consolidated financial statements are described in Note 2 on the Financial Statements.

When preparing the financial statements, it is the Directors responsibility under UK company law to select suitable accounting policies and to make judgements and estimates that are reasonable and prudent.

The accounting policies that are deemed critical to HSBC s results and financial position, in terms of the materiality of the items to which the policy is applied, and which involve a high degree of judgement including the use of assumptions and estimation, are discussed below.

Impairment of loans and advances

HSBC s accounting policy for losses arising from the impairment of customer loans and advances is described in Note 2g on the Financial Statements. Loan impairment allowances represent management s best estimate of losses incurred in the loan portfolios at the balance sheet date.

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment allowances on both individually and collectively assessed loans and advances. Of the Group s total loans and advances to customers before impairment allowances of US$922 billion (2008: US$957 billion), US$14.8 billion or 2 per cent (2008: US$7.9 billion; 1 per cent) were individually assessed for impairment, and US$907 billion or 98 per cent (2008: US$949 billion; 99 per cent) were collectively assessed for impairment.

The most significant judgemental area is the calculation of collective impairment allowances. HSBC s most significant geographical area of exposure to collectively assessed loans and advances is North America, which comprised US$219 billion or 24 per cent (2008: US$271 billion; 29 per cent) of HSBC s total collectively assessed loans and advances. Collective impairment allowances in North America were US$13.0 billion, representing 68 per cent (2008: US$15.9 billion; 77 per cent) of the total collectively assessed loan impairment allowance.

HSBC uses two alternative methods to calculate collective impairment allowances on homogeneous groups of loans that are not considered individually significant:

- when appropriate empirical information is available, HSBC utilises roll-rate methodology. This methodology employs statistical analysis of historical data and experience of delinquency and default to estimate the likelihood that loans will progress through the various stages of delinquency and ultimately prove irrecoverable. The estimated loss is the difference between the present value of expected future cash flows, discounted at the original effective interest rate of the portfolio, and the carrying amount of the portfolio; and

- when the portfolio size is small or when information is insufficient or not reliable enough to adopt a roll-rate methodology, HSBC adopts a basic formulaic approach based on historical loss rate experience.

Both methodologies are subject to estimation uncertainty, in part because it is not practicable to identify losses on an individual loan basis because of the large number of individually insignificant loans in the portfolio.

In addition, the use of statistically assessed historical information is supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience. In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio. In certain circumstances, historical loss experience provides less relevant information about the inherent loss in a given portfolio at the balance sheet date, for example, where there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in the portfolio risk factors being not fully reflected in the statistical models. In these circumstances, such risk factors are taken into account when calculating the appropriate levels of impairment allowances by adjusting the impairment allowances derived solely from historical loss experience.

This key area of judgement is subject to uncertainty and is highly sensitive to factors such as loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other factors that can affect customer payment patterns. Different factors are applied in different regions and countries to reflect the variation in economic conditions, laws and regulations. The assumptions underlying this judgement are highly subjective. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example, roll rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure they remain appropriate.

The total amount of the Group s impairment allowances on homogeneous groups of loans is inherently uncertain because it is highly sensitive to changes in economic and credit conditions across a large number of geographical areas. Economic and credit conditions within geographical areas are influenced by many factors with a high degree of interdependency so that there is no single factor to which the Group s loan impairment allowances as a whole are sensitive. However, HSBC s loan impairment allowances are particularly sensitive to general economic and credit conditions in North America. For example, a 10 per cent increase in impairment allowances on collectively assessed loans and advances in North America would increase loan impairment allowances by US$1.3 billion at 31 December 2009 (2008: US$1.6 billion). It is possible that the outcomes within the next financial year could be different from the assumptions built into the models, resulting in a material adjustment to the carrying amount of loans and advances.

Goodwill impairment

HSBC s accounting policy for goodwill is described in Note 2p on the Financial Statements. Note 22 on the Financial Statements lists the Group s cash generating units (CGU s) by geographical region and global business. Total goodwill for the Group amounted to US$23 billion as at 31 December 2009 (2008: US$22 billion).

The process of identifying and evaluating goodwill impairment is inherently uncertain because it requires significant management judgement in making a series of estimations, the results of which are highly sensitive to the assumptions used. The review of goodwill impairment represents management s best estimate of the factors below:

- the future cash flows of the CGUs are sensitive to the cash flows projected for the periods for which detailed forecasts are available, and to assumptions regarding the long-term pattern of sustainable cash flows thereafter. Forecasts are compared with actual performance and verifiable economic data in future years; however, the cash flow forecasts necessarily and appropriately reflect management s view of future business prospects at the time of the assessment; and

- the rate used to discount the future expected cash flows is based on the cost of capital assigned to an individual CGU, and can have a significant effect on the CGU s valuation. The cost of capital percentage is generally derived from a Capital Asset Pricing Model, which incorporates inputs reflecting a number of financial and economic variables, including the risk-free interest rate in the country concerned and a premium to reflect the inherent risk of the business being evaluated. These variables are subject to fluctuations in external market rates and economic conditions outside management s control and are therefore established on the basis of significant management judgement and are subject to uncertainty.

When this exercise demonstrates that the expected cash flows of a CGU have declined and/or that its cost of capital has increased, the effect is to reduce the CGU s estimated recoverable amount. If this is lower than the carrying value of the CGU, a charge for impairment of goodwill will be recognised in HSBC s income statement for the year.

The accuracy of forecast cash flows is subject to a high degree of uncertainty in volatile market conditions. In such market conditions, management retests goodwill for impairment more frequently than annually to ensure that the assumptions on which the cash flow forecasts are based continue to reflect current market conditions and management s best estimate of future business prospects.

During 2009, no impairment of goodwill was identified (2008: US$10.6 billion). In addition to the annual impairment test which was performed as at 1 July 2009, HSBC reviewed the current and expected performance of the CGUs as at 31 December 2009 and determined that there was no indication of potential impairment of the goodwill allocated to them. However, in the event of a significant deterioration in economic and credit conditions compared with those reflected by management in the cash flow forecasts for the CGUs, a material adjustment to a CGU s recoverable amount may occur which may result in the recognition of an impairment charge in the income statement.

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Note 22 on the Financial Statements includes details of the CGU s with significant balances of goodwill, states the key assumptions used to assess the goodwill in each of those CGUs for impairment, and provides a discussion of the sensitivity of the carrying value of goodwill to changes in key assumptions.

Valuation of financial instruments

HSBC s accounting policy for determining the fair value of financial instruments is described in Note 2d on the Financial Statements.

The best evidence of fair value is a quoted price in an actively traded market. In the event that the market for a financial instrument is not active, a valuation technique is used. The majority of valuation techniques employ only observable market data, and so the reliability of the fair value measurement is high. However, certain financial instruments are valued on the basis of valuation techniques that feature one or more significant market inputs that are unobservable. Valuation techniques that rely to a greater extent on unobservable inputs require a higher level of management judgement to calculate a fair value than those based wholly on observable inputs.

Valuation techniques used to calculate fair values include comparisons with similar financial instruments for which market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Valuation techniques incorporate assumptions that other market participants would use in their valuations, including assumptions about interest rate yield curves, exchange rates, volatilities, and prepayment and default rates. When valuing instruments by reference to comparable instruments, management takes into account the maturity, structure and rating of the instrument with which the position held is being compared.

The main assumptions and estimates which management considers when applying a model with valuation techniques are:

- the likelihood and expected timing of future cash flows on the instrument. These cash flows are usually governed by the terms of the instrument, although management judgement may be required when the ability of the counterparty to service the instrument in accordance with the contractual terms is in doubt. Future cash flows may be sensitive to changes in market rates;
- selecting an appropriate discount rate for the instrument. Management bases the determination of this rate on its assessment of what a market participant would regard as the appropriate spread of the rate for the instrument over the appropriate risk-free rate; and
- judgement to determine what model to use to calculate fair value in areas where the choice of valuation model is particularly subjective, for example, when valuing complex derivative products.

When applying a model with unobservable inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data inputs, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on unobservable data are inherently uncertain because there is little or no current market data available from which to determine the level at which an arm s length transaction would occur under normal business conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments will be based on some market observable inputs even where the unobservable inputs are significant.

The value of financial assets and liabilities measured at fair value that use a valuation technique was US$599 billion (2008: US$876 billion) and US$447 billion (2008: US$671 billion) or 56 per cent (2008: 71 per cent) and 75 per cent (2008: 83 per cent) of total financial assets and total financial liabilities measured at fair value, respectively.

Disclosures of types and amounts of fair value adjustments made in determining the fair value of financial instruments measured at fair value using valuation techniques is provided on page 168. In addition, a sensitivity analysis of fair values for financial instruments with significant unobservable inputs to reasonably possible alternative assumptions and a range of assumptions can be found on page 175. Given the uncertainty and subjective nature of valuing financial instruments at fair value, it is possible that the outcomes in the next financial year could differ from the assumptions used, and this could result in a material adjustment to the carrying amount of financial instruments measured at fair value.

Critical accounting policies

Impairment of available-for-sale financial assets

HSBC s accounting policy for impairment of available-for-sale financial assets is described in Note 2j on the Financial Statements.

Available-for-sale financial assets are measured at fair value, and changes in fair value are recognised in other comprehensive income in Available-for-sale investments fair value gains/(losses) until the financial assets are either sold or become impaired. An impairment loss is recognised if there is objective evidence of impairment as a result of loss events which have an impact on the estimated future cash flows of the financial asset that can be reliably estimated. If an available-for-sale financial asset becomes impaired, the cumulative balance previously recognised in other comprehensive income is removed and recognised in the income statement as an impairment loss. A further decline in the fair value of an available-for-sale debt security subsequent to the initial impairment is recognised in the income statement when there is further objective evidence of impairment.

At 31 December 2009, the Group s total available-for-sale financial assets amounted to US$352 billion (2008: US$286 billion), of which US$342 billion or 97 per cent (2008: US$279 billion; 98 per cent) were debt securities. The available-for-sale fair value reserve relating to debt securities amounted to a deficit of US$11.4 billion (2008: deficit of US$21.4 billion). A deficit in the available-for-sale fair value reserve occurs on debt securities when the fair value of a security so categorised is less than the security s acquisition cost (net of any principal repayments and amortisation) less any previous impairment loss recognised in the income statement, but where there is no evidence of any impairment or, if an impairment was previously recognised, any subsequent impairment.

Management is required to exercise judgement in determining whether there is objective evidence that an impairment loss has occurred. Once an impairment has been identified, the amount of impairment loss is measured with reference to the fair value of the asset. More information on assumptions and estimates requiring management judgement relating to the determination of fair values of financial instruments is provided above in Valuation of financial instruments .

The objective evidence required to determine whether an available-for-sale debt security is impaired comprises evidence of the occurrence of a loss event and evidence that the loss event results in a decrease in estimated future cash flows. When cash flows are readily determinable, less judgement is required. When determination of estimated future cash flows requires consideration of a number of variables, some of which may be unobservable in current market conditions, more judgement is required.

The most significant judgements concern more complex instruments, such as asset-backed securities (ABS s), where it is necessary to consider factors such as the estimated future cash flows on underlying pools of collateral including prepayment speeds, the extent and depth of market price declines and changes in credit ratings. The review of estimated future cash flows on underlying collateral is subject to uncertainties when the assessment is based on historical information on pools of assets, and judgement is required to determine whether historical performance remains representative of current economic and credit conditions.

There is no single factor to which the Group s charge for impairment of available-for-sale debt securities is particularly sensitive, because of the range of different types of securities held, the range of geographical areas in which those securities are held, and the wide range of factors which can affect the occurrence of loss events and the cash flows of securities, including different types of collateral.

Management s current assessment of the holdings of available-for-sale ABSs with the most sensitivity to possible future impairment is focused on sub-prime and Alt-A residential mortgage-backed securities. Excluding holdings in certain special purpose entities where significant first loss risks are borne by external investors, the available-for-sale holdings in these categories amounted to US$4.9 billion at 31 December 2009 (2008: US$6.1 billion). The deficit in the available-for-sale fair value reserve at 31 December 2009 in relation to these securities was US$4.3 billion (2008: US$6.0 billion).

Further details of the nature and extent of HSBC s exposures to ABSs classified as available-for-sale are provided in Impact of market turmoil under Nature and extent of HSBC s exposures on page 157 and a more detailed description of the assumptions and estimates used in assessing these securities for impairment is disclosed in Assessing available-for-sale assets for impairment on page 178.

It is possible that outcomes in the next financial year could be different from those modelled when seeking to identify impairment on available-for-sale debt securities. In this event, impairment may be

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identified in available-for-sale debt securities which had previously been determined not to be impaired, potentially resulting in the recognition of material impairment losses in the next financial year.

Deferred tax assets

HSBC s accounting policy for the recognition of deferred tax assets is described in Note 2s on the Financial Statements. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised. The recognition of a deferred tax asset relies on management s judgements about the probability and sufficiency of future taxable profits, future reversals of existing taxable temporary differences and ongoing tax planning strategies.

HSBC s most significant judgements are around the US deferred tax assets, given the recent history of losses in HSBC s US operations. Net US deferred tax assets amounted to US$5.1 billion or 59 per cent (2008: US$5.1 billion; 73 per cent) of deferred tax assets recognised on the Group s balance sheet.

Recognition of US deferred tax assets is based on the evidence available about conditions at the balance sheet date, and requires significant judgements to be made by management regarding projections of loan impairment charges and the timing of recovery in the US economy. Management s judgement takes into consideration the impact of both positive and negative evidence, including historical financial performance, projections of future taxable income, future reversals of existing taxable temporary differences, tax planning strategies and the availability of loss carrybacks.

The tax losses incurred in HSBC s US operations in 2009 were primarily caused by the high level of loan impairment charges which were due to the current housing and credit market conditions and continued weakness in the general economy, resulting in high unemployment levels. Management has evaluated the factors contributing to the losses to determine whether the factors leading to the losses are temporary or indicative of a permanent decline in earnings.

Management s projections of future taxable income in the US are based on business plans, future capital requirements and ongoing tax planning strategies. These projections include assumptions about the depth and severity of house price depreciation, assumptions about the US economic downturn, including unemployment levels and their impact on loan impairment charges, and assumptions about capital support from HSBC.

Management s forecasts are consistent with the assumption that it is probable that the results of future operations will generate sufficient taxable income to support the deferred tax assets. In management s judgement, recent market conditions, which have resulted in losses being incurred in the US over the last three years, will create significant downward pressure and volatility regarding the profit or loss before tax in the next few years. To reflect this, the assessment of recoverability of the deferred tax asset in the US significantly discounts any future expected taxable income and relies to a greater extent on capital support to the US operations from HSBC, including tax planning strategies implemented in relation to such support. The most significant tax planning strategy is HSBC s investment of capital in its US operations to ensure the realisation of the deferred tax assets. Further to the implementation of this strategy, an internal reorganisation on 31 January 2010 resulted in a capital injection that provided substantial support for the recoverability of the US deferred tax assets. HSBC expects that, with support, its US operations will continue to execute their business strategies and plans until they return to profitability. If HSBC were to decide not to provide ongoing support, the full recovery of the deferred tax asset may no longer be probable and could result in a significant write-off of the deferred tax asset which would be recognised as a charge in the income statement.

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Disclosure controls / Management s assessment of internal controls

Disclosure controls

The Group Chief Executive and Chief Financial Officer, Executive Director, Risk and Regulation, 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 of 31 December 2009. Based upon that evaluation, the Group Chief Executive and Chief Financial Officer, Executive Director, Risk and Regulation concluded that HSBC s disclosure controls and procedures as of 31 December 2009 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 2009 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 as of 31 December 2009. In making the assessment, management used the framework for Directors internal control evaluation contained within the Combined Code (The Revised Turnbull Guidance), as well as the criteria established by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) in Internal Control-Integrated Framework .

Based on the assessment performed, management concluded that as at 31 December 2009, the Group s internal control over financial reporting was effective.

KPMG Audit Plc, which has audited the consolidated financial statements of the Group for the year ended 31 December 2009, 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 350 and 351.

Customer groups and global businesses

Summary

HSBC s senior management reviews operating activity on a number of bases, including by geographical region and by customer group and global business. Although information is reviewed on a number of bases, capital resources are allocated and performance is assessed primarily by geographical region, as presented on page 85.

In addition to utilising information by geographical region, management assesses performance through two customer groups, Personal Financial Services and Commercial Banking, and two global businesses, Global Banking and Markets and Private Banking. Personal Financial Services incorporates the Group s consumer finance businesses, the largest of which is HSBC Finance.

The commentaries below present customer groups and global businesses followed by geographical regions. 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 underlying basis (see page 21) unless stated otherwise.

Profit/(loss) before tax

	2009		2008		2007	
	US$m	**%**	US$m	%	US$m	%
Personal Financial Services.	**(2,065)**	**(29.2)**	(10,974)	(117.9)	5,900	24.4
Commercial Banking	**4,275**	**60.4**	7,194	77.3	7,145	29.5
Global Banking and Markets	**10,481**	**148.1**	3,483	37.4	6,121	25.3
Private Banking	**1,108**	**15.6**	1,447	15.6	1,511	6.2
Other[40]	**(6,720)**	**(94.9)**	8,157	87.6	3,535	14.6

	7,079	**100.0**	9,307	100.0	24,212	100.0

Total assets[41]

	At 31 December			
	2009		2008	
	US$m	**%**	US$m	%
Personal Financial Services.	**554,074**	**23.4**	527,901	20.9
Commercial Banking	**251,143**	**10.6**	249,218	9.9
Global Banking and Markets	**1,683,672**	**71.2**	1,991,852	78.8
Private Banking	**116,148**	**4.9**	133,216	5.2
Other	**150,983**	**6.4**	145,581	5.8
Intra-HSBC items	**(391,568)**	**(16.5)**	(520,303)	(20.6)
	2,364,452	**100.0**	2,527,465	100.0

For footnotes, see page 149.

Basis of preparation

The results are presented in accordance with the accounting policies used in the preparation of HSBC s consolidated financial statements. HSBC s operations are closely integrated and, accordingly, the presentation of customer group data includes internal allocations of certain items of income and expense. These allocations include the costs of certain support services and Group Management Office (GMO) 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 a degree of subjectivity.

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

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Personal Financial Services

Profit/(loss) before tax

	2009 US$m	2008 US$m	2007 US$m
Net interest income	**25,107**	29,419	29,069
Net fee income	**8,238**	10,107	11,742
Trading income excluding net interest income	**637**	175	38
Net interest income on trading activities	**65**	79	140
Net trading income[42]	**702**	254	178
Net income/(expense) from financial instruments designated at fair value.	**2,339**	(2,912)	1,333
Gains less losses from financial investments	**224**	663	351
Dividend income	**33**	90	55
Net earned insurance premiums	**9,534**	10,083	8,271
Other operating income	**809**	259	387
Total operating income	**46,986**	47,963	51,386
Net insurance claims[43]	**(11,571)**	(6,474)	(8,147)
Net operating income[16]	**35,415**	41,489	43,239
Loan impairment charges and other credit risk provisions	**(19,902)**	(21,220)	(16,172)
Net operating income	**15,513**	20,269	27,067
Employee expenses	**(7,323)**	(9,243)	(9,401)
Goodwill impairment		(10,564)	
Other operating expenses	**(10,969)**	(11,897)	(12,356)
Total operating expenses	**(18,292)**	(31,704)	(21,757)

Operating profit/(loss)	**(2,779)**	(11,435)	5,310
Share of profit in associates and joint ventures	**714**	461	590
Profit/(loss) before tax	**(2,065)**	(10,974)	5,900
By geographical region			
Europe	**312**	1,658	1,581
Hong Kong	**2,728**	3,428	4,212
Rest of Asia-Pacific[27]	**463**	211	515
Middle East[27]	**(126)**	289	245
North America	**(5,226)**	(17,228)	(1,546)
Latin America	**(216)**	668	893
	(2,065)	(10,974)	5,900
	%	*%*	*%*
Share of HSBC s profit before tax	**(29.2)**	(117.9)	24.4
Cost efficiency ratio	**51.7**	76.4	50.3

Balance sheet data [41]

	US$m	US$m	US$m
Loans and advances to customers (net)	**399,460**	401,402	464,726
Total assets	**554,074**	527,901	636,185
Customer accounts	**499,109**	440,338	450,071

For footnotes, see page 149.

Strategic direction

HSBC s strategy for Personal Financial Services is to use its global reach and scale to grow profitably in selected markets by providing relationship banking and wealth management services.

In markets where HSBC already has scale, such as Hong Kong and Mexico, or in emerging markets where scale can be built over time, HSBC provides services to all customer segments. In other markets, HSBC participates more selectively, targeting mass affluent customer segments which have strong international connectivity or where HSBC s global scale is crucial.

HSBC employs two globally consistent propositions, HSBC Premier (Premier) and HSBC Advance (Advance), to serve customers who value international connectivity, who are confident using direct channels to access financial services and who are likely to require wealth management services.

HSBC s continued strategic focus on increasing penetration of wealth management services, through deepening customer relationships and offering innovative solutions, positions the Personal Financial Services business for growth as confidence and demand for equity market and insurance products improves.

Financial performance in 2009

The reported loss before tax of US$2.1 billion compared with a loss before tax of US$11.0 billion in 2008. On an underlying basis and excluding the impairment charge of US$10.6 billion in 2008 to fully write off goodwill in respect of North America Personal Financial Services, the pre-tax loss grew by US$1.1 billion. This was driven by a decline in profits due to a significant fall in deposit spreads, reflecting the very low levels of major currency interest rates throughout 2009, and a rise in loan impairment charges outside North America as global economic conditions deteriorated. Within North America, loan impairment charges and operating expenses fell, reflecting the continuing run-off of the exit portfolios, some stabilisation in the credit environment and the closure of the US Consumer Lending branch network at the beginning of 2009.

Net interest income decreased by 10 per cent. This was due to significant deposit spread compression experienced in the Group s major deposit-taking entities as a result of lower base rates and lower asset balances as customer loans

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Customer groups > Personal Financial Services

in the US declined and consumer finance and unsecured lending activities in other countries were scaled back. These factors were partially mitigated by the benefit of lower funding costs on lending spreads and growth in average liability balances as customers responded to the strength of HSBC s brand following the market turmoil in 2008.

Net fee income was 13 per cent lower, reflecting lower card fees from reduced volumes of new lending and changes in customer behaviour, particularly in North America. Weak equity market sentiment in the first half of 2009 further affected revenues from retail securities and investments, notably in Hong Kong, although relatively more buoyant markets led to some recovery in the second half of the year.

A net gain of US$2.3 billion was recorded on financial instruments designated at fair value, compared with an expense of US$2.9 billion in 2008. This was largely due to an increase in the value of assets held to meet liabilities under insurance and investment contracts.

Loan impairment charges fell by 3 per cent, with the significant decline in North America driven by the continuing reduction in balances and some stabilisation of loss experience in certain segments of the consumer finance portfolios. This was partly offset by credit deterioration elsewhere, primarily in the unsecured portfolios of various lending products in the Middle East, the UK and Brazil. The Group further strengthened collection systems and practices, reduced credit lines and tightened lending criteria in 2009.

Costs declined by US$1.4 billion excluding the goodwill impairment charge in North America in 2008. This reduction resulted primarily from the decision to discontinue originations and close the branch network in the Consumer Lending business in the US, and from the exercise of tight control of discretionary expenditure in most regions, notably in Asia. Costs also benefited from a US$0.2 billion accounting gain on staff benefits in 2009 in the UK.

Income from associates and joint ventures rose by 51 per cent, largely driven by the Group s share of profits from Ping An Insurance which increased in 2009 following the non-recurrence of an impairment on its investment in Fortis in 2008.
Customer accounts increased by 7 per cent, largely on the back of strong deposit growth in Asia. Loans and advances to customers were 5 per cent lower as the US consumer finance portfolio continued to decline and, globally, customers reduced their use of credit. At 31 December 2009, the aggregate ratio of customer advances to deposits in Personal Financial Services was 80 per cent, compared with 91 per cent at the end of 2008.

Business highlights in 2009

Premier, the Group s flagship global customer proposition, grew to 3.4 million customers in 2009, attracting 724,000 net new customers of which nearly 50 per cent were new to the Group. Premier was launched in Russia and Colombia during the year, extending the total number of markets where the service is offered to 43.

Premier was expanded in 2009 with the launch of HSBC Amanah Premier, the world s first Islamic premium banking service, in six markets (UAE, Saudi Arabia, Malaysia, Indonesia, Qatar and Bahrain), offering customers a suite of shariah compliant products and Islamic wealth management services.

A second globally consistent proposition, Advance, was developed in 2009 for launch in early 2010. Building on the success of Premier, Advance will target emerging mass affluent customers who are not yet Premier but have the potential to be so. Advance is currently available in seven markets, including Hong Kong and the UK, and will be offered in over 30 markets by the end of 2010.

As part of its wealth management strategy, HSBC successfully launched the World Selection global investment offering in seven markets. This fund, which will be available in over 20 markets by the end of 2010, is designed to meet the different needs and risk appetites of HSBC customers by offering a range of globally diversified and multi-asset portfolios. The fund had assets of US$2.7 billion at the end of the year.

HSBC s growth in personal lending in 2009 was largely in mortgage products in the UK and Hong Kong. In the UK, HSBC launched various marketing campaigns including a new Rate Matcher mortgage promotion. As a result of market share gains in 2009, the UK bank more than met its commitment to make £15 billion (US$24.7 billion) of new mortgage lending available to borrowers. In Hong Kong, HSBC maintained its market leading position with gross mortgage balance growth of 7 per cent during the year.

As part of its strategy to deliver a globally consistent customer experience, Personal Financial Services commenced a global retail store update and refresh programme including the introduction of a set of minimum service standards across customer touch points. The standardised range of design principles helps address the diverse needs of customers and enables them to recognise and be confident in their dealings with HSBC wherever they are. The customer recommendation score for Personal Financial Services increased in 2009 (see page 20).

Reconciliation of reported and underlying profit/(loss) before tax

	2009 compared with 2008								
Personal Financial Services	2008 as reported US$m	2008 acquisitions and disposals[10] US$m	Currency translation[11] US$m	2008 at 2009 exchange rates[12] US$m	2009 acquisitions and disposals[10] US$m	Underlying change US$m	2009 as reported US$m	Reported change[13] %	Underlying change[13] %
Net interest income	29,419	(36)	(1,534)	27,849	3	(2,745)	25,107	(15)	(10)
Net fee income	10,107	(32)	(645)	9,430		(1,192)	8,238	(18)	(13)
Other income[15]	1,963	(121)	(258)	1,584	1	485	2,070	5	31
Net operating income[16]	41,489	(189)	(2,437)	38,863	4	(3,452)	35,415	(15)	(9)
Loan impairment charges and other credit risk provisions	(21,220)	3	595	(20,622)		720	(19,902)	6	3
Net operating income	20,269	(186)	(1,842)	18,241	4	(2,732)	15,513	(23)	(15)
Operating expenses (excluding goodwill impairment)	(21,140)	38	1,372	(19,730)	(1)	1,439	(18,292)	13	7
Goodwill impairment	(10,564)			(10,564)		10,564		100	100
Operating loss	(11,435)	(148)	(470)	(12,053)	3	9,271	(2,779)	76	77
Income from associates	461		13	474		240	714	55	51

Loss before tax	**(10,974)**	**(148)**	**(457)**	**(11,579)**	**3**	**9,511**	**(2,065)**	**81**	**82**

	2008 compared with 2007								
Personal Financial Services	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	29,069	(224)	(126)	28,719	215	485	29,419	1	2
Net fee income	11,742	(21)	(105)	11,616	(9)	(1,500)	10,107	(14)	(13)
Other income[15]	2,428	(91)	(10)	2,327	83	(447)	1,963	(19)	(19)
Net operating income[16]	43,239	(336)	(241)	42,662	289	(1,462)	41,489	(4)	(3)
Loan impairment charges and other credit risk provisions	(16,172)	4	75	(16,093)	(3)	(5,124)	(21,220)	(31)	(32)
Net operating income	27,067	(332)	(166)	26,569	286	(6,586)	20,269	(25)	(25)
Operating expenses (excluding goodwill impairment)	(21,757)	236	117	(21,404)	(98)	362	(21,140)	3	2
Goodwill impairment						(10,564)	(10,564)		
Operating profit/(loss)	5,310	(96)	(49)	5,165	188	(16,788)	(11,435)	(315)	(325)
Income from associates	590		52	642		(181)	461	(22)	(28)
Profit/(loss) before tax	5,900	(96)	3	5,807	188	(16,969)	(10,974)	(286)	(292)

For footnotes, see page 149.

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Customer groups > Commercial Banking

Commercial Banking

Profit before tax

	2009 US$m	2008 US$m	2007 US$m
Net interest income	**7,883**	9,494	9,055
Net fee income	**3,702**	4,097	3,972
Trading income excluding net interest income	**332**	369	265
Net interest income on trading activities	**22**	17	31
Net trading income[42]	**354**	386	296
Net income/(expense) from financial instruments designated at fair value.	**100**	(224)	22
Gains less losses from financial investments	**23**	193	90
Dividend income	**8**	88	8
Net earned insurance premiums	**886**	679	733
Other operating income	**739**	939	165
Total operating income	**13,695**	15,652	14,341
Net insurance claims[43]	**(842)**	(335)	(391)
Net operating income[16]	**12,853**	15,317	13,950
Loan impairment charges and other credit risk provisions	**(3,282)**	(2,173)	(1,007)
Net operating income	**9,571**	13,144	12,943
Employee expenses	**(2,606)**	(3,056)	(3,094)
Other operating expenses	**(3,357)**	(3,525)	(3,158)
Total operating expenses	**(5,963)**	(6,581)	(6,252)
Operating profit	**3,608**	6,563	6,691
Share of profit in associates and joint ventures	**667**	631	454
Profit before tax	**4,275**	7,194	7,145
By geographical region			
Europe	**1,292**	2,722	2,516
Hong Kong	**956**	1,315	1,619
Rest of Asia-Pacific[27]	**1,064**	1,235	868
Middle East[27]	**21**	558	482

North America	**543**	658	920
Latin America	**399**	706	740
	4,275	7,194	7,145
	%	%	%
Share of HSBC s profit before tax	**60.4**	77.3	29.5
Cost efficiency ratio	**46.4**	43.0	44.8

Balance sheet data[41]

	US$m	US$m	US$m
Loans and advances to customers (net)	**199,674**	203,949	220,068
Total assets	**251,143**	249,218	307,944
Customer accounts	**267,388**	235,879	237,987

For footnotes, see page 149.

Strategic direction

HSBC s Commercial Banking strategy is focused on two key initiatives:

- to be the leading international business bank, using HSBC s extensive geographical network together with product expertise in payments, trade, receivables finance and foreign exchange to actively support customers who are trading and investing across borders; and

- to be the best bank for small and medium-sized enterprises (SME s) in target markets, building global scale and creating efficiencies by sharing systems and best practice, including customer experience, training and product offerings, and selectively rolling out the direct banking model.

Financial performance in 2009

Commercial Banking remained profitable in all regions in 2009, although profit before tax of US$4.3 billion was 41 per cent lower than in 2008. The results included a US$280 million gain from the disposal of the remaining stake in HSBC s UK card merchant acquiring business, compared with a US$425 million gain in 2008 from the sale of the first tranche. On an underlying basis, pre-tax profit declined by 35 per cent, driven by the effects of lower interest rates on deposit margins and higher loan impairment charges resulting from deterioration in the global economy.

Deposit balances increased by 7 per cent to US$267 billion, largely in Hong Kong and the UK, as HSBC s brand strength continued to attract new customers. Loans and advances were 9 per cent lower, largely as customer demand for new lending declined. This decline was partly offset by targeted growth in key markets such as mainland China. The relative movement in deposits and loans strengthened HSBC s liquidity position, with an aggregate customer advances to deposits ratio in Commercial Banking of 75 per cent compared with 86 per cent reported at 31 December 2008.

Net interest income fell by 11 per cent despite higher deposit balances, driven by deposit spread compression and reduced lending balances. This was partly offset by wider spreads on lending due to improved pricing.

Net fee income was broadly unchanged, as repricing initiatives drove higher fee income from credit facilities in North America which was offset by a reduction in fee income following the part disposal of the card merchant acquiring business to a joint venture in 2008.

Loan impairment charges and other credit risk provisions increased by 56 per cent to US$3.3 billion, representing less than 2 per cent of average reported assets. Loan impairment charges in 2009 remained at broadly the same rate as experienced in the second half of 2008, with the charge concentrated in manufacturing, general trading and real estate. The increase in loan impairment charges was mainly in the Middle East, the UK, Brazil, and India, partly offset by an improving credit environment in Hong Kong.

Operating expenses remained broadly unchanged, including the benefit in the UK of an accounting gain on staff benefits; however, the cost efficiency ratio deteriorated slightly driven by the effect of deposit spread compression on revenues.

Income from associates and joint ventures rose by 5 per cent.

Business highlights in 2009

HSBC s leading international business strategy continued to deliver customer-led and product-driven growth across all segments.

Product revenues from foreign exchange were unchanged at US$0.5 billion, and revenues from trade and supply chain also remained flat at US$1.4 billion despite the overall decline in global trade levels. While volumes of trade activity were depressed in line with world trade volumes, signs of recovery were apparent towards the end of the year.

Foreign exchange services were enhanced with the launch of GetRate on Business Internet Banking in Malaysia, India and the UK.

The number of cross-border intra-Group referrals increased by 48 per cent, notably in Asia which accounted for over half of all successful referrals. The aggregate transaction value of successful referrals was US$9.0 billion.

HSBC further strengthened its international offerings for customers, with particular focus on business flows to and from mainland China. In conjunction with Bank of Communications, HSBC launched a renminbi trade settlement service in seven ASEAN countries and a same-day credit pledge service on outward remittances into mainland China from Hong Kong.

Services for mainland China companies looking to expand overseas were also a focus of attention, with innovative solutions including a video conference account opening service for SMEs. Investment flows into mainland China were targeted by increasing the number of foreign national relationship managers in HSBC s international business teams there.

HSBC s best bank for business strategy also progressed strongly with its transaction banking and liabilities-led approach, particularly relevant in a period of low credit demand:

Business banking customer numbers increased by 12 per cent to 3 million with over 61 per cent of new customers in emerging markets.

Deposit balances in business banking were US$146 billion, providing a significant surplus of funds for deployment. Total revenue from Business Banking of US$5.8 billion, despite the effects of deposit spread compression, represented 45 per cent of total revenue, highlighting the importance of this segment to the Commercial Banking business.

Customer loans and advances in business banking were US$53 billion, and HSBC continued to support businesses in the global downturn. The US$5 billion International SME Fund was launched in December 2008 in five key markets. The fund was fully allocated by the end of 2009 and 80 per cent of it was utilised.

In 2009, the global roll-out of internationally consistent offerings continued. Business Direct, the direct channel proposition, was launched in a further three countries and is now live in ten, while the roll-out of a credit scoring platform and deployment of globally consistent training programmes illustrated HSBC s ability to leverage best practice and drive efficiencies across its worldwide network.

In the corporate segment (see page 145 for details), HSBC s ability to provide or arrange debt finance combined with its international reach for payments and trade activity across developed and emerging markets was evident in the number of new multi-country banking relationships won in 2009, despite the more cautious sentiment within the global economy.

The number of customers using HSBCnet continued to grow strongly, and full regional connectivity was rolled out in Latin America. The receivables finance capability was extended to deliver supplier funding programmes for large buyers, and new pan-European deals were written.

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Customer groups > Commercial Banking / Global Banking and Markets

Total revenue in the corporate segment was US$6.3 billion. Deposits from corporate customers were US$121 billion, while loans and advances were US$147 billion. Signs of returning confidence in the second half of 2009 were accompanied by higher levels of new lending, particularly in Asia and other emerging markets.

Commercial Banking continued to seek opportunities to deliver intra-Group referrals:

A new global referral programme between Commercial Banking and Personal Financial Services was launched, resulting in over 15,000 successful referrals to HSBC Premier.

The number of referrals to Private Banking was 1,057, generating over US$2.5 billion in assets under management.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Commercial Banking	**2008 as reported US$m**	**2008 acquisitions and disposals[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 acquisitions and disposals[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**9,494**	**(29)**	**(697)**	**8,768**	**45**	**(930)**	**7,883**	**(17)**	**(11)**
Net fee income	**4,097**	**(26)**	**(367)**	**3,704**	**5**	**(7)**	**3,702**	**(10)**	
Other income[15]	**1,726**	**(464)**	**(213)**	**1,049**	**295**	**(76)**	**1,268**	**(27)**	**(7)**
Net operating income[16]	**15,317**	**(519)**	**(1,277)**	**13,521**	**345**	**(1,013)**	**12,853**	**(16)**	**(7)**
Loan impairment charges and other credit risk provisions	**(2,173)**	**3**	**68**	**(2,102)**		**(1,180)**	**(3,282)**	**(51)**	**(56)**
Net operating income	**13,144**	**(516)**	**(1,209)**	**11,419**	**345**	**(2,193)**	**9,571**	**(27)**	**(19)**
Operating expenses	**(6,581)**	**30**	**537**	**(6,014)**	**(27)**	**78**	**(5,963)**	**9**	**1**
Operating profit	**6,563**	**(486)**	**(672)**	**5,405**	**318**	**(2,115)**	**3,608**	**(45)**	**(39)**
Income from associates	**631**		**7**	**638**		**29**	**667**	**6**	**5**
Profit before tax	**7,194**	**(486)**	**(665)**	**6,043**	**318**	**(2,086)**	**4,275**	**(41)**	**(35)**

2008 compared with 2007

2007

Commercial Banking	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[12] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	9,055	(166)	(77)	8,812	41	641	9,494	5	7
Net fee income	3,972	(113)	(76)	3,783	27	287	4,097	3	8
Other income[15]	923	(7)	(28)	888	525	313	1,726	87	35
Net operating income[16]	13,950	(286)	(181)	13,483	593	1,241	15,317	10	9
Loan impairment charges and other credit risk provisions	(1,007)	3	36	(968)	(3)	(1,202)	(2,173)	(116)	(124)
Net operating income	12,943	(283)	(145)	12,515	590	39	13,144	2	
Operating expenses	(6,252)	180	47	(6,025)	(106)	(450)	(6,581)	(5)	(7)
Operating profit	6,691	(103)	(98)	6,490	484	(411)	6,563	(2)	(6)
Income from associates	454		26	480		151	631	39	31
Profit before tax	7,145	(103)	(72)	6,970	484	(260)	7,194	1	(4)

For footnotes, see page 149.

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Global Banking and Markets
Profit before tax

	2009	2008	2007
	US$m	US$m	US$m
Net interest income	**8,610**	8,541	4,430
Net fee income	**4,363**	4,291	4,901
Trading income excluding net interest income	**4,701**	157	3,503
Net interest income/ (expense) on trading activities	**2,174**	324	(236)
Net trading income[42]	**6,875**	481	3,267
Net income/(expense) from financial instruments designated at fair value	**473**	(438)	(164)
Gains less losses from financial investments	**265**	(327)	1,313
Dividend income	**68**	76	222
Net earned insurance premiums	**54**	105	93
Other operating income	**1,146**	868	1,218
Total operating income	**21,854**	13,597	15,280
Net insurance claims[43]	**(34)**	(79)	(70)
Net operating income[16]	**21,820**	13,518	15,210
Loan impairment charges and other credit risk provisions.	**(3,168)**	(1,471)	(38)
Net operating income	**18,652**	12,047	15,172
Employee expenses	**(4,703)**	(4,928)	(5,572)
Other operating expenses	**(3,834)**	(4,164)	(3,786)
Total operating expenses	**(8,537)**	(9,092)	(9,358)
Operating profit	**10,115**	2,955	5,814
Share of profit in associates and joint ventures	**366**	528	307
Profit before tax	**10,481**	3,483	6,121
By geographical region			
Europe	**4,545**	195	2,527
Hong Kong	**1,507**	1,436	1,578
Rest of Asia-Pacific[27]	**2,319**	2,970	1,969
Middle East[27]	**467**	816	495
North America	**712**	(2,575)	(965)
Latin America	**931**	641	517
	10,481	3,483	6,121

	%	%	%
Share of HSBC s profit before tax	**148.1**	37.4	25.3
Cost efficiency ratio	**39.1**	67.3	61.5

For footnotes, see page 149.

Strategic direction

In 2009, Global Banking and Markets continued to pursue its now well-established emerging markets-led and financing-focused strategy, encompassing HSBC s objective to be a leading wholesale bank by:

- utilising the Group s extensive distribution network;
- developing Global Banking and Markets hub-and-spoke business model; and
- continuing to build capabilities in major hubs to support the delivery of an advanced suite of services to corporate, institutional and government clients across the HSBC network.

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

Financial performance in 2009

- Global Banking and Markets delivered a considerably improved performance with reported pre-tax profits of US$10.5 billion, an increase of US$7.0 billion or 201 per cent compared with 2008. On an underlying basis, profit before tax increased by 249 per cent with strong performances in both developed and emerging markets. Robust revenues across core businesses were driven by higher margins and an increase in market share, with particularly strong performances in Rates and Balance Sheet Management. Revenues grew faster than operating expenses with continued emphasis on active cost management limiting the latter to a relatively modest rise. The cost efficiency ratio improved by 29.1 percentage points to 39.1 per cent.
- Write-downs on legacy positions in credit trading, leveraged and acquisition financing and monoline credit exposures, which totalled US$331 million, were significantly lower than those recorded in 2008, primarily driven by the stabilisation of asset prices. This was partly offset by a fair value loss of US$444 million resulting from tightening credit spreads on structured liabilities; a gain of US$529 million was reported in 2008.
- Loan impairment charges and other credit risk provisions increased by US$1.7 billion. Loan impairment charges were US$1.7 billion compared with US$0.8 billion in 2008, reflecting a deterioration in the credit position of

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Customer groups > Global Banking and Markets
Management view of total operating income

	2009 **US$m**	2008 US$m	2007 US$m
Global Markets[44]	**10,364**	2,676	5,720
Credit	**2,330**	(5,502)	(1,319)
Rates	**2,648**	2,033	1,291
Foreign exchange	**2,979**	3,842	2,178
Equities	**641**	(64)	1,177
Securities services[45]	**1,420**	2,116	1,926
Asset and structured finance	**346**	251	467
Global Banking	**4,630**	5,718	4,190
Financing and equity capital markets	**3,070**	3,572	2,186
Payments and cash management[46]	**1,053**	1,665	1,632
Other transaction services[47]	**507**	481	372
Balance Sheet Management	**5,390**	3,618	1,226
Global Asset Management	**939**	934	1,336
Principal Investments	**42**	(415)	1,253
Other[48]	**489**	1,066	1,555
Total operating income	**21,854**	13,597	15,280

Comparative information has been adjusted to reflect the current management view.

For footnotes, see page 149.

a small number of clients. This was in line with market trends of a rise in the number and severity of defaults on loans, despite a return of liquidity to the market. Impairment charges on the available-for-sale portfolio at US$1.4 billion were US$0.8 billion higher than in 2008; however, they remained within the range of the stress tests described on page 156 of the *Annual Report and Accounts 2008*.

Within the Group s available-for-sale portfolio, the negative reserves in respect of asset-backed securities (ABS s) reduced significantly from US$18.7 billion to US$12.2 billion, reflecting the impact of amortisation and recent increases in ABS prices. Impairment charges of US$1.4 billion were identified on ABSs with a nominal value of

US$2.6 billion and were taken to the income statement in 2009. However, due to the underlying credit quality and seniority of the tranches held by HSBC, the expected cash flow impairment on these securities was a more modest US$378 million. A further US$666 million of impairments was absorbed by income noteholders who take the first loss on positions within the securities investment conduits (SIC s) now consolidated in HSBC s accounts. Further details on the SICs are provided on page 182.

Business highlights in 2009

HSBC was recognised for the continuing success of its emerging markets-led and financing-focused strategy with numerous key industry awards, including *Euromoney* s Best Debt House in the following emerging market countries and regions: Mexico, Turkey, Asia, Latin America and the Middle East, along with Best Global Bank , and Best Global Debt House . Other awards included European DCM House of the Year , European Corporate Bond House of the Year and European Financial Institutions Bond House of the Year in *Financial News*.

Global Markets revenues grew significantly as volatile markets and increased customer activity gave impetus to client-facing businesses. Exceptional revenues in Rates and improved revenues in Credit were boosted by greater market share in both primary and secondary client business. Credit revenues were also assisted by a general tightening of credit spreads and an increase in asset prices following a return of liquidity in financial markets. Foreign exchange revenues normalised following unprecedented levels of market volatility in 2008, as the business established deeper institutional client relationships. Equities took advantage of a changed competitive landscape to capture a greater share of business in strategic markets from key institutional clients, particularly in Europe, the Middle East and Asia.

Securities Services revenues declined as lower interest rates drove down overall margins, although this was partially offset by recent improvements in Asian equity markets which stimulated increases in volumes and assets under custody in the second half of 2009.

In Global Banking, certain credit default swap transactions which hedge risk within the portfolio, recorded fair value losses of US$429 million as credit spreads tightened, compared with gains of US$912 million reported in 2008. Excluding this, higher spreads drove an increase in credit and lending revenues, reflecting the strength of HSBC s franchise and the quality of the client portfolio. Revenues in the equity capital markets business doubled following increased market share in key strategic regions. Payments and cash management activities continued to be adversely affected by the low interest rate environment, partly countered by an increase in liability balances.

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Balance Sheet Management continued to benefit from early positioning against the backdrop of a low interest rate environment although, as expected, revenues slowed in the second half of 2009 as certain higher yield positions matured.

In Global Asset Management, positive fee income growth was recorded in each consecutive quarter, with an improving contribution from emerging markets. Funds under management at 31 December 2009 were US$423 billion, 14 per cent higher than at the start of the year, assisted by positive net inflows of US$11 billion and strengthening market performance. Fund launches during the year included HSBC World Selection in conjunction with Personal Financial Services, which had assets of US$2.7 billion at year end. In August 2009, Global Asset Management entered the European Exchange Traded Funds (ETF) market, working closely with Global Markets and HSBC Securities Services, and launched three ETF funds.

In Principal Investments, opportunities for private equity realisations were limited and impairment charges were made against a small number of equity investments.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Global Banking and Markets	**2008 as reported US$m**	**2008 acquisitions and disposals[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 acquisitions and disposals[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**8,541**		**(451)**	**8,090**	**5**	**515**	**8,610**	**1**	**6**
Net fee income	**4,291**		**(267)**	**4,024**	**1**	**338**	**4,363**	**2**	**8**
Other income[15]	**686**		**(555)**	**131**	**2**	**8,714**	**8,847**	**1,190**	**6,652**
Net operating income[16]	**13,518**		**(1,273)**	**12,245**	**8**	**9,567**	**21,820**	**61**	**78**
Loan impairment charges and other credit risk provisions	**(1,471)**		**45**	**(1,426)**		**(1,742)**	**(3,168)**	**(115)**	**(122)**
Net operating income	**12,047**		**(1,228)**	**10,819**	**8**	**7,825**	**18,652**	**55**	**72**
Operating expenses	**(9,092)**		**743**	**(8,349)**	**(3)**	**(185)**	**(8,537)**	**6**	**(2)**
Operating profit	**2,955**		**(485)**	**2,470**	**5**	**7,640**	**10,115**	**242**	**309**
Income from associates	**528**		**6**	**534**		**(168)**	**366**	**(31)**	**(31)**
Profit before tax	**3,483**		**(479)**	**3,004**	**5**	**7,472**	**10,481**	**201**	**249**

2008 compared with 2007

2007

Global Banking and Markets	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	4,430		(32)	4,398		4,143	8,541	93	94
Net fee income	4,901		(46)	4,855		(564)	4,291	(12)	(12)
Other income[15]	5,879		(57)	5,822		(5,136)	686	(88)	(88)
Net operating income[16]	15,210		(135)	15,075		(1,557)	13,518	(11)	(10)
Loan impairment charges and other credit risk provisions	(38)		1	(37)		(1,434)	(1,471)	(3,771)	(3,876)
Net operating income	15,172		(134)	15,038		(2,991)	12,047	(21)	(20)
Operating expenses	(9,358)		175	(9,183)		91	(9,092)	3	1
Operating profit	5,814		41	5,855		(2,900)	2,955	(49)	(50)
Income from associates	307		18	325		203	528	72	62
Profit before tax	6,121		59	6,180		(2,697)	3,483	(43)	(44)

For footnotes, see page 149.

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Customer groups > Global Banking and Markets / Private Banking

Balance sheet data significant to Global Banking and Markets

	Europe US$m	Hong Kong US$m	Rest of Asia-Pacific[27] US$m	Middle East[27] US$m	North America US$m	Latin America US$m	Total US$m
At 31 December 2009							
Trading assets[49]	**294,951**	**25,742**	**15,960**	**511**	**67,466**	**6,283**	**410,913**
Derivative assets	**190,900**	**16,937**	**15,660**	**668**	**61,192**	**2,820**	**288,177**
Loans and advances to:							
customers (net)	**176,123**	**21,991**	**23,989**	**6,554**	**18,654**	**9,645**	**256,956**
banks (net)	**59,171**	**27,789**	**29,388**	**6,385**	**14,403**	**16,638**	**153,774**
Financial investments[49]	**83,715**	**92,181**	**36,355**	**9,688**	**49,386**	**14,659**	**285,984**
Total assets[41]	**981,831**	**217,146**	**138,884**	**28,189**	**260,131**	**57,491**	**1,683,672**
Deposits by banks	**88,043**	**5,824**	**7,874**	**1,357**	**13,229**	**3,948**	**120,275**
Customer accounts	**169,390**	**26,650**	**43,698**	**5,752**	**19,095**	**20,142**	**284,727**
Trading liabilities	**169,814**	**10,720**	**3,040**	**13**	**69,302**	**2,875**	**255,764**
Derivative liabilities	**191,480**	**16,619**	**15,500**	**651**	**60,178**	**3,270**	**287,698**
At 31 December 2008							
Trading assets[49]	281,089	45,398	19,192	414	74,498	5,004	425,595
Derivative assets	303,265	26,989	25,492	1,014	125,848	5,145	487,753
Loans and advances to:							
customers (net)	185,818	23,042	27,941	6,649	35,583	8,273	287,306
banks (net)	49,508	20,970	21,309	5,401	9,238	12,574	119,000
Financial investments[49]	105,546	46,964	29,772	7,574	39,841	8,179	237,876
Total assets[41]	1,180,759	233,187	147,714	27,975	348,347	53,870	1,991,852
Deposits by banks	79,509	11,509	12,261	944	16,244	3,871	124,338
Customer accounts	199,687	30,866	42,977	7,628	23,844	15,384	320,386
Trading liabilities	144,759	13,056	3,633	54	72,325	2,546	236,373
Derivative liabilities	300,200	28,536	25,465	1,016	122,699	4,615	482,531
At 31 December 2007							

Trading assets[49]	294,078	26,877	18,119	1,613	93,395	8,570	442,652
Derivative assets	102,409	11,492	9,795	439	56,531	1,814	182,480
Loans and advances to:							
customers (net)	163,066	19,171	26,476	5,630	26,186	9,935	250,464
banks (net)	89,651	53,725	24,733	6,120	14,938	10,339	199,506
Financial investments[49]	94,416	46,765	31,301	8,147	33,273	10,155	224,057
Total assets[41]	912,299	218,293	130,096	26,548	263,008	46,606	1,596,850
Deposits by banks	85,315	6,251	14,737	2,437	14,825	2,830	126,395
Customer accounts	163,713	37,364	45,773	8,347	30,732	13,950	299,879
Trading liabilities	201,010	15,939	8,517	84	73,081	4,998	303,629
Derivative liabilities	104,687	10,865	9,204	452	53,058	1,986	180,252

For footnotes, see page 149.

Private Banking

Profit before tax

	2009 US$m	2008 US$m	2007 US$m
Net interest income	**1,474**	1,612	1,216
Net fee income	**1,236**	1,476	1,615
Trading income excluding net interest income	**322**	408	525
Net interest income on trading activities	**22**	14	9
Net trading income[42]	**344**	422	534
Net expense from financial instruments designated at fair value			(1)
Gains less losses from financial investments	**5**	64	119
Dividend income	**5**	8	7
Other operating income	**48**	49	58
Total operating income	**3,112**	3,631	3,548
Net insurance claims[43]			
Net operating income[16]	**3,112**	3,631	3,548
Loan impairment charges and other credit risk provisions	**(128)**	(68)	(14)
Net operating income	**2,984**	3,563	3,534
Employee expenses	**(1,234)**	(1,367)	(1,250)
Other operating expenses	**(650)**	(749)	(775)
Total operating expenses	**(1,884)**	(2,116)	(2,025)
Operating profit	**1,100**	1,447	1,509
Share of profit in associates and joint ventures	**8**		2

Profit before tax	**1,108**	1,447	1,511
By geographical region			
Europe	**854**	998	915
Hong Kong	**197**	237	305
Rest of Asia-Pacific[27]	**90**	109	89
Middle East[27]	**6**	4	3
North America	**(50)**	83	174
Latin America	**11**	16	25
	1,108	1,447	1,511
	%	%	%
Share of HSBC s profit before tax	**15.6**	15.6	6.2
Cost efficiency ratio	**60.5**	58.3	57.1

Balance sheet data[41]

	US$m	US$m	US$m
Loans and advances to customers (net)	**37,031**	37,590	43,612
Total assets	**116,148**	133,216	130,893
Customer accounts	**106,533**	116,683	106,197

For footnotes, see page 149.

Strategic direction

Private Banking strives to be the world s leading international private bank, recognised for excellent client experience and global connections.

The strength of HSBC s brand, capital position, and extensive global network provides a foundation from which Private Banking continues to attract and retain clients. Product and service leadership in areas such as credit, estate planning, hedge funds, and investment advice helps Private Banking meet the complex international financial needs of individuals and families.

Through continuing investment in its people, integrated IT solutions and emerging markets-focused domestic operations, Private Banking is well-positioned for sustainable long-term growth.

Financial performance in 2009

Reported pre-tax profit was 23 per cent lower at US$1.1 billion, a fall of 21 per cent on an underlying basis, primarily from a decline in fee income. This was due to a change in the risk tolerance of private banking customers and consequent reduction in client activity, lower fiduciary fees and the effect of weak markets on the value of funds under management. Strong cost control including reduced performance-related costs partially offset the lower revenues.

Net interest income fell by 6 per cent as lower interest rates in the major economies, combined with aggressive competition for deposits from weaker competitors, particularly in Europe and North America, led to tighter spreads and a decline in balances. Lending volumes declined due to client deleveraging and a lower appetite for credit, although this was partly mitigated by re-pricing historically low margin business to reflect the changed conditions. Favourable interest rate and yield curve movements at the beginning of 2009 generated higher treasury income in Asia and Europe, benefiting net interest income.

Net fee income decreased by 14 per cent, affected by the fall in the value of equity markets in the second half of 2008 and the first quarter of 2009. This resulted in a lower average value of funds under management and the redemption of investments, particularly hedge funds, in early 2009. Commission income on fiduciary deposits decreased as low interest rates resulted in a decline in volumes, and annual fund performance fees earned in January 2008 were not repeated in 2009.

Customer groups > Private Banking

Trading income fell by 18 per cent, also reflecting lower client trading activity, mainly in foreign exchange and structured products.

Gains less losses from financial investments decreased by 90 per cent due to gains made on the disposal of HSBC s residual interest in the Hermitage Fund in the first half of 2008 which did not recur in 2009.

Other operating income was in line with 2008, and included gains on the sale of two office buildings in Switzerland and Luxembourg.

Loan impairment charges and other credit risk provisions increased by US$62 million, largely due to a single specific charge in the US in 2009.

Operating expenses decreased by 9 per cent as performance-related costs were cut, staff numbers were reduced and discretionary costs such as travel and marketing were tightly managed. These steps were taken in response to the lower revenues earned in the weaker economic environment. Costs included US$19 million of integration costs relating to the merger of HSBC s two Swiss private banks, US$17 million of redundancy costs worldwide and the up-front cost of establishing Private Banking in new developing markets, including investments in mainland China, India and Russia.

The cost efficiency ratio increased by 2.1 percentage points to 60.5 per cent.

Client assets

	2009	2008
	US$bn	US$bn
At 1 January	**352**	421
Net new money	**(7)**	24
Value change	**27**	(71)
Exchange and other	**(5)**	(22)
At 31 December	**367**	352

Client assets by investment class

	2009	2008
	US$bn	US$bn
Equities	**73**	53
Bonds	**69**	57
Structured products	**10**	7
Funds	**82**	87
Cash, fiduciary deposits and other	**133**	148

367	352

Reported client assets increased by 4 per cent to US$367 billion due to portfolio appreciation and foreign exchange movements, partly offset by a net outflow of funds due to hedge fund redemptions, client deleveraging and the decision not to match aggressive deposit prices offered by weaker competitors, particularly in Europe and North America. Private Banking continued to experience net client inflows in emerging markets, namely Asia, the Middle East and Latin America, with net new money of US$6.6 billion generated in these markets in the year.

Reported total client assets increased by 6 per cent to US$460 billion, largely due to an increase in the market value of assets. Total client assets is a measure equivalent to many industry definitions of assets under management which include some non-financial assets held in client trusts.

Business highlights in 2009

Intragroup referrals continued to result in good inflows with US$5.8 billion raised during 2009.

The legal merger of HSBC s two Swiss private banks was achieved as planned in April 2009 and technical integration was completed in early January 2010. The combined bank is expected to achieve significant operational and cost efficiencies.

HSBC Alternative Investments Limited continued to achieve strong returns on hedge fund products in the second half of 2009, including its flagship fund of hedge funds, the GH fund, which achieved a return of 12.3 per cent during the year. A series of new products were launched including one of the first UCITS III hedge funds of hedge funds and as a result, the business saw net inflows in the second half of 2009.

Major awards included Outstanding Global Private Bank by *Private Banker International*, and Best Global Private Bank , Best Private Bank in Asia and Best Private Bank in the Middle East by *The Banker* and *The Financial Times*. The *Euromoney* 2010 Private Banking Survey placed HSBC second in the Global Private Banking category for the second consecutive year.

Investment in emerging markets and domestic businesses continued, including the launch of Private Banking in Russia and further investments in Private Banking operations in Asia, Latin America and the Middle East.

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Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Private Banking	**2008 as reported US$m**	**2008 acquisitions and disposals[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 acquisitions and disposals[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**1,612**		**(52)**	**1,560**		**(86)**	**1,474**	**(9)**	**(6)**
Net fee income	**1,476**		**(33)**	**1,443**		**(207)**	**1,236**	**(16)**	**(14)**
Other income[15]	**543**		**(19)**	**524**		**(122)**	**402**	**(26)**	**(23)**
Net operating income[16]	**3,631**		**(104)**	**3,527**		**(415)**	**3,112**	**(14)**	**(12)**
Loan impairment charges and other credit risk provisions	**(68)**		**2**	**(66)**		**(62)**	**(128)**	**(88)**	**(94)**
Net operating income	**3,563**		**(102)**	**3,461**		**(477)**	**2,984**	**(16)**	**(14)**
Operating expenses	**(2,116)**		**54**	**(2,062)**		**178**	**(1,884)**	**11**	**9**
Operating profit	**1,447**		**(48)**	**1,399**		**(299)**	**1,100**	**(24)**	**(21)**
Income from associates						**8**	**8**		
Profit before tax	**1,447**		**(48)**	**1,399**		**(291)**	**1,108**	**(23)**	**(21)**

	2008 compared with 2007								
Private Banking	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	1,216	1	(12)	1,205		407	1,612	33	34

Net fee income	1,615	(105)	26	1,536	(60)	1,476	(9)	(4)
Other income[15]	717	(18)	5	704	(161)	543	(24)	(23)
Net operating income[16]	3,548	(122)	19	3,445	186	3,631	2	5
Loan impairment charges and other credit risk provisions	(14)			(14)	(54)	(68)	(386)	(386)
Net operating income	3,534	(122)	19	3,431	132	3,563	1	4
Operating expenses	(2,025)	98	(17)	(1,944)	(172)	(2,116)	(4)	(9)
Operating profit	1,509	(24)	2	1,487	(40)	1,447	(4)	(3)
Income from associates	2			2	(2)		(100)	(100)
Profit before tax	1,511	(24)	2	1,489	(42)	1,447	(4)	(3)

For footnotes, see page 149.

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Customer groups > Other

Other

Profit/(loss) before tax

	2009 **US$m**	2008 US$m	2007 US$m
Net interest expense	**(1,035)**	(956)	(542)
Net fee income/(expense)	**125**	53	(228)
Trading income/(expense) excluding net interest income	**244**	(262)	127
Net interest income/(expense) on trading activities	**35**	(268)	(1)
Net trading income/(expense)[42]	**279**	(530)	126
Changes in fair value of long-term debt issued and related derivatives	**(6,247)**	6,679	2,812
Net income/(expense) from other financial instruments designated at fair value	**(196)**	747	81
Net income/(expense) from financial instruments designated at fair value	**(6,443)**	7,426	2,893
Gains less losses from financial investments	**3**	(396)	83
Gains arising from dilution of interests in associates			1,092
Dividend income	**12**	10	32
Net earned insurance premiums	**(3)**	(17)	(21)
Gains on disposal of French regional banks		2,445	
Other operating income	**5,042**	4,261	3,523
Total operating income/(expense)	**(2,020)**	12,296	6,958
Net insurance claims[43]	**(3)**	(1)	
Net operating income/(expense)[16]	**(2,023)**	12,295	6,958
Loan impairment charges and other credit risk provisions	**(8)**	(5)	(11)
Net operating income/(expense)	**(2,031)**	12,290	6,947
Employee expenses	**(2,602)**	(2,198)	(2,017)

Other operating expenses	**(2,113)**	(1,976)	(1,545)
Total operating expenses	**(4,715)**	(4,174)	(3,562)
Operating profit/(loss)	**(6,746)**	8,116	3,385
Share of profit in joint ventures and associates	**26**	41	150
Profit/(loss) before tax	**(6,720)**	8,157	3,535
By geographical region			
Europe	**(2,994)**	5,296	1,056
Hong Kong	**(359)**	(955)	(375)
Rest of Asia-Pacific[27]	**264**	197	1,261
Middle East[27]	**87**	79	82
North America	**(3,717)**	3,534	1,508
Latin America	**(1)**	6	3
	(6,720)	8,157	3,535
	%	%	%
Share of HSBC s profit before tax	**(94.9)**	87.6	14.6
Cost efficiency ratio	**(233.1)**	33.9	51.2

Balance sheet data[41]

	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**3,110**	2,621	2,678
Total assets	**150,983**	145,581	164,806
Customer accounts	**1,277**	2,041	2,006

For footnotes, see page 149.

Notes

Reported loss before tax in Other was US$6.7 billion, compared with a profit of US$8.2 billion in 2008. For a description of the main items reported under Other , see footnote 40 on page 150.

Net interest expense substantially comprises the interest paid on third-party debt issues at the holding company level.

Net trading income was US$279 million, compared with a net trading expense in 2008; this reflected fair value gains on certain non-qualifying hedges, compared with fair value losses in 2008. This caption also included a one-off hedging loss of US$344 million relating to forward foreign exchange contracts entered into to hedge the proceeds of the Group s rights issue, and a US$121 million loss arising from the mark-to-market of the implied contingent forward contract entered into with the underwriters of the Group s rights issue. Both of these items were part of the net proceeds of the rights issue but for technical accounting reasons were reflected through the income statement.

Net expense from financial instruments designated at fair value declined by 90 per cent to US$90 million due to reduced income from non-qualifying interest and exchange rate hedges related to long-term debt issued by HSBC Holdings and its North American and European subsidiaries.

HSBC recognised a gain of US$576 million in respect of the sale and leaseback of 8 Canada Square, its global headquarters in London, which was effected through the disposal of its entire shareholding in PMII. In 2008, a gain of US$416 million was reported in respect of the purchase of PMII from Metrovacesa. See Note 23 on the Financial Statements.

Operating expenses increased by 15 per cent to US$4.7 billion, mainly due to further centralisation of certain operational functions in the US to HSBC Technology Services USA

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resulting in cost savings across the other customer groups in North America. These expenses were previously incurred directly by customer groups, and are now substantially recovered from them through a recharge mechanism with the revenue reported in other operating income. Costs at HSBC s Group Service Centres rose by 10 per cent as the number of migrated activities increased in line with the Group s Global Resourcing model.

Reconciliation of reported and underlying profit/(loss) before tax

	2009 compared with 2008								
Other	**2008 as reported US$m**	**2008 adjust-ments[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjust-ments[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest expense	**(956)**		**12**	**(944)**		**(91)**	**(1,035)**	**(8)**	**(10)**
Net fee income	**53**		**(3)**	**50**		**75**	**125**	**136**	**150**
Changes in fair value	**6,570**	**(6,570)**			**(6,533)**		**(6,533)**	**(199)**	
Gains on disposal of French regional banks	**2,445**	**(2,445)**						**(100)**	
Other income[15]	**4,183**	**(95)**	**(13)**	**4,075**		**1,345**	**5,420**	**30**	**33**
Net operating income/ (expense)[16]	**12,295**	**(9,110)**	**(4)**	**3,181**	**(6,533)**	**1,329**	**(2,023)**	**(116)**	**42**
Loan impairment charges and other credit risk provisions	**(5)**		**(1)**	**(6)**		**(2)**	**(8)**	**(60)**	**(33)**
Net operating income/ (expense)	**12,290**	**(9,110)**	**(5)**	**3,175**	**(6,533)**	**1,327**	**(2,031)**	**(117)**	**42**
Operating expenses	**(4,174)**		**70**	**(4,104)**		**(611)**	**(4,715)**	**(13)**	**(15)**
Operating profit/(loss)	**8,116**	**(9,110)**	**65**	**(929)**	**(6,533)**	**716**	**(6,746)**	**(183)**	**77**
Income from associates	**41**		**(1)**	**40**		**(14)**	**26**	**(37)**	**(35)**

Profit/(loss) before tax	**8,157**	**(9,110)**	**64**	**(889)**	**(6,533)**	**702**	**(6,720)**	**(182)**	**79**

	2008 compared with 2007								
Other	2007 as reported US$m	2007 adjustments and dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjustments[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest expense	(542)		(38)	(580)	(6)	(370)	(956)	(76)	(64)
Net fee income/ (expense)	(228)		49	(179)		232	53	123	130
Changes in fair value	3,055	(3,055)			6,570		6,570	115	
Gains on disposal of French regional banks					2,445		2,445		
Other income[15]	4,673	(1,116)	36	3,593	95	495	4,183	(10)	14
Net operating income[16]	6,958	(4,171)	47	2,834	9,104	357	12,295	77	13
Loan impairment charges and other credit risk provisions	(11)	24	1	14		(19)	(5)	55	(136)
Net operating income	6,947	(4,147)	48	2,848	9,104	338	12,290	77	12
Operating expenses	(3,562)		(15)	(3,577)	6	(603)	(4,174)	(17)	(17)
Operating profit	3,385	(4,147)	33	(729)	9,110	(265)	8,116	140	(36)
Income from associates	150	(12)	11	149		(108)	41	(73)	(72)
Profit before tax	3,535	(4,159)	44	(580)	9,110	(373)	8,157	131	(64)

For footnotes, see page 149.

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Customer groups > Profit/(loss) before tax

Analysis by customer group and global business
Profit/(loss) before tax

	2009						
Total	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other[40] US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
Net interest income/(expense)	**25,107**	**7,883**	**8,610**	**1,474**	**(1,035)**	**(1,309)**	**40,730**
Net fee income	**8,238**	**3,702**	**4,363**	**1,236**	**125**		**17,664**
Trading income excluding net interest income	**637**	**332**	**4,701**	**322**	**244**		**6,236**
Net interest income on trading activities	**65**	**22**	**2,174**	**22**	**35**	**1,309**	**3,627**
Net trading income[42]	**702**	**354**	**6,875**	**344**	**279**	**1,309**	**9,863**
Changes in fair value of long-term debt issued and related derivatives					**(6,247)**		**(6,247)**
Net income/(expense) from other financial instruments designated at fair value	**2,339**	**100**	**473**		**(196)**		**2,716**
Net income/(expense) from financial instruments designated at fair value	**2,339**	**100**	**473**		**(6,443)**		**(3,531)**
	224	**23**	**265**	**5**	**3**		**520**

Gains less losses from financial investments							
Dividend income	**33**	**8**	**68**	**5**	**12**		**126**
Net earned insurance premiums	**9,534**	**886**	**54**		**(3)**		**10,471**
Other operating income	**809**	**739**	**1,146**	**48**	**5,042**	**(4,996)**	**2,788**
Total operating income/ (expense)	**46,986**	**13,695**	**21,854**	**3,112**	**(2,020)**	**(4,996)**	**78,631**
Net insurance claims[43]	**(11,571)**	**(842)**	**(34)**		**(3)**		**(12,450)**
Net operating income/ (expense)[16]	**35,415**	**12,853**	**21,820**	**3,112**	**(2,023)**	**(4,996)**	**66,181**
Loan impairment charges and other credit risk provisions	**(19,902)**	**(3,282)**	**(3,168)**	**(128)**	**(8)**		**(26,488)**
Net operating income/ (expense)	**15,513**	**9,571**	**18,652**	**2,984**	**(2,031)**	**(4,996)**	**39,693**
Operating expenses	**(18,292)**	**(5,963)**	**(8,537)**	**(1,884)**	**(4,715)**	**4,996**	**(34,395)**
Operating profit/(loss)	**(2,779)**	**3,608**	**10,115**	**1,100**	**(6,746)**		**5,298**
Share of profit in associates and joint ventures	**714**	**667**	**366**	**8**	**26**		**1,781**
Profit/(loss) before tax	**(2,065)**	**4,275**	**10,481**	**1,108**	**(6,720)**		**7,079**
	%	%	%	%	%		%
Share of HSBC s profit before tax	**(29.2)**	**60.4**	**148.1**	**15.6**	**(94.9)**		**100.0**
Cost efficiency ratio	**51.7**	**46.4**	**39.1**	**60.5**	**(233.1)**		**52.0**
Balance sheet data[41]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
	399,460	**199,674**	**256,956**	**37,031**	**3,110**		**896,231**

Loans and advances to customers (net)							
Total assets	**554,074**	**251,143**	**1,683,672**	**116,148**	**150,983**	**(391,568)**	**2,364,452**
Customer accounts	**499,109**	**267,388**	**284,727**	**106,533**	**1,277**		**1,159,034**

For footnotes, see page 149.

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	2008						
Total	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other[40] US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income/(expense)	29,419	9,494	8,541	1,612	(956)	(5,547)	42,563
Net fee income	10,107	4,097	4,291	1,476	53		20,024
Trading income/(expense) excluding net interest income	175	369	157	408	(262)		847
Net interest income/(expense) on trading activities	79	17	324	14	(268)	5,547	5,713
Net trading income/(expense)[42]	254	386	481	422	(530)	5,547	6,560
Changes in fair value of long-term debt issued and related derivatives					6,679		6,679
Net income/(expense) from other financial instruments designated at fair value	(2,912)	(224)	(438)		747		(2,827)
Net income/(expense) from financial instruments designated at fair value	(2,912)	(224)	(438)		7,426		3,852
Gains less losses from financial investments	663	193	(327)	64	(396)		197
Dividend income	90	88	76	8	10		272
Net earned insurance premiums	10,083	679	105		(17)		10,850
Gains on disposal of French regional banks					2,445		2,445

Other operating income	259	939	868	49	4,261	(4,568)	1,808
Total operating income	47,963	15,652	13,597	3,631	12,296	(4,568)	88,571
Net insurance claims[43]	(6,474)	(335)	(79)		(1)		(6,889)
Net operating income[16]	41,489	15,317	13,518	3,631	12,295	(4,568)	81,682
Loan impairment charges and other credit risk provisions	(21,220)	(2,173)	(1,471)	(68)	(5)		(24,937)
Net operating income	20,269	13,144	12,047	3,563	12,290	(4,568)	56,745
Operating expenses (excluding goodwill impairment)	(21,140)	(6,581)	(9,092)	(2,116)	(4,174)	4,568	(38,535)
Goodwill impairment	(10,564)						(10,564)
Operating profit/(loss)	(11,435)	6,563	2,955	1,447	8,116		7,646
Share of profit in associates and joint ventures	461	631	528		41		1,661
Profit/(loss) before tax	(10,974)	7,194	3,483	1,447	8,157		9,307
	%	%	%	%	%		%
Share of HSBC s profit before tax	(117.9)	77.3	37.4	15.6	87.6		100.0
Cost efficiency ratio	76.4	43.0	67.3	58.3	33.9		60.1
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	401,402	203,949	287,306	37,590	2,621		932,868
Total assets	527,901	249,218	1,991,852	133,216	145,581	(520,303)	2,527,465
Customer accounts	440,338	235,879	320,386	116,683	2,041		1,115,327

For footnotes, see page 149.

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Customer groups > Profit/(loss) before tax // Geographical regions > Summary

Profit/(loss) before tax (continued)

	2007						
Total	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other[40] US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income/(expense)	29,069	9,055	4,430	1,216	(542)	(5,433)	37,795
Net fee income/(expense)	11,742	3,972	4,901	1,615	(228)		22,002
Trading income excluding net interest income	38	265	3,503	525	127		4,458
Net interest income/(expense) on trading activities	140	31	(236)	9	(1)	5,433	5,376
Net trading income[42]	178	296	3,267	534	126	5,433	9,834
Changes in fair value of long-term debt issued and related derivatives					2,812		2,812
Net income/(expense) from other financial instruments designated at fair value	1,333	22	(164)	(1)	81		1,271
Net income/(expense) from financial instruments	1,333	22	(164)	(1)	2,893		4,083

designated at fair value							
Gains less losses from financial investments	351	90	1,313	119	83		1,956
Gains arising from dilution of interests in associates					1,092		1,092
Dividend income	55	8	222	7	32		324
Net earned insurance premiums	8,271	733	93		(21)		9,076
Other operating income	387	165	1,218	58	3,523	(3,912)	1,439
Total operating income	51,386	14,341	15,280	3,548	6,958	(3,912)	87,601
Net insurance claims[43]	(8,147)	(391)	(70)				(8,608)
Net operating income[16]	43,239	13,950	15,210	3,548	6,958	(3,912)	78,993
Loan impairment charges and other credit risk provisions	(16,172)	(1,007)	(38)	(14)	(11)		(17,242)
Net operating income	27,067	12,943	15,172	3,534	6,947	(3,912)	61,751
Total operating expenses	(21,757)	(6,252)	(9,358)	(2,025)	(3,562)	3,912	(39,042)
Operating profit	5,310	6,691	5,814	1,509	3,385		22,709
Share of profit in associates and joint ventures	590	454	307	2	150		1,503
Profit before tax	5,900	7,145	6,121	1,511	3,535		24,212
	%	%	%	%	%		%
Share of HSBC s profit before tax	24.4	29.5	25.3	6.2	14.6		100.0

Cost efficiency ratio	50.3	44.8	61.5	57.1	51.2		49.4
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	464,726	220,068	250,464	43,612	2,678		981,548
Total assets	636,185	307,944	1,596,850	130,893	164,806	(482,412)	2,354,266
Customer accounts	450,071	237,987	299,879	106,197	2,006		1,096,140

For footnotes, see page 149.

Geographical regions

Additional information on results in 2009 may be found in the Financial Summary on pages 23 to 60.

Summary

Europe

HSBC s principal banking operations in Europe are HSBC Bank plc (HSBC Bank) in the UK, HSBC France, HSBC Bank A.S. in Turkey, HSBC Bank Malta p.l.c., HSBC Private Bank (Suisse) S.A. (HSBC Private Bank (Suisse)) and HSBC Trinkaus & Burkhardt AG. Through these operations HSBC provides a wide range of banking, treasury and financial services to personal, commercial and corporate customers across Europe.

Hong Kong

HSBC s principal banking subsidiaries in Hong Kong are The Hongkong and Shanghai Banking Corporation Limited (The Hongkong and Shanghai Banking Corporation) and Hang Seng Bank Limited (Hang Seng Bank). The former is the largest bank incorporated in Hong Kong and is HSBC s flagship bank in the Asia-Pacific region. It is one of Hong Kong s three note-issuing banks, accounting for more than 67.2 per cent by value of banknotes in circulation in 2008.

Rest of Asia-Pacific

HSBC offers personal, commercial, global banking and markets services in mainland China, mainly through its local subsidiary, HSBC Bank (China) Company Limited (HSBC Bank China). HSBC also participates indirectly in mainland China through its four associates, Bank of Communications (19.01 per cent owned), Ping An Insurance (16.78 per cent), Industrial Bank (12.78 per cent) and Yantai City Commercial Bank (20 per cent) and has a further interest of 8 per cent in Bank of Shanghai.

Outside Hong Kong and mainland China, HSBC conducts business in 20 countries in the Asia-Pacific region, primarily through branches and subsidiaries of The Hongkong and Shanghai Banking Corporation, with particularly strong coverage in Australia, India, Indonesia, Malaysia, South Korea, Singapore and Taiwan. HSBC s presence in Australia is led by HSBC Bank Australia Limited and in Malaysia by HSBC Bank Malaysia Berhad (HSBC Bank Malaysia), which has the largest foreign bank-owned branch network in the country.

Middle East

In the Middle East, the network of branches of HSBC Bank Middle East Limited (HSBC Bank Middle East), together with HSBC s subsidiaries and associates, gives it the widest coverage in the region. HSBC s associate in Saudi Arabia, The Saudi British Bank (40 per cent owned), is the Kingdom s fifth largest bank by total assets.

North America

HSBC s North American businesses are located in the US, Canada and Bermuda. Operations in the US are primarily conducted through HSBC Bank USA, N.A. (HSBC Bank USA) which is concentrated in New York State, and HSBC Finance, a national consumer finance company based in the Chicago metropolitan area. HSBC Markets (USA) Inc. is the intermediate holding company of, *inter alia*, HSBC Securities (USA) Inc., a registered broker and dealer of securities and a registered futures commission merchant. HSBC Bank Canada and The Bank of Bermuda Limited

(Bank of Bermuda) operate in their respective countries.

Latin America

HSBC s operations in Latin America principally comprise HSBC México, S.A. (HSBC Mexico), HSBC Bank Brasil S.A.-Banco Múltiplo (HSBC Bank Brazil), HSBC Bank Argentina S.A. (HSBC Bank Argentina) and HSBC Bank (Panama) S.A. (HSBC Bank Panama), which owns subsidiaries in Costa Rica, Honduras, Colombia and El Salvador. HSBC is also represented by subsidiaries in Chile, the Bahamas, Peru, Paraguay and Uruguay. In addition to banking services, HSBC operates insurance businesses in Mexico, Argentina, Brazil, Panama, Honduras and El Salvador. In Brazil, HSBC offers consumer finance products through its subsidiary, Losango Promoções e Vendas Ltda.

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Geographical regions > Summary / Europe

In the analysis of profit by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US$2,756 million (2008: US$2,492 million; 2007: US$1,985 million).

Profit/(loss) before tax

	2009		2008		2007	
	US$m	**%**	US$m	%	US$m	%
Europe	**4,009**	**56.7**	10,869	116.7	8,595	35.5
Hong Kong	**5,029**	**71.0**	5,461	58.7	7,339	30.3
Rest of Asia-Pacific[27]	**4,200**	**59.3**	4,722	50.7	4,702	19.4
Middle East[27]	**455**	**6.4**	1,746	18.8	1,307	5.4
North America	**(7,738)**	**(109.3)**	(15,528)	(166.8)	91	0.4
Latin America	**1,124**	**15.9**	2,037	21.9	2,178	9.0
	7,079	**100.0**	9,307	100.0	24,212	100.0

Total assets[41]

	At 31 December			
	2009		2008	
	US$m	**%**	US$m	%
Europe	**1,268,600**	**53.7**	1,392,049	55.1
Hong Kong	**399,243**	**16.9**	414,484	16.4
Rest of Asia-Pacific[27]	**222,139**	**9.4**	225,573	8.9
Middle East[27]	**48,107**	**2.0**	50,952	2.0
North America	**475,014**	**20.1**	596,302	23.6
Latin America	**115,967**	**4.9**	102,946	4.1
Intra-HSBC items	**(164,618)**	**(7.0)**	(254,841)	(10.1)
	2,364,452	**100.0**	2,527,465	100.0

For footnotes, see page 149.

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Europe

Profit/(loss) before tax by country within customer groups and global businesses

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Total US$m
2009						
UK	**364**	**1,026**	**3,045**	**252**	**(2,561)**	**2,126**
France[51]	**54**	**102**	**894**	**3**	**(429)**	**624**
Germany		**21**	**255**	**32**	**(18)**	**290**
Malta	**33**	**58**	**9**			**100**
Switzerland			**5**	**448**	**(3)**	**450**
Turkey	**43**	**97**	**119**	**2**		**261**
Other	**(182)**	**(12)**	**218**	**117**	**17**	**158**
	312	**1,292**	**4,545**	**854**	**(2,994)**	**4,009**
2008						
UK	1,546	2,361	(469)	250	2,997	6,685
France[51]	139	176	273	10	2,242	2,840
Germany		31	184	32	(22)	225
Malta	59	67	16			142
Switzerland				553		553
Turkey	3	91	130			224
Other	(89)	(4)	61	153	79	200
	1,658	2,722	195	998	5,296	10,869
2007						
UK	1,221	2,064	1,214	317	976	5,792
France[51]	173	192	692	25	(49)	1,033
Germany		36	195	45	19	295
Malta	45	67	45			157
Switzerland				475		475
Turkey	144	75	118	(1)		336
Other	(2)	82	263	54	110	507
	1,581	2,516	2,527	915	1,056	8,595

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
UK	**329,182**	313,065	326,927
France[51]	**71,567**	70,896	81,473
Germany	**4,131**	5,756	6,411
Malta	**4,649**	4,343	4,157
Switzerland	**12,072**	12,708	13,789
Turkey	**5,758**	6,125	7,974
Other	**12,122**	13,298	11,544
	439,481	426,191	452,275

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
UK	**349,162**	351,253	367,363
France[51]	**70,899**	74,826	64,905
Germany	**8,134**	11,611	10,282
Malta	**5,888**	5,604	5,947
Switzerland	**45,148**	44,643	41,015
Turkey	**5,830**	5,845	6,473
Other	**9,958**	8,694	8,969
	495,019	502,476	504,954

For footnote, see page 149.

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Geographical regions > Europe > 2009

Profit before tax

Europe	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**12,268**	9,696	7,746
Net fee income	**6,267**	7,492	8,431
Net trading income	**5,459**	5,357	6,943
Changes in fair value of long-term debt issued and related derivatives	**(2,746)**	2,939	1,059
Net income/(expense) from other financial instruments designated at fair value	**1,321**	(1,826)	167
Net income/(expense) from financial instruments designated at fair value	**(1,425)**	1,113	1,226
Gains less losses from financial investments	**50**	418	1,326
Dividend income	**29**	130	171
Net earned insurance premiums	**4,223**	5,299	4,010
Gains on disposal of French regional banks		2,445	
Other operating income	**2,262**	2,096	1,193
Total operating income	**29,133**	34,046	31,046
Net insurance claims incurred and movement in liabilities to policyholders	**(5,589)**	(3,367)	(3,479)
Net operating income before loan impairment charges and other credit risk provisions	**23,544**	30,679	27,567
Loan impairment charges and other credit risk provisions	**(5,568)**	(3,754)	(2,542)
Net operating income	**17,976**	26,925	25,025
Total operating expenses	**(13,988)**	(16,072)	(16,525)
Operating profit	**3,988**	10,853	8,500
Share of profit in associates and joint ventures	**21**	16	95

Profit before tax	**4,009**	10,869	8,595
	%	%	%
Share of HSBC s profit before tax	**56.7**	116.7	35.5
Cost efficiency ratio	**59.4**	52.4	59.9
Year-end staff numbers (full-time equivalent)	**76,703**	82,093	82,166

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**439,481**	426,191	452,275
Loans and advances to banks (net)	**65,521**	61,949	104,527
Trading assets, financial assets designated at fair value and financial investments[49]	**450,727**	433,885	445,258
Total assets	**1,268,600**	1,392,049	1,256,220
Deposits by banks	**89,893**	80,847	87,491
Customer accounts	**495,019**	502,476	504,954

For footnotes, see page 149.

All commentaries on Europe are on an underlying basis unless stated otherwise.

2009 compared with 2008

Economic briefing

The **UK** economy suffered a sharp contraction during the course of 2009, although evidence from the final months of the year suggested that some growth had resumed. Gross Domestic Product (GDP) fell by 5 per cent in 2009 the sharpest contraction in over 60 years after a 0.5 per cent increase in 2008. Weakness affected most sectors of the economy, and the unemployment rate hit a 13-year high of 7.9 per cent in July 2009, although some stabilisation of labour market conditions was apparent towards the end of the year. Consumer Price Index (CPI) inflation reached a five-year low of 1.1 per cent in September 2009 before moving towards the Bank of England s 2 per cent target by the end of the year. Nominal house prices appreciated modestly during the second half of 2009, although indicators of housing market activity remained at relatively weak levels. After reducing interest rates to just 0.5 per cent in March 2009, the Bank of England launched the Asset Purchase Facility in an attempt to improve the circulation of credit throughout the economy and support expectations of future economic activity.

The **eurozone** economy also performed poorly during 2009, with GDP falling by 4 per cent following a 0.5 per cent expansion in 2008. Much of this weakness was concentrated in the early months of 2009 and growth resumed in the third quarter, helped by a variety of fiscal stimulus programmes and a rebuilding of inventory levels. Consumer spending proved relatively resilient in early 2009, boosted by a number of purchase incentive schemes, and some weakness was observed as these programmes expired. Unemployment rose to an 11-year high of 10 per cent in December 2009, while CPI temporarily turned negative during the third quarter of the year. The European Central Bank cut interest rates by 150 basis points to finish the year at 1 per cent.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Europe	**2008 as reported US$m**	**2008 adjust-ments[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjust-ments[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**9,696**	**(65)**	**(1,049)**	**8,582**		**3,686**	**12,268**	**27**	**43**
Net fee income	**7,492**	**(58)**	**(917)**	**6,517**		**(250)**	**6,267**	**(16)**	**(4)**
Changes in fair value[14]	**3,118**	**(3,118)**			**(2,841)**		**(2,841)**	**(191)**	
Gains on disposal of French regional banks	**2,445**	**(2,445)**						**(100)**	
Other income[15]	**7,928**	**(609)**	**(1,206)**	**6,113**	**280**	**1,457**	**7,850**	**(1)**	**24**
Net operating income[16]	**30,679**	**(6,295)**	**(3,172)**	**21,212**	**(2,561)**	**4,893**	**23,544**	**(23)**	**23**
Loan impairment charges and other credit risk provisions	**(3,754)**	**6**	**395**	**(3,353)**		**(2,215)**	**(5,568)**	**(48)**	**(66)**
Net operating income	**26,925**	**(6,289)**	**(2,777)**	**17,859**	**(2,561)**	**2,678**	**17,976**	**(33)**	**15**

Operating expenses	**(16,072)**	**68**	**1,723**	**(14,281)**		**293**	**(13,988)**	**13**	**2**
Operating profit	**10,853**	**(6,221)**	**(1,054)**	**3,578**	**(2,561)**	**2,971**	**3,988**	**(63)**	**83**
Income from associates	**16**			**16**		**5**	**21**	**31**	**31**
Profit before tax	**10,869**	**(6,221)**	**(1,054)**	**3,594**	**(2,561)**	**2,976**	**4,009**	**(63)**	**83**

For footnotes, see page 149.

Review of business performance

HSBC s European operations reported a pre-tax profit of US$4.0 billion, compared with US$10.9 billion in 2008. This decline was largely caused by movement in the fair value attributable to credit spread on the Group s own debt. A US$2.8 billion expense in 2009 following stabilisation in financial markets and a narrowing of credit spreads largely reversed the US$3.1 billion income recognised in 2008, giving a US$5.9 billion year on year movement. Also included within these results was a gain on the sale of the residual stake in the UK card merchant acquiring business to Global Payments Inc. of US$280 million in June 2009. This followed a US$425 million gain realised in 2008 on the sale of the first tranche. Excluding these gains on sale, the profit on disposal of the French regional banks in July 2008 and the reversal of movements in the fair value of own debt, underlying pre-tax profits grew by US$3.0 billion or 83 per cent. This was driven by robust performances in the European Global Banking and Markets businesses, in particular from the non-recurrence of significant credit-related write-downs taken in 2008 and outstanding results in Rates and Balance Sheet Management. Deterioration in the economic environment and higher unemployment levels led to a rise in loan impairment charges in the Personal Financial Services and Commercial Banking businesses. HSBC Bank continued to provide lending services to its customers while maintaining effective credit control and strengthening collection practices and systems.

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Geographical regions > Europe > 2009

Net interest income increased by 43 per cent, with Balance Sheet Management revenues in Global Banking and Markets rising robustly. This resulted from the early positioning of the balance sheet in anticipation of decisions by central banks to maintain a low base rate environment. Net interest income also benefited from a reduction in the cost of funding trading activities as interest rates fell. Conversely, the Personal Financial Services and Commercial Banking businesses and payments and cash management were adversely affected by continued margin compression following interest rate reductions in late 2008 and early 2009.

Excluding one-off gains and movements in fair value of own debt, underlying profit grew by US$3.0 billion or 83 per cent.

Mortgage balances increased as HSBC gained market share in the UK through the success of a new Rate Matcher mortgage promotion and other campaigns launched in line with its secured lending growth strategy. In 2009, the UK bank more than met its commitment to make £15 billion (US$24.7 billion) of new mortgage lending available to borrowers. In Commercial Banking, net lending fell compared with 2008 as a result of muted customer demand. Utilisation of committed overdraft facilities provided by HSBC in the UK to commercial customers was only 40 per cent at the end of 2009, illustrating the potential availability of credit when customer demand resumes. Across most businesses, asset balances declined reflecting reduced customer demand for credit, increased debt issuance as the bond markets reopened in 2009 and HSBC s diminished appetite for unsecured lending in Europe. Asset spreads widened, most notably in the UK and Turkey, as funding costs fell in the low interest rate environment and market pricing of corporate lending increased.

Throughout 2009, HSBC worked to retain and build on the personal and commercial banking deposit bases gained in the last quarter of 2008 in the face of fierce competition and the narrowing of spreads across the region following interest rate cuts.

Net fee income fell by 4 per cent. The overall reduction in fees was a consequence of the part-disposal of the UK card merchant acquiring business to a joint venture in 2008 and lower insurance income following the closure of the consumer finance branch network in the UK and reduced sales of discontinued products. In Private Banking, lower equity brokerage commissions and reduced performance and management fees reflected subdued investor sentiment for risk and structured products; this, together with stock market declines, reduced the average value of funds under management during the year.

HSBC generated higher underwriting fees than in 2008 from increased government and corporate debt issuances, and by taking market share in equity capital markets issues as corporates and financial institutions restructured their balance sheets by raising share capital. As part of its wealth management strategy, HSBC continued to grow the Premier customer base and successfully launched the World Selection fund in the UK which raised US$1.5 billion. In France, the Premier customer base grew by over 10 per cent as HSBC brand awareness increased.

Trading income increased by 23 per cent to US$5.5 billion due to strong revenues across core businesses. Rates reported a significant increase in income driven by a growth in market share, higher client trading volumes and wider bid-offer spreads. Similarly, revenue in the Credit trading business also rose as credit prices improved and client activity increased with the return of liquidity to the market. Foreign exchange revenue fell, however, reflecting a combination of reduced customer volumes and relatively low market volatility when compared with the exceptional experience of 2008.

In 2009, the UK bank more than met its commitment to make £15 billion (US$24.7 billion) of new mortgage lending available to borrowers.

Trading income also benefited from significantly lower write-downs on legacy positions in Credit trading, leveraged and acquisition financing and monoline exposures, and from the non-recurrence of a reported US$854 million loss in 2008 following the fraud at Madoff Securities. These benefits were partly offset by losses on structured liabilities as credit spreads narrowed (compared with gains in 2008) and a reduction in net interest income on trading activities. This was due to the decline in interest rates, which also contributed to the reduction in the cost of funding trading activities as reported in Net interest income . The tightening of credit spreads also led to a reduction in the carrying value of credit default swap transactions held as hedges in parts of the Global Banking portfolio. In 2008, gains were reported on these credit default swaps following widening credit spreads.

A net expense of US$1.4 billion was incurred on *financial instruments designated at fair value,* compared with income in 2008. Gains on the fair value of assets held to meet liabilities under insurance and investment contracts were recognised as equity markets recovered from declines sustained in 2008. To the extent that these gains were attributed to policyholders holding either insurance contracts or investment contracts with DPF, there was a corresponding increase in *net insurance claims incurred and movement in liabilities to policyholders*.

Gains less losses from financial investments were US$192 million lower than in 2008 due to the non-recurrence of certain disposals in that year, including MasterCard shares, private equity investments and the remaining stake in the Hermitage Fund.

Net earned insurance premiums decreased by 12 per cent. In the UK demand for the insurance-linked Guaranteed Income Bond fell as HSBC offered more favourable rates on an alternative non-insurance deposit product, giving rise to a US$1.1 billion decrease in insurance premium income, with a corresponding decrease in Net insurance claims incurred and movement in liabilities to policyholders . Excluding the effect of a significant re-insurance transaction in 2008 which passed insurance premiums to a third-party reinsurer, net premiums in France increased despite a significant reduction in the distribution network following the disposal of the regional banks in July 2008.

Other operating income increased by 45 per cent, mainly due to a US$576 million gain on the sale and leaseback of 8 Canada Square in London which was effected through the disposal of HSBC s entire shareholding in the company which was the legal owner of the building and long leasehold interest in 8 Canada Square. In 2008, HSBC reported a gain of US$416 million representing the equity deposit on a previously negotiated sale of the building which ultimately did not complete. In addition, a change in mortality assumptions in France resulted in increased PVIF of long-term insurance business. The growth in revenue also reflected the non-recurrence of costs associated with the support of money market funds in the global asset management business in 2008. Offsetting this was the non-recurrence of a favourable embedded value adjustment following HSBC s introduction of enhanced benefits to existing pension products in the UK in 2008, and lower gains on the sale and leaseback of branches.

Net insurance claims incurred and movement in liabilities to policyholders increased by US$2.5 billion. The majority of the movement was due to the change in liabilities to policyholders reported above in Financial instruments designated
at fair value , and the large one-off reinsurance transaction in France in 2008. In addition, an increase of US$310 million in claims reserving was required to reflect a higher incidence and severity of insurance claims in the UK motor underwriting business and a higher incidence of credit protection claims through the reinsurance business in Ireland. Risk mitigation measures implemented in 2009 included the decision to cease originations of UK motor insurance business. This was partly offset by the decrease in liabilities following reduced sales of the personal customer bond product offering noted above.

Utilisation of committed overdraft facilities to commercial customers in the UK only 40 per cent.

Loan impairment charges and other credit risk provisions rose by 66 per cent to US$5.6 billion as the impact of weaker economic conditions across the region fed through to higher delinquency and default. In Global Banking and Markets, loan impairment charges and credit risk provisions increased, with the charges concentrated among a small number of clients in the financial and property sectors. The emergence in the year of cash flow impairment on certain asset-backed debt securities held within the available-for-sale portfolios added US$1.1 billion to the charge. Impairment booked on these exposures reflects mark-to-market losses which HSBC judges to be significantly in excess of the likely ultimate cash losses.

In Commercial Banking, loan impairment charges rose by US$471 million, again reflecting the economic downturn. The commercial property portfolio in the UK declined during 2009, reflecting HSBC s efforts to reduce risk in this sector. In the personal sector, deterioration was most evident in the unsecured portfolios as unemployment rose. As a result of past management action, unsecured lending remained a small proportion of HSBC s personal lending portfolio, with the bulk of the portfolio secured in the form of residential mortgages. Despite some increase in losses in the residential sector, impairment charges as a percentage of total lending in this portfolio remained very low at 0.14 per cent.

Operating expenses were held broadly in line with 2008. Excluding an accounting gain of US$499 million following a change in the basis of delivering death-in-service, ill health and early retirement benefits for some UK employees, operating expenses increased slightly despite efficiency benefits as higher performance-related awards were made to reflect Global Banking and

Markets exceptional revenue and profit growth in selective businesses.

In Personal Financial Services and Commercial Banking businesses, operational cost savings reflected HSBC s leverage of its global technology platforms and processes to reduce costs and improve customer experience, complemented by tight control over discretionary expenditure and a reduction in staff numbers. Payroll savings and lower Financial Services Compensation Scheme costs were partly offset by an increase in rental costs following the sale and leaseback of properties and higher regular defined benefit pension charges. In Europe, full time equivalent staff numbers fell by some 6,000 during the year.

2008 compared with 2007

Economic briefing

In the **UK**, growth in GDP decelerated markedly in 2008 to 0.7 per cent from 3 per cent in 2007, with a technical recession of two successive quarterly contractions in GDP confirmed during the second half of the year. Weakness proved widespread across most of the economy, prompting a sharp deterioration in labour market conditions as unemployment hit a nine-year high of 6.1 per cent in November 2008. CPI inflation reached a decade-long high of 5.2 per cent in September 2008 before falling back to 3.1 per cent by the year-end, still some way above the Bank of England s 2 per cent target. House prices continued to fall throughout the year and housing activity decreased sharply. The Bank of England reduced interest rates by 350 basis points during 2008, to finish the year at 2 per cent, as policymakers sought to mitigate the worst effects of the economic slowdown.

The expansion of the **eurozone** economy slowed sharply in 2008, with GDP growth of 0.7 per cent following a 2.6 per cent expansion in 2007. As in the UK, conditions deteriorated markedly as the year progressed and three successive quarterly declines in GDP were recorded during 2008, confirming that the economy had entered a period of recession. Consumer spending growth proved subdued following the sharp rise in oil prices during the first of half of 2008 and a progressive increase in the unemployment rate towards the year-end. Inflation remained a concern for much of 2008, hitting a peak of 4 per cent in July before falling rapidly to 1.6 per cent in December. The European Central Bank, having initially raised interest rates by 25 basis points in July, cut them by 175 basis points to finish the year at 2.5 per cent.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Europe	2007 as reported US$m	2007 adjustments & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjustments[10] US$m	Underlying change US$m	2008 as reported US$m	Reported change[13] %	Underlying change[13] %
Net interest income	7,746	(390)	(224)	7,132	219	2,345	9,696	25	33
Net fee income	8,431	(134)	(244)	8,053	15	(576)	7,492	(11)	(7)
	1,294	(1,294)			3,118		3,118	141	

Changes in fair value[14]									
Gains on disposal of French regional banks					2,445		2,445		
Other income[15]	10,096	(121)	(321)	9,654	562	(2,288)	7,928	(21)	(24)
Net operating income[16]	27,567	(1,939)	(789)	24,839	6,359	(519)	30,679	11	(2)
Loan impairment charges and other credit risk provisions	(2,542)	30	152	(2,360)	(6)	(1,388)	(3,754)	(48)	(59)
Net operating income	25,025	(1,909)	(637)	22,479	6,353	(1,907)	26,925	8	(8)
Operating expenses	(16,525)	416	531	(15,578)	(88)	(406)	(16,072)	3	(3)
Operating profit	8,500	(1,493)	(106)	6,901	6,265	(2,313)	10,853	28	(34)
Income from associates	95	(12)	14	97		(81)	16	(83)	(84)
Profit before tax	8,595	(1,505)	(92)	6,998	6,265	(2,394)	10,869	26	(34)

For footnotes, see page 149.

Review of business performance

HSBC s European operations reported a pre-tax profit of US$10.9 billion, compared with US$8.6 billion in 2007, an increase of 26 per cent.

These results included gains of US$2.4 billion on the disposal of seven regional banks in France in July 2008, and of US$425 million on the sale of the card acquiring business in the UK to a joint venture with Global Payments, Inc. in June 2008. Excluding these disposals and, in 2007, the acquisition of HSBC Assurances and the disposal of Hamilton Insurance Company Limited and Hamilton Life Assurance Company Limited and substantial fair value gains on own debt, underlying pre-tax profits fell by 34 per cent. This primarily reflected a sharp decline in Global Banking and Markets revenues, which was mainly attributable to the deterioration in credit markets, the continuing illiquidity in asset-backed securities markets which led to further write-downs, and a US$854 million charge within the equities business following the alleged fraud at Madoff Securities. Personal Financial Services and Private Banking delivered underlying growth.

Net interest income increased by 33 per cent. There was significant growth in Balance Sheet Management revenues, which reflected favourable interest rate risk positioning in expectation of interest rate cuts by central banks. Net interest income also benefited from necessarily selective incremental lending as credit availability generally contracted. In Global Banking, net interest income was boosted by improved spreads.

Falling confidence in the UK banking sector necessitated government intervention in a number of competitor banks. HSBC experienced a strong increase in customer numbers, with corresponding growth in liability balances as the market turmoil intensified. The volume benefit was partially offset by narrowing deposit spreads, as base rates were cut in the UK, and increased funding costs, principally for trading activities, in France. Higher net interest income from the expansion of credit card lending and commercial loan portfolio growth in the small and mid-market customer segments in Turkey was partially offset by narrower spreads following credit card interest rate cap reductions by the central bank.

Net fee income fell by 7 per cent, with lower fees from mergers and acquisitions and equity capital markets due to origination and execution difficulties, coupled with a rise in brokerage expenses in line with increased trading activity in France. Lower performance and management fees in the UK and France, as the value of funds under management reduced, reflected the decline in global equity markets. Increased customer acquisition partly offset this, with higher fees derived from growth in packaged accounts and transaction volumes in France and credit card fees in Turkey.

Trading income was 20 per cent lower than in 2007, falling significantly in Global Banking and Markets due to further write-downs on legacy exposures in credit, structured credit derivatives and leveraged and acquisition finance caused by the ongoing turmoil in the credit markets. In addition, a US$854 million charge was taken in equities in respect of the alleged fraud at Madoff Securities. US$11.4 billion and US$2.4 billion of held-for-trading financial assets were reclassified under revised IFRS rules as loans and receivables and available for sale, respectively, preventing any further mark-to-market trading losses on these assets. If these reclassifications had not been made, the profit before tax would have been US$2.6 billion lower.

Excluding the write-downs on legacy exposures and the charge relating to Madoff Securities, trading income grew by 11 per cent, driven by a significant increase in foreign exchange revenues against the backdrop of greater market volatility, and robust revenues in the Rates business, which was positioned to take advantage of falling interest rates. The widening of credit spreads, particularly in the second half of 2008, contributed to fair value gains on structured liabilities and on credit protection bought in the form of credit default swaps.

A rise in the *Net expense from financial instruments designated at fair value* was recorded as a result of a reduction in the value of assets held to meet liabilities under insurance and investment contracts. The reduction in fair value of assets held to meet liabilities under unit-linked insurance contracts is offset by a corresponding reduction in Net insurance claims and liabilities to policyholders .

Gains less losses from financial investments of US$418 million were US$915 million lower than in 2007 as there were fewer disposal opportunities in 2008 and the significant realisations from equity investments in the UK and

France in 2007 did not recur. Gains mainly reflected the sale of MasterCard shares in 2008.

Net earned insurance premiums increased by 22 per cent, largely due to growth in the Guaranteed Income Bond launched in June 2007 and the introduction of enhanced death benefits to certain pension products in the UK. In France, HSBC Assurances performed well in a declining market, as the launch of new guaranteed rate products

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contributed to 3 per cent growth in gross earned premiums. However, net earned insurance premiums fell following a significant reinsurance transaction undertaken in the first half of 2008.

Other operating income increased by 33 per cent. This was primarily due to recognition of the gain in respect of the purchase of the subsidiary of Metrovacesa which owned the property and long leasehold land comprising 8 Canada Square, London. See Note 23 on the Financial Statements for further details. The growth in revenue also reflected the non-recurrence of a decrease in the value of PVIF business in 2007 following regulatory changes to the rules governing the calculation of insurance liabilities. In addition, there was a favourable embedded value adjustment following HSBC s introduction of enhanced benefits to existing commercial pension products in the first half of 2008. These benefits were partially offset by costs associated with the support of money market funds in the global asset management business.

Net insurance claims incurred and movement in liabilities to policyholders decreased by 5 per cent as a reduction in insurance liabilities reflected the fall in value of market-linked funds. This was partially offset by an increase in liabilities following increased sales of the Guaranteed Income Bond and the implementation of FSA rule changes in 2007 which lowered the liability valuation on life policies.

Loan impairment charges and credit risk provisions rose by 59 per cent to US$3.8 billion; in the UK, primarily in Global Banking and Markets. The deteriorating credit environment resulted in a rise in loan impairment charges, largely reflecting an exposure to a single European property company, and additional credit risk provisions on debt securities held within the Group s available-for-sale portfolio, mainly in Solitaire Funding Limited (Solitaire), a special purpose entity managed by HSBC. A modest improvement in the UK personal finance sector reflected the non-recurrence of a change in the methodology in the consumer finance business which resulted in a higher charge in 2007. Excluding this factor, delinquency rates in cards were marginally higher and there was a rise in impairments in the consumer finance business driven by worsening economic conditions and credit quality deterioration, partly offset by action taken to mitigate risk through the continued application of strict lending criteria and the sale of non-core credit card portfolios.

Credit conditions weakened in the commercial business and specific loan impairment charges increased in the UK and France due to the deteriorating credit environment in the second half of 2008. In Turkey, credit card and personal loan delinquency rates were significantly higher, resulting in the implementation of tighter underwriting criteria, reduced credit limits and revised account management policies throughout 2008.

Operating costs increased by 3 per cent to US$16.1 billion. Costs in the UK were in line with 2007, which included ex-gratia payments expensed in respect of overdraft fees applied in previous years and a provision for reimbursement of certain charges on historic will trusts and other related services. Excluding these items, costs rose as a result of an increase in the Financial Services Compensation Scheme levy, restructuring costs and increased rental charges following the sale and leaseback of branch properties, partially offset by lower performance-related pay and a reduction in defined benefit pension scheme costs due to a change in actuarial assumptions.

Operating costs in France decreased slightly with lower performance-related pay and a reduction in pension and retirement healthcare costs following the transfer of certain obligations to a third-party offsetting the higher costs of a voluntary retirement programme.

There was investment in premises and new staff to support business expansion in Turkey, Russia and central and eastern Europe. In 2008, 112 new branches opened and staff numbers increased by 30 per cent in these markets.

Share of profit in associates and joint ventures declined by 84 per cent to US$16 million with 2007 benefiting from an adjustment to the embedded value of HSBC Assurances. The absence of this gain was partially offset by increased joint venture profits following the sale of the card acquiring business in the UK.

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Analysis by customer group and global business

Profit/(loss) before tax

	2009						
Europe	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
Net interest income/(expense)	**5,413**	**2,739**	**4,367**	**949**	**(525)**	**(675)**	**12,268**
Net fee income	**1,949**	**1,679**	**1,670**	**883**	**86**		**6,267**
Trading income excluding net interest income	**34**	**3**	**2,267**	**175**	**382**		**2,861**
Net interest income/(expense) on trading activities	**(1)**	**17**	**1,869**	**23**	**15**	**675**	**2,598**
Net trading income[42]	**33**	**20**	**4,136**	**198**	**397**	**675**	**5,459**
Changes in fair value of long- term debt issued and related derivatives					**(2,746)**		**(2,746)**
Net income/(expense) from other financial instruments designated at fair value	**1,012**	**133**	**375**		**(199)**		**1,321**
Net income/(expense) from financial instruments designated at fair value	**1,012**	**133**	**375**		**(2,945)**		**(1,425)**
Gains less losses from financial investments	**20**	**2**	**25**	**5**	**(2)**		**50**
Dividend income	**2**	**1**	**26**	**3**	**(3)**		**29**
	3,975	**253**	**(2)**		**(3)**		**4,223**

Net earned insurance premiums							
Other operating income	**182**	**373**	**670**	**28**	**914**	**95**	**2,262**
Total operating income/ (expense)	**12,586**	**5,200**	**11,267**	**2,066**	**(2,081)**	**95**	**29,133**
Net insurance claims[43]	**(5,221)**	**(365)**			**(3)**		**(5,589)**
Net operating income/ (expense)[16]	**7,365**	**4,835**	**11,267**	**2,066**	**(2,084)**	**95**	**23,544**
Loan impairment charges and other credit risk provisions	**(1,992)**	**(1,267)**	**(2,277)**	**(29)**	**(3)**		**(5,568)**
Net operating income/ (expense)	**5,373**	**3,568**	**8,990**	**2,037**	**(2,087)**	**95**	**17,976**
Total operating expenses	**(5,062)**	**(2,294)**	**(4,447)**	**(1,183)**	**(907)**	**(95)**	**(13,988)**
Operating profit/(loss)	**311**	**1,274**	**4,543**	**854**	**(2,994)**		**3,988**
Share of profit in associates and joint ventures	**1**	**18**	**2**				**21**
Profit/(loss) before tax	**312**	**1,292**	**4,545**	**854**	**(2,994)**		**4,009**
	%	%	%	%	%		%
Share of HSBC s profit before tax	**4.4**	**18.3**	**64.2**	**12.1**	**(42.3)**		**56.7**
Cost efficiency ratio	**68.7**	**47.4**	**39.5**	**57.3**	**(43.5)**		**59.4**
Balance sheet data[41]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**147,760**	**89,084**	**176,123**	**25,541**	**973**		**439,481**
Total assets	**208,669**	**111,874**	**981,831**	**76,871**	**84,010**	**(194,655)**	**1,268,600**

Customer accounts	**165,161**	**102,249**	**169,390**	**58,213**	**6**		**495,019**

For footnotes, see page 149.

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Geographical regions > Europe > Profit/(loss) before tax by customer group

Profit/(loss) before tax (continued)

	2008						
Europe	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income/(expense)	6,464	3,435	3,488	1,046	(459)	(4,278)	9,696
Net fee income	2,612	2,025	1,763	1,020	72		7,492
Trading income/(expense) excluding net interest income	47	71	1,513	198	(138)		1,691
Net interest income/(expense) on trading activities		12	(655)	14	17	4,278	3,666
Net trading income/(expense)[42]	47	83	858	212	(121)	4,278	5,357
Changes in fair value of long-term debt issued and related derivatives					2,939		2,939
Net income/(expense) from other financial instruments designated at fair value	(1,634)	(214)	(611)		633		(1,826)
Net income/(expense) from financial instruments designated at fair value	(1,634)	(214)	(611)		3,572		1,113
Gains less losses from financial investments	281	132	(30)	62	(27)		418

Dividend income	35	74	25	5	(9)		130
Net earned insurance premiums	4,927	391			(19)		5,299
Gains on disposal of French regional banks					2,445		2,445
Other operating income	230	620	398	16	832		2,096
Total operating income	12,962	6,546	5,891	2,361	6,286		34,046
Net insurance claims[43]	(3,224)	(143)					(3,367)
Net operating income[16]	9,738	6,403	5,891	2,361	6,286		30,679
Loan impairment charges and other credit risk provisions	(1,971)	(867)	(875)	(38)	(3)		(3,754)
Net operating income	7,767	5,536	5,016	2,323	6,283		26,925
Total operating expenses	(6,107)	(2,830)	(4,823)	(1,325)	(987)		(16,072)
Operating profit	1,660	2,706	193	998	5,296		10,853
Share of profit/(loss) in associates and joint ventures	(2)	16	2				16
Profit before tax	1,658	2,722	195	998	5,296		10,869
	%	%	%	%	%		%
Share of HSBC s profit before tax	17.8	29.2	2.1	10.7	56.9		116.7
Cost efficiency ratio	62.7	44.2	81.9	56.1	15.7		52.4
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	126,909	87,245	185,818	25,722	497		426,191
Total assets	171,962	107,495	1,180,759	84,485	64,423	(217,075)	1,392,049
Customer accounts	145,411	91,188	199,687	66,007	183		502,476

For footnotes, see page 149.

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	2007						
Europe	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	6,604	3,419	1,361	793	86	(4,517)	7,746
Net fee income/(expense)	3,060	2,194	2,316	1,032	(171)		8,431
Trading income excluding net interest income	60	36	2,657	161	89		3,003
Net interest income/(expense) on trading activities	(7)	30	(610)	9	1	4,517	3,940
Net trading income[42]	53	66	2,047	170	90	4,517	6,943
Changes in fair value of long-term debt issued and related derivatives					1,059		1,059
Net income/(expense) from other financial instruments designated at fair value	126	31	(185)		195		167
Net income/(expense) from financial instruments designated at fair value	126	31	(185)		1,254		1,226
Gains less losses from financial investments	50	36	1,100	115	25		1,326
Dividend income	1	4	155	7	4		171
Net earned insurance premiums	3,511	521			(22)		4,010

Other operating income/(expense)	54	(35)	853	8	301	12	1,193
Total operating income	13,459	6,236	7,647	2,125	1,567	12	31,046
Net insurance claims[43]	(3,214)	(265)					(3,479)
Net operating income[16]	10,245	5,971	7,647	2,125	1,567	12	27,567
Loan impairment (charges)/recoveries and other credit risk provisions	(2,044)	(515)	26	(4)	(5)		(2,542)
Net operating income	8,201	5,456	7,673	2,121	1,562	12	25,025
Total operating expenses	(6,635)	(2,941)	(5,150)	(1,208)	(579)	(12)	(16,525)
Operating profit	1,566	2,515	2,523	913	983		8,500
Share of profit in associates and joint ventures	15	1	4	2	73		95
Profit before tax	1,581	2,516	2,527	915	1,056		8,595
	%	%	%	%	%		%
Share of HSBC s profit before tax	6.5	10.4	10.4	3.8	4.4		35.5
Cost efficiency ratio	64.8	49.3	67.3	56.8	36.9		59.9
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	151,687	106,846	163,066	30,195	481		452,275
Total assets	240,361	168,846	912,299	83,740	96,346	(245,372)	1,256,220
Customer accounts	178,757	99,704	163,713	62,055	725		504,954

For footnotes, see page 149.

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HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Geographical regions > Hong Kong > 2009

Hong Kong
Profit/(loss) before tax by customer group and global business

	2009	2008	2007
	US$m	US$m	US$m
Personal Financial Services	**2,728**	3,428	4,212
Commercial Banking	**956**	1,315	1,619
Global Banking and Markets	**1,507**	1,436	1,578
Private Banking	**197**	237	305
Other	**(359)**	(955)	(375)
	5,029	5,461	7,339

Profit before tax

	2009	2008	2007
	US$m	US$m	US$m
Net interest income	**4,195**	5,698	5,483
Net fee income	**2,669**	2,580	3,362
Net trading income	**1,225**	1,193	1,242
Changes in fair value of long-term debt issued and related derivatives	**(3)**	3	2
Net income/(expense) from other financial instruments designated at fair value	**788**	(1,194)	674
Net income/(expense) from financial instruments designated at fair value	**785**	(1,191)	676
Gains less losses from financial investments	**9**	(309)	94
Dividend income	**28**	41	31
Net earned insurance premiums	**3,674**	3,247	2,797
Other operating income	**1,274**	817	845
Total operating income	**13,859**	12,076	14,530
	(4,392)	(1,922)	(3,208)

Net insurance claims incurred and movement in liabilities to policyholders			
Net operating income before loan impairment charges and other credit risk provisions	**9,467**	10,154	11,322
Loan impairment charges and other credit risk provisions	**(500)**	(765)	(231)
Net operating income	**8,967**	9,389	11,091
Total operating expenses	**(3,946)**	(3,943)	(3,780)
Operating profit	**5,021**	5,446	7,311
Share of profit in associates and joint ventures	**8**	15	28
Profit before tax	**5,029**	5,461	7,339
	%	*%*	*%*
Share of HSBC s profit before tax	**71.0**	58.7	30.3
Cost efficiency ratio	**41.7**	38.8	33.4
Year-end staff numbers (full-time equivalent)	**27,614**	29,330	27,655

Balance sheet data[41]

		At 31 December	
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**99,381**	100,220	89,638
Loans and advances to banks (net)	**36,197**	29,646	63,737
Trading assets, financial assets designated at fair value, and financial investments	**154,418**	122,602	102,180
Total assets	**399,243**	414,484	359,386
Deposits by banks	**6,023**	11,769	6,420
Customer accounts	**275,441**	250,517	234,488

For footnote, see page 149.

All commentaries on Hong Kong are on an underlying basis unless stated otherwise.

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

HSBC Holdings plc

By:

Name: Douglas J Flint
Title: Chief Financial Officer, Executive Director, Risk and Regulation

Dated: 15 March 2009

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2009 compared with 2008

Economic briefing

The performance of the **Hong Kong** economy proved variable during the course of 2009, with a robust recovery developing after a sharp contraction was recorded during the first quarter of the year. GDP in 2009 fell by 2.7 per cent after growth of 2.1 per cent in 2008. Unemployment rose during the first half of 2009, before falling slightly to end the year at 4.9 per cent, a figure still well below the average of the past 10 years. The CPI profile proved volatile during the course of the year, turning negative between June and August before rising to 1.3 per cent by December 2009, although these movements largely reflected the trends of food and energy prices. The Hong Kong Monetary Authority held the base rates steady at 0.5 per cent throughout the course of the year. Asset price performance proved unusually volatile as the Hang Seng Index recovered strongly from a weak start to 2009 to record a 52 per cent increase during the year.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Hong Kong	**2008 as reported US$m**	**2008 adjustments US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjustments[10] US$m**	**Underlying change US$m**	**2009 as reported US$m**	**Reported change[13] %**	**Underlying change[13] %**
Net interest income	**5,698**		**21**	**5,719**		**(1,524)**	**4,195**	**(26)**	**(27)**
Net fee income	**2,580**		**10**	**2,590**		**79**	**2,669**	**3**	**3**
Changes in fair value[14]	**5**	**(5)**			**(1)**		**(1)**	**(120)**	
Other income[15]	**1,871**		**7**	**1,878**		**726**	**2,604**	**39**	**39**
Net operating income[16]	**10,154**	**(5)**	**38**	**10,187**	**(1)**	**(719)**	**9,467**	**(7)**	**(7)**
Loan impairment charges and other credit risk provisions	**(765)**		**(2)**	**(767)**		**267**	**(500)**	**35**	**35**
Net operating income	**9,389**	**(5)**	**36**	**9,420**	**(1)**	**(452)**	**8,967**	**(4)**	**(5)**
Operating expenses	**(3,943)**		**(16)**	**(3,959)**		**13**	**(3,946)**		

Operating profit	**5,446**	**(5)**	**20**	**5,461**	**(1)**	**(439)**	**5,021**	**(8)**	**(8)**
Income from associates	**15**			**15**		**(7)**	**8**	**(47)**	**(47)**
Profit before tax	**5,461**	**(5)**	**20**	**5,476**	**(1)**	**(446)**	**5,029**	**(8)**	**(8)**

For footnotes, see page 149.

Review of business performance

HSBC s operations in Hong Kong reported pre-tax profits of US$5.0 billion compared with US$5.5 billion in 2008, an 8 per cent decline on both a reported and an underlying basis.

The decrease in profits came from lower revenue, which resulted from compressed deposit spreads in a near-zero interest rate environment. This loss of revenue was partly offset by significantly lower loan impairment charges and other credit risk provisions during 2009, and a recovery in trade activity triggered by an improvement in regional economic conditions in the second half of the year.

Despite continuing economic challenges, performance remained robust, and was underpinned by HSBC s market-leading share in deposits, residential mortgages, cards and insurance. In particular, HSBC consolidated its position as Hong Kong s leading bancassurer, growing the value of
new life insurance business by 38 per cent. In residential mortgages, business growth was combined with conservative loan-to-value ratios on new business.

Net interest income declined by 27 per cent to US$4.2 billion, driven by significant deposit spread compression as HIBOR and LIBOR remained low throughout 2009. Selective repricing of customer loans helped to mitigate the impact of lower rates on lending spreads and the continued increase in customer account balances has positioned HSBC to benefit from economic recovery and a resulting widening of deposit spreads.

Average customer lending balances remained broadly in line with 2008, as lower Commercial Banking balances, which reflected the reduction in exports in the first half of 2009, were broadly offset by higher lending in Personal Financial Services and Global Banking and Markets. As the regional economy rebounded, trade volumes and Commercial

HSBC HOLDINGS PLC
Report of the Directors: Operating and Financial Review (continued)

Geographical regions > Hong Kong > 2009 / 2008

Banking lending activity increased in the second half of the year. Throughout this challenging period for trade, HSBC continued to support local business through its HK$20 billion (US$2.6 billion) global loan fund for smaller businesses. These facilities were fully utilised by over 8,600 companies at 31 December 2009.

As residential property prices increased, personal lending volumes rose, and HSBC consolidated its mortgage market share by originating significant volumes of new mortgages. HSBC led this market with a 38 per cent share of new loan drawdowns with an average loan-to-value ratio of 58 per cent on new business. Asset spreads improved as a result of selective risk-based repricing, notably in cards, while funding costs fell in the low interest rate environment. Pre-tax profit declined by 8 per cent to US$5.0 billion as deposit spreads compressed in the near-zero interest rate environment.

HSBC continued to increase market share in savings and deposit accounts, and balances grew following a series of deposit acquisition campaigns. In Personal Financial Services, customer account balances rose by 15 per cent and Premier customer numbers grew to over 380,000. Strong growth in Commercial Banking was driven by a rise in customer numbers, also supported by a series of deposit acquisition campaigns and increased liquidity in the region.

Overall, deposit balances grew by 10 per cent. Liability spreads remained under severe pressure throughout 2009, however.

Net fee income increased by 3 per cent with an increase in IPO underwriting fees in the second half of the year, triggered by improved investor sentiment and a recovery in equity markets. Personal Financial Services customers preference for deposit products rather than equity-linked products in the first half of the year reversed as equity markets recovered in the second half of 2009, resulting in a recovery in revenue generated from unit trusts, wealth management, custody and other investment products. Similarly, the increase in trade flows in the second half of 2009 affected trade-related fee income in Commercial Banking.

Trading income increased by 2 per cent, primarily due to increased volumes of bond trading and wider margins on market making activities. The non-recurrence of US$0.2 billion of write-downs on a legacy monoline exposure also contributed to the rise. Foreign exchange trading revenue decreased from the exceptional results reported in 2008, reflecting the lower market volatility and a decline in customer volumes. Interest on trading assets declined due to a reduced holding of trading debt securities.

Income of US$0.8 billion was generated from *financial instruments designated at fair value*, compared with an expense of US$1.2 billion in 2008. The positive movement in fair value was primarily driven by equity market-related gains in unit-linked insurance products. To the extent that these gains were attributed to policyholders, there was a corresponding increase in *net insurance claims incurred and movement in liabilities to policyholders.*

Net earned premiums increased by 13 per cent to US$3.7 billion due to strong sales of both existing and new products, including a life insurance product designed for high net worth individuals, all of which contributed to a rise in market share. The proportion of regular premium policies grew and sales of investment-linked insurance products began to improve in the second half of the year. HSBC retained its market leadership position in the regular-premium individual-life new business. The growth in insurance business also resulted in higher net insurance claims incurred and movement in liabilities to policyholders.

Gains less losses from financial investments moved from a loss of US$310 million to a net gain of US$9 million, mainly due to the non-recurrence of impairments against available-for-sale equity investments following declines in market valuations in 2008. The loss recognised in 2008 on the equity investments concerned was partially recovered in 2009 but this gain was reflected in reserves rather than reversing through the income statement.

Other operating income of US$1.3 billion was 55 per cent higher than in 2008, reflecting a positive movement in PVIF driven largely by an increase in insurance sales to new customers. A gain of US$110 million was recognised in respect of the disposal of a property in Hong Kong.

Loan impairment charges and other credit risk provisions fell by 35 per cent to US$0.5 billion, as the credit environment was more stable in 2009 following deterioration in the second half of 2008. The high level of credit risk provisions and loan impairment charges taken in 2008 against financial institutions and export-led customers moderated in 2009 as credit conditions recovered and international trade volumes improved.

A rise in unemployment and in bankruptcy petitions led to increased impairment charges against unsecured lending in Personal Financial Services, though bankruptcy levels improved in the second half of the year. Property prices increased during 2009 and mortgage lending remained well secured with conservative loan-to-value ratios and origination subject to tight internal and regulatory guidelines.

Operating expenditure was held in line with 2008 as higher staff costs were offset by lower general and administrative costs. The increase in staff costs, driven by higher performance-related pay, was partly offset by reduced staff numbers. Non-staff costs fell as marketing expenditure was reduced and operational efficiencies improved as a result of the increased use of direct channels.

2008 compared with 2007

Economic briefing

Hong Kong s GDP growth slowed to 2.5 per cent in 2008 from 6.4 per cent in 2007. After performing strongly during the early months of the year, the economy slowed sharply and a technical recession was confirmed with the release of the third quarter GDP statistics. External demand proved especially weak during the second half of 2008 and the growth in private consumption also slowed sharply. The unemployment rate rose from a ten-year low of 3.2 per cent in August 2008 to 4.1 per cent by the year-end. Consumer price inflation proved volatile during the year, rising to a ten-year high of 6.3 per cent in July before slowing to 2.1 per cent by December 2008, although this movement largely reflected the trends in food and energy prices. In response to interest rate cuts in the US, Hong Kong cut its base interest rate on seven occasions during 2008, finishing the year at 0.5 per cent compared with 5.75 per cent at the end of 2007. The Hang Seng Index fell by 48 per cent during 2008.

Review of business performance

Hong Kong reported pre-tax profits of US$5.5 billion, a 26 per cent decline compared with record profits of US$7.3 billion in 2007. Lower revenues largely reflected a decline in wealth management and insurance income as economic conditions deteriorated. Revenue decline was compounded by impairment charges recognised on certain investments, which arose as a consequence of significant falls in equity market prices. Offsetting this, in part, was considerably stronger Balance Sheet Management income from treasury positions which correctly anticipated the decline in interest rates.

Net interest income rose by 4 per cent, driven by the strong Balance Sheet Management performance in Global Banking and Markets mainly driven by liquidity generated by retail banking in the environment of falling short-term interest rates.

Savings and deposit balances grew strongly, particularly in Personal Financial Services, as customers revealed a preference for security and liquidity following declines in equity markets. Deposit growth was augmented by the launch of campaigns offering both preferential time deposit rates and an enhanced HSBC online platform. The significant decline in interest rates during 2008 led to a narrowing of deposit spreads.

Customer lending volumes were 11 per cent higher, due in part to an 11 per cent rise in mortgage balances. Lending margins narrowed, however, due to interest rate cuts, particularly affecting mortgage lending and other loans linked to HIBOR. Balances outstanding on credit cards rose, driven by increased cardholder spending, and spreads on this business increased due to lower funding costs. Nearly one million new cards were issued in the year, bringing the total cards in circulation to 5.3 million. Volumes of trade finance grew strongly, driven by demand from corporates with international trade requirements, and commercial lending balances rose, particularly during the first half of the year.

Fee income declined by 23 per cent, driven by lower equity market-related revenues. Weak market sentiment led to lower volumes of retail brokerage and a decrease in income from wealth management activity. This was partly offset by a rise in fees from cards following increases in both cards in circulation and cardholder spending. Fees from account services rose due to greater customer activity and there were higher fees generated from bundled products.

Trading income was 4 per cent lower, driven by further write-downs of US$0.2 billion in Global Banking and Markets on a legacy monoline exposure. Excluding these write-downs, trading income grew due to a rise in foreign exchange and rates income as continuing market volatility generated increased trading opportunities and demand for active hedging products.

The net loss of US$1.2 billion on *financial instruments designated at fair value* compared with income of US$676 million in 2007. The loss reflected a decline in the value of assets linked to the insurance business. To a large extent, these losses are attributable to policyholders, with an equivalent reduction in *net insurance claims and movement in liabilities to policyholders*. While the decline in the value of assets which relate to unit-linked products is

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Geographical regions > Hong Kong > 2008 / Profit(loss) before tax by customer group

allocated to policyholders in full, the portion of decline in the value passed on to clients who have products with discretionary participation features and guarantees may be restricted.

Losses from financial investments of US$309 million reflected impairments required on investments which have experienced significant falls in equity market prices. These equity investments are classified as available for sale, are not held for trading, and remain part of the strategic positioning of HSBC s businesses in Asia. These losses were partly offset by an aggregate gain of US$203 million from the redemption of shares in the Visa initial public offering (IPO) and the disposal of MasterCard shares.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Hong Kong	2007 as reported US$m	2007 adjustments and dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjustments[10] US$m	Underlying change US$m	2008 as reported US$m	Reported change[13] %	Underlying change[13] %
Net interest income	5,483		15	5,498		200	5,698	4	4
Net fee income	3,362		9	3,371		(791)	2,580	(23)	(23)
Changes in fair value[14]	1	(1)			5		5	400	
Other income[15]	2,476	(1)	3	2,478		(607)	1,871	(24)	(24)
Net operating income[16]	11,322	(2)	27	11,347	5	(1,198)	10,154	(10)	(11)
Loan impairment charges and other credit risk provisions	(231)	1	(1)	(231)		(534)	(765)	(231)	(231)
Net operating income	11,091	(1)	26	11,116	5	(1,732)	9,389	(15)	(16)
Operating expenses	(3,780)		(9)	(3,789)		(154)	(3,943)	(4)	(4)

Operating profit	7,311	(1)	17	7,327	5	(1,886)	5,446	(26)	(26)
Income from associates	28			28		(13)	15	(46)	(46)
Profit before tax	7,339	(1)	17	7,355	5	(1,899)	5,461	(26)	(26)

For footnotes, see page 149.

Net earned insurance premiums increased by 16 per cent to US$3.2 billion, largely due to growth in the life insurance business, in particular for policies with discretionary participation features.

Net insurance claims and movement in liabilities to policyholders fell by 40 per cent, reflecting the decline in asset values noted above partly offset by increases due to growth in premiums.

Loan impairment charges and other credit risk provisions rose markedly from the previously low level to US$765 million as economic conditions deteriorated. Within these charges were exposures to financial institutions held within Global Banking and Markets, which resulted in other credit risk provisions. In Commercial Banking, the combination of an absence of significant recoveries recorded in 2007 and weakness among certain exporters in Hong Kong, who were affected by reduced demand from the US and other developed countries, raised loan impairment charges. As local businesses responded to the economic environment, unemployment rose in the second half of 2008. Credit policies were consequently adjusted across certain products as delinquency and bankruptcy increased in Hong Kong. Although property market declines reduced equity levels for residential mortgage customers, the impact on loan impairment charges was limited as this lending was well-secured and regulatory restrictions constrained origination loan-to-value ratios to below 70 per cent.

Operating expenses rose by 4 per cent. Staff costs declined by 3 per cent despite wage increases and a rise in the number of customer-facing staff, largely due to lower performance-related costs in Global Banking and Markets. Staff numbers were higher than in 2007 notwithstanding reductions within the branch network for lower business volumes in the latter part of 2008. IT costs rose as investment in systems continued. Marketing costs were lower following active management of costs while property rental costs increased due to higher market rental rates. Overall, cost growth was curtailed in response to the more difficult economic climate.

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Analysis by customer group and global business

Profit/(loss) before tax

	2009						
Hong Kong	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
Net interest income/(expense)	**2,577**	**938**	**1,150**	**212**	**(558)**	**(124)**	**4,195**
Net fee income	**1,410**	**530**	**563**	**125**	**41**		**2,669**
Trading income/(expense) excluding net interest income	**186**	**92**	**792**	**91**	**(93)**		**1,068**
Net interest income on trading activities	**3**		**16**		**14**	**124**	**157**
Net trading income/(expense)[42]	**189**	**92**	**808**	**91**	**(79)**	**124**	**1,225**
Changes in fair value of long-term debt issued and related derivatives					**(3)**		**(3)**
Net income/(expense) from other financial instruments designated at fair value	**707**	**(46)**	**138**		**(11)**		**788**
Net income/(expense) from financial instruments designated at fair value	**707**	**(46)**	**138**		**(14)**		**785**
Gains less losses from financial investments	**80**	**18**	**(108)**		**19**		**9**
Dividend income	**1**	**1**	**10**		**16**		**28**
Net earned insurance premiums	**3,161**	**500**	**13**				**3,674**
Other operating income	**346**	**64**	**59**	**10**	**1,062**	**(267)**	**1,274**
Total operating income	**8,471**	**2,097**	**2,633**	**438**	**487**	**(267)**	**13,859**
Net insurance claims[43]	**(3,979)**	**(404)**	**(9)**				**(4,392)**

Net operating income[16]	**4,492**	**1,693**	**2,624**	**438**	**487**	**(267)**	**9,467**
Loan impairment (charges)/ recoveries and other credit risk provisions	**(203)**	**(168)**	**(131)**	**1**	**1**		**(500)**
Net operating income	**4,289**	**1,525**	**2,493**	**439**	**488**	**(267)**	**8,967**
Total operating expenses	**(1,566)**	**(570)**	**(987)**	**(242)**	**(848)**	**267**	**(3,946)**
Operating profit/(loss)	**2,723**	**955**	**1,506**	**197**	**(360)**		**5,021**
Share of profit in associates and joint ventures	**5**	**1**	**1**		**1**		**8**
Profit/(loss) before tax	**2,728**	**956**	**1,507**	**197**	**(359)**		**5,029**
	%	*%*	*%*	*%*	*%*		*%*
Share of HSBC s profit before tax	**38.5**	**13.5**	**21.3**	**2.8**	**(5.1)**		**71.0**
Cost efficiency ratio	**34.9**	**33.7**	**37.6**	**55.3**	**174.1**		**41.7**
Balance sheet data[41]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**43,869**	**28,217**	**21,991**	**3,361**	**1,943**		**99,381**
Total assets	**83,497**	**34,743**	**217,146**	**20,353**	**52,508**	**(9,004)**	**399,243**
Customer accounts	**166,445**	**62,146**	**26,650**	**19,474**	**726**		**275,441**

For footnotes, see page 149.

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Report of the Directors: Operating and Financial Review (continued)

Hong Kong > Profit/(loss) before tax by customer group

Analysis by customer group and global business *(continued)*
Profit/(loss) before tax (continued)

	2008						
Hong Kong	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income/(expense)	3,381	1,498	1,524	214	(669)	(250)	5,698
Net fee income	1,441	548	414	163	14		2,580
Trading income excluding net interest income	143	79	483	120	30		855
Net interest income/(expense) on trading activities	11	1	244		(168)	250	338
Net trading income/(expense)[42]	154	80	727	120	(138)	250	1,193
Changes in fair value of long-term debt issued and related derivatives					3		3
Net income/(expense) from other financial instruments designated at fair value	(1,291)	(10)	39		68		(1,194)
Net income/(expense) from financial instruments designated at fair value	(1,291)	(10)	39		71		(1,191)
Gains less losses from financial investments	156	32	(109)		(388)		(309)
Dividend income	3	2	17		19		41
Net earned insurance premiums	3,047	181	17		2		3,247
Other operating income	132	38	101	8	906	(368)	817

Total operating income	7,023	2,369	2,730	505	(183)	(368)	12,076
Net insurance claims[43]	(1,773)	(136)	(11)		(2)		(1,922)
Net operating income[16]	5,250	2,233	2,719	505	(185)	(368)	10,154
Loan impairment (charges)/ recoveries and other credit risk provisions	(134)	(335)	(284)	(13)	1		(765)
Net operating income/(expense)	5,116	1,898	2,435	492	(184)	(368)	9,389
Total operating expenses	(1,691)	(584)	(1,000)	(255)	(781)	368	(3,943)
Operating profit/(loss)	3,425	1,314	1,435	237	(965)		5,446
Share of profit in associates and joint ventures	3	1	1		10		15
Profit/(loss) before tax	3,428	1,315	1,436	237	(955)		5,461
	%	%	%	%	%		%
Share of HSBC s profit before tax	36.9	14.1	15.4	2.6	(10.3)		58.7
Cost efficiency ratio	32.2	26.2	36.8	50.5	(422.2)		38.8
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	41,447	30,331	23,042	3,605	1,795		100,220
Total assets	75,419	36,428	233,187	28,800	66,192	(25,542)	414,484
Customer accounts	145,002	54,869	30,866	19,416	364		250,517

For footnotes, see page 149.

	2007						
	Personal Financial Services	Commercial Banking	Global Banking & Markets	Private Banking	Other	Inter-segment elimination[50]	Total
Hong Kong	US$m	US$m	US$m	US$m	US$m	US$m	US$m
Net interest income/(expense)	3,342	1,540	986	70	(767)	312	5,483
Net fee income	1,973	526	682	179	2		3,362
Trading income excluding net interest income	188	63	553	280	186		1,270
Net interest income on trading activities	5		241		38	(312)	(28)
Net trading income[42]	193	63	794	280	224	(312)	1,242
Changes in fair value of long-term debt issued and related derivatives					2		2
Net income/(expense) from other financial instruments designated at fair value	820	(13)	7		(140)		674
Net income/(expense) from financial instruments designated at fair value	820	(13)	7		(138)		676
Gains less losses from financial investments			38	1	55		94
Dividend income	2	1	6		22		31
Net earned insurance premiums	2,654	130	13				2,797
Other operating income	153	28	114	6	881	(337)	845
Total operating income	9,137	2,275	2,640	536	279	(337)	14,530
Net insurance claims[43]	(3,116)	(82)	(10)				(3,208)
Net operating income[16]	6,021	2,193	2,630	536	279	(337)	11,322

Loan impairment charges and other credit risk provisions	(175)	(28)	(28)				(231)
Net operating income	5,846	2,165	2,602	536	279	(337)	11,091
Total operating expenses	(1,639)	(547)	(1,025)	(231)	(675)	337	(3,780)
Operating profit/(loss)	4,207	1,618	1,577	305	(396)		7,311
Share of profit in associates and joint ventures	5	1	1		21		28
Profit/(loss) before tax	4,212	1,619	1,578	305	(375)		7,339
	%	%	%	%	%		%
Share of HSBC s profit before tax	17.4	6.7	6.5	1.3	(1.6)		30.3
Cost efficiency ratio	27.2	24.9	39.0	43.1	241.9		33.4
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	38,197	25,890	19,171	4,329	2,051		89,638
Total assets	66,002	32,059	218,293	17,484	53,227	(27,679)	359,386
Customer accounts	129,159	51,562	37,364	15,649	754		234,488

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Geographical regions > Rest of Asia-Pacific > 2009

Rest of Asia-Pacific[27]
Profit/(loss) before tax by country within customer groups and global businesses

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Total US$m
2009						
Australia	**30**	**32**	**140**		**(4)**	**198**
India	**(219)**	**(41)**	**393**	**1**	**240**	**374**
Indonesia	**(24)**	**60**	**129**		**(11)**	**154**
Japan	**(79)**		**65**	**(4)**	**1**	**(17)**
Mainland China	**494**	**616**	**479**	**(7)**	**50**	**1,632**
Associates	**678**	**558**	**285**			**1,521**
Other mainland China	**(184)**	**58**	**194**	**(7)**	**50**	**111**
Malaysia	**88**	**53**	**140**		**5**	**286**
Singapore	**129**	**77**	**247**	**98**	**(9)**	**542**
South Korea	**(3)**	**(5)**	**342**		**25**	**359**
Taiwan	**(3)**	**65**	**96**		**2**	**160**
Other	**50**	**207**	**288**	**2**	**(35)**	**512**
	463	**1,064**	**2,319**	**90**	**264**	**4,200**
2008						
Australia	19	68	102		(13)	176
India	(155)	118	578	2	123	666
Indonesia	(22)	17	126			121
Japan	(88)	(1)	88	1	4	4
Mainland China	284	622	688	(5)	16	1,605
Associates	393	558	335			1,286
Other mainland China	(109)	64	353	(5)	16	319
Malaysia	94	96	171		8	369
Singapore	104	83	337	110	(37)	597

South Korea	(16)	(13)	304		38	313
Taiwan	(41)	45	179		(8)	175
Other	32	200	397	1	66	696
	211	1,235	2,970	109	197	4,722
2007						
Australia	41	37	42		4	124
India	(70)	88	429	(1)	83	529
Indonesia	(7)	29	86		(4)	104
Japan	(34)	(3)	75		5	43
Mainland China	494	397	369		1,101	2,361
Associates	516	351	220		1,093	2,180
Other mainland China	(22)	46	149		8	181
Malaysia	81	90	146		13	330
Singapore	101	112	240	90	7	550
South Korea	(44)	(20)	159		28	123
Taiwan	(52)	27	144		4	123
Other	5	111	279		20	415
	515	868	1,969	89	1,261	4,702

For footnote see page 149.

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Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Australia	**12,112**	9,321	11,339
India	**4,893**	6,244	7,220
Indonesia	**2,721**	1,904	1,642
Japan	**2,496**	5,839	4,258
Mainland China	**13,294**	11,440	11,647
Malaysia	**9,132**	9,404	8,856
Singapore	**14,817**	13,441	11,505
South Korea	**4,438**	5,336	7,124
Taiwan	**4,280**	4,329	3,658
Other	**11,860**	13,403	12,996
	80,043	80,661	80,245

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Australia	**12,093**	9,201	11,418
India	**11,676**	9,767	12,021
Indonesia	**5,014**	2,896	2,574
Japan	**4,914**	6,204	4,657
Mainland China	**21,867**	19,171	14,537
Malaysia	**12,809**	11,963	11,701
Singapore	**33,211**	32,748	28,962
South Korea	**4,162**	4,383	5,760
Taiwan	**9,891**	9,689	9,426
Other	**18,362**	18,172	18,240
	133,999	124,194	119,296

2009 compared with 2008

Economic briefing

Growth in **mainland China** accelerated throughout the course of the year as the government s fiscal stimulus package helped offset weak levels of demand within key export markets. Overall GDP growth totalled 8.7 per cent in 2009, down from 9.6 per cent in 2008, although on a quarterly basis the annual rate of growth rose to a very high 10.7 per cent in the final three months of the year. Industrial production also gathered momentum as the year progressed, while very strong levels of bank lending growth helped fixed asset investment expenditure to maintain a rapid pace of expansion throughout 2009. Consumer spending remained robust, with retail sales rising by 17.5 per cent in the year. The annual CPI rate was negative throughout much of 2009, largely reflecting the earlier movements in food and energy prices, before accelerating to 1.9 per cent in December 2009. The renminbi exchange rate was little changed against the US dollar throughout the course of the year.

Economic conditions proved difficult in **Japan** during 2009, although some signs of stabilisation did

emerge following an extremely weak start to the year. First quarter GDP fell by 3.2 per cent on a quarter-on-quarter basis, before gains of 1.3 per cent, zero and 1.1 per cent were recorded in the next three quarters, respectively. The unemployment rate rose from 4.3 per cent in December 2008 to a record high of 5.7 per cent in July 2009, before declining to finish the year at 5.1 per cent. The Bank of Japan introduced a range of initiatives in January 2009 with the intention of improving financing conditions across the corporate sector, while fiscal stimulus packages were also implemented.

Elsewhere in Asia, most economies experienced a further year of uneven growth in 2009. Sharp economic contractions proved commonplace across the region during the early months of 2009 before economic recovery began, often helped by an aggressive loosening of both monetary and fiscal policy. Such trends were particularly evident in **Singapore** where, following a very weak start to 2009, a rapid rate of expansion was recorded during the second quarter, although GDP growth fell back into negative territory during the final months of the year. Growth proved much more stable in **India**, with GDP rising by 6.3 per cent in the first three

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Geographical regions > Rest of Asia-Pacific > 2009

Profit before tax

Rest of Asia-Pacific[27]	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**3,539**	3,937	3,049
Net fee income	**1,557**	1,867	1,775
Net trading income	**1,606**	2,042	1,346
Changes in fair value of long-term debt issued and related derivatives	**(1)**	1	1
Net income/(expense) from other financial instruments designated at fair value	**111**	(172)	110
Net income/(expense) from financial instruments designated at fair value	**110**	(171)	111
Gains less losses from financial investments	**(19)**	24	36
Gains arising from dilution of interests in associates			1,081
Dividend income	**2**	2	6
Net earned insurance premiums	**365**	197	226
Other operating income	**1,238**	1,055	781
Total operating income	**8,398**	8,953	8,411
Net insurance claims incurred and movement in liabilities to policyholders	**(395)**	28	(253)
Net operating income before loan impairment charges and other credit risk provisions	**8,003**	8,981	8,158
Loan impairment charges and other credit risk provisions	**(896)**	(852)	(561)
Net operating income	**7,107**	8,129	7,597
Total operating expenses	**(4,450)**	(4,704)	(3,991)
Operating profit	**2,657**	3,425	3,606
Share of profit in associates and joint ventures	**1,543**	1,297	1,096

Profit before tax	**4,200**	4,722	4,702
	%	%	%
Share of HSBC s profit before tax	**59.3**	50.7	19.4
Cost efficiency ratio	**55.6**	52.4	48.9
Year-end staff numbers (full-time equivalent)	**87,141**	89,706	80,523

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**80,043**	80,661	80,245
Loans and advances to banks (net)	**35,648**	28,665	32,373
Trading assets, financial assets designated at fair value, and financial investments	**58,941**	53,167	54,541
Total assets	**222,139**	225,573	208,195
Deposits by banks	**8,075**	12,688	15,100
Customer accounts	**133,999**	124,194	119,296

For footnotes, see page 149.

All commentaries on Rest of Asia-Pacific are on an underlying basis unless stated otherwise.

quarters of the fiscal year 2009/10 following a 5.7 per cent expansion in the same period in 2008/09, helped by an aggressive reduction in interest rates and a sharp increase in government expenditure. Although growth slowed in 2009 in **Indonesia**, the 4.5 per cent increase in GDP and the relative stability of growth left the country as one of the region s better performers. Economic conditions proved very weak during the early months of 2009 in **Malaysia** as first quarter GDP fell by 6.2 per cent on

the same period in 2008, but a strong recovery, helped by an improvement in regional trade activity and a domestic stimulus package, placed fourth quarter GDP some 4.5 per cent above the comparable figure from a year earlier. A recovery in both exports and domestic demand helped the **South Korean** economy to record a strong recovery from a very weak start to 2009, with GDP increasing slightly by 0.2 per cent for the full year, following a 2.2 per cent increase during 2008. Increased public

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expenditure helped the **Philippines** economy to return to growth following a weak start to 2009, with full year growth of 0.9 per cent being recorded, down from 3.8 per cent in 2008. **Taiwan s** economy proved particularly vulnerable to the sharp fall in global trade activity during the early months of 2009, although the year-on-year rate of decline in GDP moderated as 2009 progressed, thanks in part to a recovery in consumer expenditure around the middle of the year. A substantial fiscal stimulus package in **Vietnam** contributed to improved growth momentum during the first half of 2009, although concerns over the deterioration in the trade position led to a devaluation of the currency and a tightening of monetary policy during the final weeks of the year. Full year 2009 GDP growth slowed slightly to 5.3 per cent from 6.2 per cent in 2008.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Rest of Asia-Pacific[27]	**2008 as reported US$m**	**2008 adjust-ments**[10] **US$m**	**Currency translation**[11] **US$m**	**2008 at 2009 exchange rates**[12] **US$m**	**2009 adjust-ments**[10] **US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change**[13] **%**	**Under-lying change**[13] **%**
Net interest income	**3,937**		**(165)**	**3,772**	**53**	**(286)**	**3,539**	**(10)**	**(8)**
Net fee income	**1,867**		**(80)**	**1,787**	**6**	**(236)**	**1,557**	**(17)**	**(13)**
Changes in fair value[14]	**3**	**(3)**			**(3)**		**(3)**	**(200)**	
Other income[15]	**3,174**		**(205)**	**2,969**	**18**	**(77)**	**2,910**	**(8)**	**(3)**
Net operating income[16]	**8,981**	**(3)**	**(450)**	**8,528**	**74**	**(599)**	**8,003**	**(11)**	**(7)**
Loan impairment charges and other credit risk provisions	**(852)**		**31**	**(821)**		**(75)**	**(896)**	**(5)**	**(9)**
Net operating income	**8,129**	**(3)**	**(419)**	**7,707**	**74**	**(674)**	**7,107**	**(13)**	**(9)**
Operating expenses	**(4,704)**		**208**	**(4,496)**	**(31)**	**77**	**(4,450)**	**5**	**2**
Operating profit	**3,425**	**(3)**	**(211)**	**3,211**	**43**	**(597)**	**2,657**	**(22)**	**(19)**
Income from associates	**1,297**		**27**	**1,324**		**219**	**1,543**	**19**	**17**
Profit before tax	**4,722**	**(3)**	**(184)**	**4,535**	**43**	**(378)**	**4,200**	**(11)**	**(8)**

For footnotes, see page 149.

Review of business performance

HSBC s operations in the Rest of Asia-Pacific region reported a pre-tax profit of US$4.2 billion compared with US$4.7 billion in 2008, a decline of 11 per cent or 8 per cent on an underlying basis. The decline in regional performance was primarily attributable to the challenging economic conditions which resulted in deposit spread compression, lower fee income and credit quality deterioration.

During 2009, HSBC continued to build its presence in the region through organic growth, the acquisition of Bank Ekonomi, and strategic investments. The purchase of Bank Ekonomi nearly doubled HSBC s presence in Indonesia to over 200 outlets in 27 cities. HSBC became the first foreign bank to incorporate locally in Vietnam in January 2009, creating the opportunity to widen the product range and increase distribution channels to customers. The integration of IL&FS Investsmart, subsequently rebranded to HSBC InvestDirect, has strengthened HSBC s network in India, allowing it to offer wealth management products through over 200 additional outlets. Building the Group s mainland China business and renminbi capabilities continued to be a key focus, as demonstrated by the opening of onshore renminbi accounts in mainland China and the launch of renminbi trade settlement in seven ASEAN countries. 19 new HSBC branded outlets were opened in mainland China in 2009, as well as eight additional rural bank outlets and four new Hang Seng Bank branches, consolidating HSBC s position as the leading foreign bank in the country. HSBC also launched a new jointly-owned life insurance company in mainland China, and announced the intention to establish a new cards joint venture with Bank of Communications to which over 11 million cards in force will be transferred. In insurance, HSBC expanded its regional coverage and increased its stake in Bao Viet in January 2010, allowing it to extend its position in the Vietnamese market.

Net interest income declined by 8 per cent to US$3.5 billion, driven by deposit spread compression in the low interest rate environment and a decline in lending balances. This was partly offset

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Geographical regions > Rest of Asia-Pacific > 2009 / 2008

by asset repricing, particularly in Commercial Banking.

Average lending balances fell in Global Banking and Markets and Commercial Banking as a result of lower demand for financing as international trade volumes declined, especially in the first half of the year. Growth returned in the second half of the year as the volume of trade activity improved.

Customer deposits grew compared with 2008. Personal Financial Services continued to successfully attract deposits and the acquisition of Premier customers was strong with the region growing customer numbers by 35 per cent to over 580,000. Payments and cash management was adversely affected by the low interest rate environment.

Net fee income was 13 per cent lower than in 2008, driven by a decline in income from funds under management and global custody. Fees from funds under management in Singapore, Japan and Taiwan declined as a result of weak investor sentiment and lower fee margins as customers moved away from equity investment products though, in the latter part of the year, an improvement in equity markets drove a recovery in investment-related fee income. In India, tightened credit criteria resulted in lower fees from the card business. By contrast, trade services and cash management increased in a number of countries, and the Group took various steps to capture cross-border business and continued to benefit from its international business reach. Significant cross-border referral growth was seen in Greater China where numbers rose compared with 2008.

Net trading income declined by 16 per cent, as the fall in interest rates reduced net interest income from trading activities. Foreign exchange and Rates trading income also declined across the region, reflecting relatively low market volatility, though Credit trading performance was strong, particularly in mainland China, Japan and Singapore. In mainland China, the decline in Rates income resulted from losses on bond positions following an upward shift in yields. However, in South Korea, revenue increased as opportunities arose from market-making and client hedging activities.

Net income from *financial instruments designated at fair value* of US$110 million was recorded compared with a net expense of US$171 million in 2008. This was primarily attributable to equity market-related gains on unit-linked insurance products and was largely offset by a corresponding increase in liabilities to policyholders reflected in net insurance claims incurred and movement in liabilities to policyholders.

Net earned insurance premiums increased by 91 per cent to US$365 million. Sales growth was particularly strong in Singapore following the launch of new products, including a life insurance product designed for high net worth individuals and a single premium guaranteed saver product. Growth in insurance business resulted in higher *net insurance claims incurred and movement in liabilities to policyholders*.

Deposit spread compression, lower fees and a rise in loan impairment charges reduced underlying profit before tax by 8 per cent.

Loan impairment charges and other credit risk provisions rose by 9 per cent compared with 2008 as credit quality deteriorated in India.

In Personal Financial Services, loan impairment charges rose by 9 per cent to US$649 million, primarily due to rising delinquencies in the unsecured consumer lending businesses in India and Indonesia. In India, a challenging credit environment and high delinquency rates contributed to increased loan impairment charges in personal loans, consumer finance and mortgages. The delinquencies in India began to moderate in the second half of 2009 as the measures implemented by HSBC in the second half of 2008 to mitigate loan losses, including ceasing consumer finance loan origination and tightening lending criteria on other unsecured lending products, began to take effect. As a result, loan impairment charges against cards remained broadly in line with 2008. In Commercial Banking, significant deterioration was experienced in India in the first half of 2009. The loan impairment charges across the region improved in the second half of 2009 with credit quality stabilising as a result of support from the governments various economic stimulus initiatives, together with improved liquidity and actions taken by customers to adjust in difficult times. Notwithstanding the improvement towards the end of the year, HSBC continues to closely monitor portfolios for signs of weakness.

Operating expenditure was broadly in line with 2008. Tight cost control resulted in lower administrative costs and marketing expenditure. Staff costs fell due to lower performance-related costs and a decrease in staff numbers. These were broadly offset by expenditure to support the ongoing development of infrastructure in the region, including branch expansion in mainland China, Vietnam and Malaysia and integration and development costs related to HSBC InvestDirect and the operations of The Chinese Bank Co., Ltd (The Chinese Bank) in Taiwan.

In an effort to improve operational efficiencies and reduce costs, an increased number of transactions were completed through direct channels, including internet banking, telephone services and self-service machines compared with 2008.

Operating expenses within the Group Service and Software Development Centres rose by 9 per cent as the number of migrated activities and processes increased in accordance with the Group s global resourcing strategy to develop centres of excellence. All related costs are recharged to other Group entities and the income from these recharges is reported within *other operating income*.

New outlets, the launch of a new jointly-owned life insurance company and a planned card joint venture with Bank of Communications consolidated HSBC s position as the leading foreign bank in mainland China.

Profit from associates and joint ventures in the region was 17 per cent higher as a result of the non-recurrence of Ping An Insurance s impairment of its investment in Fortis in 2008, and an increase in new business sales and investment returns which were boosted by a recovery in equity markets. Income from Bank of Communications remained in line with 2008.

2008 compared with 2007

Economic briefing

Growth in **mainland China** was steady during 2008, although lower than in previous years. Overall GDP growth totalled 9 per cent in 2008, down from 13 per cent in 2007, as weakness in key export markets led to a slowdown in industrial activity during the final months of the year. The tightening of monetary conditions in 2007 and early 2008 also contributed to the slowdown, although interest rates and reserve requirements were both reduced significantly during the final months of the year and a significant fiscal stimulus package was also announced. Consumer spending continued to advance at a strong pace with retail spending increasing by 21.6 per cent over the course of 2008. After accelerating to an eleven year high of 8.7 per cent in February 2008, consumer price inflation slowed to 1.2 per cent by the year-end, largely reflecting the movements in food and energy prices. The renminbi appreciated by more than 6 per cent against the US dollar during 2008, although the exchange rate was little changed during the second half of the year.

Japan s economy slowed sharply during the course of 2008, with industrial activity declining rapidly during the final quarter of the year in response to much weaker external demand. Contractions were registered in both second and third quarter GDP data, confirming a technical recession, while the unemployment rate rose from 3.8 per cent in January 2008 to 4.4 per cent by the year-end. Inflationary pressures increased during the first half before subsiding during the final months of 2008, while measures of business confidence also fell sharply.

Elsewhere in Asia, most economies followed an uneven pattern of growth during 2008. Policymakers focused on the rise in inflation during the first half of the year, but the sharp slowdown in growth during the final months of 2008 came to dominate, with a series of monetary and fiscal policy measures being introduced across the region to stimulate activity. The sustained rise in inflation prompted the Reserve Bank of **India** to tighten policy by raising both interest rates and reserve requirements during the first half of 2008, before then cutting the cash reserve ratio by 350 basis points and the repo rate by 250 basis points during the final quarter of the year. A recession was confirmed in **Singapore** after GDP contracted for three consecutive quarters in 2008, as an economic slowdown initially focused on specific industries turned more pervasive. After rising to a 26-year high of 7.5 per cent in June 2008, the annual rate of inflation slowed to 4.3 per cent by the year-end.

Inflation also proved the predominant concern in **Vietnam** during the first half of 2008 as the annual rate of consumer price inflation more than doubled to 28.3 per cent, prompting the State Bank of Vietnam to sanction substantial interest rate increases, before these measures were rapidly reversed during the final months of the year. Interest rate increases were also forthcoming in **Indonesia** between May and October 2008, although with growth levels maintaining a relatively robust level during much of the year, a tentative easing cycle was only initiated during the final weeks of 2008. Bank Negara **Malaysia** proved the exception by refraining from interest rate increases during the year, even as consumer price inflation accelerated to 8.5 per cent in July 2008, before cutting the policy rate to 3.25 per cent in November. The outlook for the **South Korean** economy was affected by the open nature of the economy and the relatively high levels of household and corporate sector indebtedness. Full year GDP rose by 2.5 per cent in 2008, down from 5.0 per cent in 2007 and the weakest performance for ten years, while fourth quarter GDP fell by 3.4 per

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Geographical regions > Rest of Asia-Pacific > 2008

cent on a year-on-year basis. Rising food prices proved particularly problematic for the **Philippines** during the first half of the year as inflation moved well above the central bank s targeted range, although the earlier tightening of monetary policy was partially reversed at the end of 2008. Growth slowed sharply in **Taiwan** during the course of the year, driven by deteriorating conditions overseas.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Rest of Asia-Pacific[27]	2007 as reported US$m	2007 adjustments and dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjust-ments[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	3,049		38	3,087	31	819	3,937	29	27
Net fee income	1,775		22	1,797	3	67	1,867	5	4
Changes in fair value[14]					3		3		
Other income[15]	3,334	(1,081)	15	2,268	70	836	3,174	(5)	37
Net operating income[16]	8,158	(1,081)	75	7,152	107	1,722	8,981	10	24
Loan impairment charges and other credit risk provisions	(561)		15	(546)		(306)	(852)	(52)	(56)
Net operating income	7,597	(1,081)	90	6,606	107	1,416	8,129	7	21
Operating expenses	(3,991)		(12)	(4,003)	(110)	(591)	(4,704)	(18)	(15)
Operating profit	3,606	(1,081)	78	2,603	(3)	825	3,425	(5)	32
Income from associates	1,096		93	1,189		108	1,297	18	9

Profit before tax	4,702	(1,081)	171	3,792	(3)	933	4,722	25

For footnotes, see page 149.

Review of business performance

HSBC s operations in Rest of Asia-Pacific reported a pre-tax profit of US$4.7 billion which was in line with 2007. HSBC continued to increase its presence in key markets, augmenting organic growth with the integration of the operations of The Chinese Bank in Taiwan and the purchase of IL&FS Investsmart Ltd in India, which was completed in September. On an underlying basis, excluding the dilution gains on Chinese associates of US$1.1 billion recorded in 2007 and the acquisitions noted above, profit before tax increased by 25 per cent, with notable growth in South Korea, mainland China, India, and an increased contribution from associates in the region. Branches were added in mainland China, Indonesia, Japan, Malaysia and Bangladesh.

Net interest income increased by 27 per cent, with growth across most major countries and all customer groups. Deposit acquisition and related asset deployment across the region drove net interest income, though this volume growth was partly offset by deposit spread compression in the second half of the year due to declining interest rates, compounded by strong competition to acquire deposits.

In India, net interest income increased by 44 per cent as deposit balances in Personal Financial Services and Commercial Banking rose due to
customer acquisition, notably among small businesses following the launch of the HSBC Direct for Business product. These deposits were deployed in increasing lending, where spreads improved on the corporate lending and credit card portfolios and mortgage spreads widened following a re-pricing in the second half of the year.

In mainland China, net interest income also rose due to deposit growth, as investors increasingly preferred deposits over market-led investments as market sentiment deteriorated. This facilitated an increase in personal lending balances following branch network expansion and successful re-pricing initiatives on corporate and commercial loans.

There was strong growth in net interest income from Balance Sheet Management within Global Banking and Markets, due to lower funding costs and steeper yield curves, notably in Singapore, mainland China, India and Japan.

Net fee income rose by 4 per cent, driven by a growth in fees from personal credit cards and trade and supply chain services. Credit card fees rose, particularly in India, driven by increases in interchange fees from higher cardholder spending and late payment and over-limit fees from higher delinquencies. There were lower fees from investment products and broking across the region, driven by a decline in equity markets and weakened investor sentiment.

Fee income from credit facilities rose, notably in India, Australia and Singapore, reflecting increases in the number of customers.

Net trading income rose by 54 per cent, predominantly due to strong Rates and foreign exchange trading across the region as volatile market conditions continued, encouraging increased corporate hedging activity.

Growth was particularly strong in South Korea, mainland China and Australia due to strategic positioning of HSBC s balance sheet to benefit from the interest rate cuts and foreign exchange volatility in 2008, and increased activity in these local markets. In India, foreign exchange and, to a lesser extent, Rates revenues rose, driven mainly by increased customer activity and high levels of market volatility.

A net expense from *financial instruments designated at fair value* of US$171 million was recorded compared with income of US$121 million in 2007. Declines in equity markets affected unit-linked insurance products, particularly in Singapore. This was largely offset by a corresponding decrease in liabilities to policyholders reflected in *net insurance claims incurred and movement in liabilities to policyholders.*

Net earned insurance premiums decreased by 17 per cent to US$197 million, mainly in Singapore and Malaysia due to lower sales of single premium unit-linked products. This was partly offset by an increase in the sale of general insurance products.

Loan impairment charges rose sharply, increasing by 56 per cent to US$852 million, following a marked deterioration in credit quality across the region in the final quarter of the year. These charges rose most significantly in India and, to a lesser extent, in Australia.

In India, the rise was attributable to increased delinquency across personal lending portfolios, in response to which HSBC took action to restrict mortgage and personal lending. However, HSBC continued to extend credit to selected cards customers, which resulted in volume growth and also contributed to higher loan impairment charges.

In Australia, higher delinquencies arose from the maturing of the cards portfolio and, to a lesser extent, volume growth, in addition to a credit risk provision related to an exposure to an Icelandic Bank. Partly offsetting this, loan impairment charges declined by 41 per cent in Taiwan due to an improvement in asset quality. Similarly, in Thailand, loan impairment charges were 69 per cent lower due to the non-recurrence of charges attributable to the down-grading of certain corporate customers.

Operating expenses increased by 15 per cent to US$4.7 billion. Significant investment in the region continued, notably in mainland China where 29 new outlets were opened and staff numbers increased. Related premises and equipment costs rose accordingly. Expansion was also pursued in Indonesia with the addition of new branches, and in Japan with the rollout of seven HSBC Premier centres. In India, the rise in operating expenses was driven mainly by investment in IT, premises costs and an increase in collection activities as default rates rose. Business growth contributed to higher operating expenses in Australia. Litigation costs in the region rose.

Growth in operating expenses at the Group Service and Software Development Centres was driven by increased volumes of activity as HSBC continued to implement a global resourcing strategy to minimise costs throughout the Group. All related costs are recharged to other Group entities and the income is reported within *Other operating income.*

Profit from associates and joint ventures in the region increased by 9 per cent, notwithstanding a significant impairment recorded in Ping An Insurance in respect of its stake in Fortis Bank. Growth was strong across HSBC s other principal associates, the Bank of Communications and Industrial Bank.

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Geographical regions > Rest of Asia-Pacific > Profit before tax by customer groups

Analysis by customer group and global business
Profit before tax

	2009						
Rest of Asia-Pacific[27]	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
Net interest income	**1,493**	**807**	**1,174**	**115**	**91**	**(141)**	**3,539**
Net fee income/(expense)	**554**	**331**	**636**	**55**	**(19)**		**1,557**
Trading income/(expense) excluding net interest income	**80**	**134**	**1,013**	**55**	**(18)**		**1,264**
Net interest income/(expense) on trading activities	**(1)**		**202**			**141**	**342**
Net trading income/(expense)[42]	**79**	**134**	**1,215**	**55**	**(18)**	**141**	**1,606**
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	**110**	**1**	**(2)**		**2**		**111**
Net income/(expense) from financial instruments designated at fair value	**110**	**1**	**(2)**		**1**		**110**
Gains less losses from financial investments	**5**	**2**	**(7)**		**(19)**		**(19)**
Dividend income			**1**		**1**		**2**
Net earned insurance premiums	**337**	**28**					**365**
Other operating income	**67**	**66**	**41**	**(2)**	**1,200**	**(134)**	**1,238**
Total operating income	**2,645**	**1,369**	**3,058**	**223**	**1,237**	**(134)**	**8,398**

Net insurance claims[43]	**(380)**	**(15)**					**(395)**
Net operating income[16]	**2,265**	**1,354**	**3,058**	**223**	**1,237**	**(134)**	**8,003**
Loan impairment charges and other credit risk provisions	**(649)**	**(221)**	**(23)**	**(2)**	**(1)**		**(896)**
Net operating income	**1,616**	**1,133**	**3,035**	**221**	**1,236**	**(134)**	**7,107**
Total operating expenses	**(1,839)**	**(636)**	**(1,006)**	**(131)**	**(972)**	**134**	**(4,450)**
Operating profit/(loss)	**(223)**	**497**	**2,029**	**90**	**264**		**2,657**
Share of profit in associates and joint ventures	**686**	**567**	**290**				**1,543**
Profit before tax	**463**	**1,064**	**2,319**	**90**	**264**		**4,200**
	%	*%*	*%*	*%*	*%*		*%*
Share of HSBC s profit before tax	**6.5**	**15.0**	**32.8**	**1.3**	**3.7**		**59.3**
Cost efficiency ratio	**81.2**	**47.0**	**32.9**	**58.7**	**78.6**		**55.6**
Balance sheet data[41]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**30,433**	**22,595**	**23,989**	**2,834**	**192**		**80,043**
Total assets	**40,266**	**31,221**	**138,884**	**11,928**	**7,160**	**(7,320)**	**222,139**
Customer accounts	**47,573**	**30,196**	**43,698**	**12,496**	**36**		**133,999**

For footnotes, see page 149.

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	2008						
Rest of Asia-Pacific[27]	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	1,708	934	1,524	103	139	(471)	3,937
Net fee income	592	356	831	71	17		1,867
Trading income/(expense) excluding net interest income	65	122	1,233	77	(54)		1,443
Net interest income/(expense) on trading activities	(5)		123		10	471	599
Net trading income/(expense)[42]	60	122	1,356	77	(44)	471	2,042
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	(172)		(4)		4		(172)
Net income/(expense) from financial instruments designated at fair value	(172)		(4)		5		(171)
Gains less losses from financial investments	15	3	6				24
Dividend income			2				2
Net earned insurance premiums	172	25					197
Other operating income/(expense)	58	76	79	(1)	1,070	(227)	1,055
Total operating income	2,433	1,516	3,794	250	1,187	(227)	8,953
Net insurance claims[43]	42	(14)					28
Net operating income[16]	2,475	1,502	3,794	250	1,187	(227)	8,981
Loan impairment charges and other credit risk provisions	(640)	(137)	(73)	(1)	(1)		(852)

Net operating income	1,835	1,365	3,721	249	1,186	(227)	8,129
Total operating expenses	(2,016)	(689)	(1,086)	(140)	(1,000)	227	(4,704)
Operating profit/(loss)	(181)	676	2,635	109	186		3,425
Share of profit in associates and joint ventures	392	559	335		11		1,297
Profit before tax	211	1,235	2,970	109	197		4,722
	%	%	%	%	%		%
Share of HSBC s profit before tax	2.3	13.3	31.9	1.2	2.0		50.7
Cost efficiency ratio	81.5	45.9	28.6	56.0	84.2		52.4
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	27,634	21,967	27,941	2,960	159		80,661
Total assets	36,310	29,030	147,714	12,440	5,528	(5,449)	225,573
Customer accounts	42,778	25,372	42,977	12,713	354		124,194

For footnotes, see page 149.

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Geographical regions > Rest of Asia-Pacific > Profit before tax by customer group // Middle East

Profit before tax (continued)

	2007						
Rest of Asia-Pacific[27]	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	1,507	750	1,035	59	135	(437)	3,049
Net fee income	594	265	820	82	14		1,775
Trading income/(expense) excluding net interest income	42	86	817	71	(70)		946
Net interest income/(expense) on trading activities	(2)		(21)		(14)	437	400
Net trading income/(expense)[42]	40	86	796	71	(84)	437	1,346
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	73	4	(3)	(1)	37		110
Net income/(expense) from financial instruments designated at fair value	73	4	(3)	(1)	38		111
Gains less losses from financial investments	3	4	28		1		36
Gains arising from dilution of interests in associates					1,081		1,081
Dividend income					6		6
Net earned insurance premiums	209	16			1		226
Other operating income	18	3	44	1	848	(133)	781
Total operating income	2,444	1,128	2,720	212	2,040	(133)	8,411

Net insurance claims[43]	(246)	(7)					(253)
Net operating income[16]	2,198	1,121	2,720	212	2,040	(133)	8,158
Loan impairment charges and other credit risk provisions	(486)	(72)	(3)				(561)
Net operating income	1,712	1,049	2,717	212	2,040	(133)	7,597
Total operating expenses	(1,713)	(532)	(969)	(123)	(787)	133	(3,991)
Operating profit	(1)	517	1,748	89	1,253		3,606
Share of profit in associates and joint ventures	516	351	221		8		1,096
Profit before tax	515	868	1,969	89	1,261		4,702
	%	%	%	%	%		%
Share of HSBC s profit before tax	2.1	3.6	8.1	0.4	5.2		19.4
Cost efficiency ratio	77.9	47.5	35.6	58.0	38.6		48.9
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	29,313	21,397	26,476	2,913	146		80,245
Total assets	36,292	27,524	130,096	9,245	9,487	(4,449)	208,195
Customer accounts	38,625	25,306	45,773	9,491	101		119,296

For footnotes, see page 149.

Middle East[27]

Profit/(loss) before tax by country within customer groups and global businesses

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Total US$m
2009						
Egypt	**18**	**51**	**97**		**58**	**224**
United Arab Emirates	**(177)**	**(136)**	**307**	**(2)**	**5**	**(3)**
Other	**13**	**45**	**(14)**		**(3)**	**41**
Middle East (excluding Saudi Arabia)	**(146)**	**(40)**	**390**	**(2)**	**60**	**262**
Saudi Arabia	**20**	**61**	**77**	**8**	**27**	**193**
	(126)	**21**	**467**	**6**	**87**	**455**
2008						
Egypt	16	68	90		49	223
United Arab Emirates	133	330	388	4	6	861
Other	80	125	161		1	367
Middle East (excluding Saudi Arabia)	229	523	639	4	56	1,451
Saudi Arabia	60	35	177		23	295
	289	558	816	4	79	1,746
2007						
Egypt	10	46	65		32	153
United Arab Emirates	108	262	242	3	2	617
Other	83	101	116			300
Middle East (excluding Saudi Arabia)	201	409	423	3	34	1,070
Saudi Arabia	44	73	72		48	237
	245	482	495	3	82	1,307

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Egypt	**2,553**	2,473	1,853
United Arab Emirates	**13,883**	17,537	14,103
Other	**6,408**	7,285	5,651
	22,844	27,295	21,607

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Egypt	**5,743**	5,363	4,056
United Arab Emirates	**17,498**	19,808	18,455
Other	**9,288**	9,994	8,426
	32,529	35,165	30,937

For footnote, see page 149.

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Geographical regions > Middle East > 2009

Profit before tax

Middle East[27]	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**1,485**	1,556	1,094
Net fee income	**625**	691	471
Net trading income	**394**	402	297
Gains less losses from financial investments	**16**	8	2
Dividend income	**3**	2	2
Other operating income	**71**	9	17
Total operating income	**2,594**	2,668	1,883
Net insurance claims incurred and movement in liabilities to policyholders			
Net operating income before loan impairment charges and other credit risk provisions	**2,594**	2,668	1,883
Loan impairment charges and other credit risk provisions	**(1,334)**	(279)	(55)
Net operating income	**1,260**	2,389	1,828
Total operating expenses	**(1,001)**	(959)	(773)
Operating profit	**259**	1,430	1,055
Share of profit in associates and joint ventures	**196**	316	252
Profit before tax	**455**	1,746	1,307
	%	%	%

Share of HSBC s profit before tax	**6.4**	18.8	5.4
Cost efficiency ratio	**38.6**	35.9	41.1
Year-end staff numbers (full-time equivalent)	**8,281**	8,453	8,050

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**22,844**	27,295	21,607
Loans and advances to banks (net)	**8,420**	7,476	7,488
Trading assets, financial assets designated at fair value, and financial investments	**10,230**	8,056	9,840
Total assets	**48,107**	50,952	45,669
Deposits by banks	**1,491**	1,001	2,460
Customer accounts	**32,529**	35,165	30,937

For footnotes, see page 149.

All commentaries on Middle East are on an underlying basis unless stated otherwise.

2009 compared with 2008

Economic briefing

Although the majority of economies in the **Middle East** were spared the most severe effects of the global recession, 2009 marked a dramatic downturn as growth slowed markedly, bringing a sharp end to a five-year run of strong expansion.

In part, the region proved vulnerable to weakened external demand, particularly economies such as Egypt and the UAE that are significant service and merchandise exporters to the West and are exposed to global trade patterns. A sharp drop in hydrocarbon prices in late 2008 and early 2009 adversely affected sentiment and caused some oil-exporters to reassess spending plans as their revenue streams weakened.

In addition, the liquidity environment tightened considerably during the course of the year. This led to a rapid slowdown in credit creation, weighing heavily on private consumption and investment spending and contributing to marked downward pressure on asset prices. Access to international funding was also impaired as global capital flows slowed, further impeding local investment spending.

The recovery of the region may lag that of some other emerging markets. However, in contrast to

1998 (the last occasion on which growth trends sharply reversed) policymakers in Saudi Arabia and elsewhere were able to draw on reserves built up during years of high oil earnings to maintain spending, rather than boosting borrowing. With the recovery in oil prices from mid-2009 onward, the reserves allowed the region to weather the difficult economic environment without experiencing pressure on external balances or a downturn in the dollar value of local currencies. Inflation also fell across the region as growth slowed and import prices fell, and policymakers were able to track the exceptionally low level of interest rates in the US.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Middle East[27]	**2008 as reported US$m**	**2008 acquisitions and disposals**[10] **US$m**	**Currency translation**[11] **US$m**	**2008 at 2009 exchange rates**[12] **US$m**	**2009 acquisitions and disposals**[10] **US$m**	**Underlying change US$m**	**2009 as reported US$m**	**Reported change**[13] **%**	**Underlying change**[13] **%**
Net interest income	**1,556**		**(7)**	**1,549**		**(64)**	**1,485**	**(5)**	**(4)**
Net fee income	**691**		**(4)**	**687**		**(62)**	**625**	**(10)**	**(9)**
Other income[15]	**421**		**(7)**	**414**		**70**	**484**	**15**	**17**
Net operating income[16]	**2,668**		**(18)**	**2,650**		**(56)**	**2,594**	**(3)**	**(2)**
Loan impairment charges and other credit risk provisions	**(279)**		**(1)**	**(280)**		**(1,054)**	**(1,334)**	**(378)**	**(376)**
Net operating income	**2,389**		**(19)**	**2,370**		**(1,110)**	**1,260**	**(47)**	**(47)**
Operating expenses	**(959)**		**11**	**(948)**		**(53)**	**(1,001)**	**(4)**	**(6)**
Operating profit	**1,430**		**(8)**	**1,422**		**(1,163)**	**259**	**(82)**	**(82)**
Income from associates	**316**		**1**	**317**		**(121)**	**196**	**(38)**	**(38)**

Profit before tax	**1,746**	**(7)**	**1,739**	**(1,284)**	**455**	**(74)**	**(74)**

For footnotes, see page 149.

Review of business performance

HSBC s operations in the Middle East reported a pre-tax profit of US$0.5 billion compared with US$1.7 billion in 2008, a decrease of 74 per cent on both reported and underlying bases. The decline in profitability was largely due to the impact of the global recession, which brought a sharp decline in oil prices and a considerable reduction in capital inflows in the second half of 2008, triggering a regional economic downturn which continued throughout 2009. The UAE was significantly affected by declines in construction and global trade, losses incurred by regional investors, and tight liquidity and lower real-estate prices, which together resulted in higher loan impairment charges as the crisis affected both personal and corporate customers. However, despite the severe deterioration in credit conditions, the region remained profitable due to Global Banking and Markets. In Personal Financial Services, HSBC continued to focus on Premier and affluent mass market customers, growing its Premier customer base by 32 per cent compared with 2008. HSBC further expanded its presence in Egypt, opening 15 new branches in 2009.

Net interest income declined by 4 per cent, driven by lower deposit and lending balances and deposit spread compression across all customer groups.

Commercial Banking lending balances fell as trade levels declined. In Personal Financial Services, average mortgages and credit card balances were higher than in 2008, reflecting the deferred drawdown of facilities approved in 2008. Unsecured personal lending balances declined during the year due to tighter origination criteria and a move towards relationship lending. The shift in the composition of personal lending portfolios, from unsecured to secured lending, resulted in narrower asset spreads.

Customer deposit balances fell, mainly due to an outflow of funds from corporate customers reflecting tighter liquidity in the local markets. In Personal Financial Services, liability balances rose due to the combination of attractive rates offered and ongoing marketing campaigns, although the higher rates resulted in narrower deposit spreads.

Net fee income fell by 9 per cent, due to a decline in custody, insurance and unit trust income as investor sentiment weakened in the difficult

market conditions, and trade finance fees declined as regional trade deteriorated. Cards income also fell due to lower drawdowns and originations as underwriting criteria were tightened.
Loan impairment charges and other credit provisions increased by US$1.1 billion as real estate and construction were hard hit in the UAE.

Trading income was broadly in line with 2008 as weaker foreign exchange and Rates trading revenue were offset by higher revenue from Credit trading on favourable positioning of the trading portfolio in expectation of spreads narrowing from their peak in the third quarter of 2008.

Other operating income rose by US$62 million, driven by gains arising from the buy-back and extinguishment of HSBC s own debt issued locally.

Loan impairment charges and other credit risk provisions rose significantly from US$0.3 billion to US$1.3 billion, reflecting substantially higher charges in the UAE where the deterioration in credit quality was particularly significant. The UAE s real estate and construction industries were adversely affected by the global economic crisis, resulting in several large infrastructure projects being postponed or cancelled, and triggering higher levels of unemployment. This resulted in increased delinquencies, notably in credit cards and personal loans, which were exacerbated by large numbers of expatriate workers departing the region leaving debts unpaid. Management has taken steps to mitigate losses, including reducing credit lines, tightening origination criteria and strengthening collections activities.

Commercial and corporate banking loan impairment charges rose sharply, primarily due to a few individually significant impairment charges recorded on exposures to large corporates.

Operating expenditure increased by 6 per cent. Staff costs remained broadly flat as higher expenditure in Global Banking and Markets was offset by lower staff costs in Personal Financial Services and Commercial Banking as headcount declined. Non-staff costs rose as new headquarter buildings in the UAE and Qatar caused higher rental costs, and IT investment increased from systems upgrades and rollouts.

Profit from associates and joint ventures in the region fell by 38 per cent as the Group s share of income from The Saudi British Bank declined as a result of higher loan impairment charges. HSBC s share of income from HSBC Saudi Arabia Ltd declined as a result of a slowdown in IPOs and a decline in assets under management.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Middle East[27]	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
	1,094		5	1,099		457	1,556	42	42

Net interest income							
Net fee income	471	2	473	218	691	47	46
Other income[15]	318	3	321	100	421	32	31
Net operating income[16]	1,883	10	1,893	775	2,668	42	41
Loan impairment charges and other credit risk provisions	(55)	(1)	(56)	(223)	(279)	(407)	(398)
Net operating income	1,828	9	1,837	552	2,389	31	30
Operating expenses	(773)	(5)	(778)	(181)	(959)	(24)	(23)
Operating profit	1,055	4	1,059	371	1,430	36	35
Income from associates	252		252	64	316	25	25
Profit before tax	1,307	4	1,311	435	1,746	34	33

For footnotes, see page 149.

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2008 compared with 2007

Economic briefing

The economies of the **Middle East** performed strongly for much of 2008, although inflationary concerns were a feature for much of the year, driven by the surge in oil prices to record levels and private and public investment expenditure. High oil revenues continued to boost fiscal and current account surpluses throughout the region during 2008, although the impact of the decline in oil prices during the final months of the year, together with the OPEC-mandated production cuts, are expected to lead to slower growth in 2009.

Review of business performance

HSBC s operations in the Middle East performed strongly, reporting a pre-tax profit of US$1.7 billion, an increase of 33 per cent on an underlying basis. Record oil prices which peaked in July 2008 boosted domestic spending on infrastructure and real estate in the first half of 2008. The resulting increase in demand for credit was reflected by growth in both volumes and the average loan size. HSBC also successfully launched new banking products across the region, in addition to growing the Premier customer base. Business volume growth and wider asset spreads drove higher net interest income, and fee income rose as volumes of cards and trade products grew.

As global financial conditions began to worsen in the second half of 2008, liquidity in the region declined, which combined with deteriorating consumer confidence, adversely impacted real-estate prices. This triggered an increase in construction-related unemployment as large developments were cancelled or suspended resulting in an increase in loan impairment charges.

Net interest income increased by 42 per cent driven by balance sheet growth in the region.

In Personal Financial Services, the strong lending growth was driven by increased balances in unsecured lending as both cards in circulation and cardholder spending drove higher card balances. Similarly new personal loan products were launched. Mortgage balances rose in the UAE, driven by increased customer demand. The increase in Commercial Banking lending balances reflected a strong rise in corporate lending aligned to trade and infrastructure investments. Asset spreads benefited
from a decline in local base rates following US dollar interest rate cuts, which resulted in a lower cost of funds.

Growth in personal customer deposits was driven by a significant increase in the number of e-saver and Premier accounts. Deposit spreads narrowed due to declining market interest rates in the region.

There was strong growth in net interest income from Balance Sheet Management, due to early positioning in anticipation of lower market interest rates.

Net fee income rose by 46 per cent driven by higher fees in Global Banking and Markets as increased interest from foreign investors and asset growth drove securities services income. Credit card fees rose, driven by increases in interchange fees from higher cardholder spending, and late payment and over-limit fees from higher delinquencies. Fee income from credit facilities rose reflecting increases in the numbers of customers. Trade and supply chain services contributed strongly to fee income primarily in the construction and infrastructure industries.

Trading income rose by 34 per cent resulting from market uncertainty regarding possible currency revaluations which drove volatility and together with robust client demand, led to higher foreign exchange income.

Loan impairment charges rose significantly, albeit from a low base, to US$279 million as a result of increased delinquency rates on higher personal unsecured lending in the UAE. A deterioration in credit conditions also led to increased charges in Commercial Banking.

Operating expenses were 23 per cent higher, reflecting substantially increased levels of operating volumes, related headcount growth and wage inflation driven by competitive labour market conditions. Non-staff costs rose as a result of higher premises costs, and increased marketing expenditure in line with new product launches.

Profit from associates and joint ventures rose by 25 per cent as the Group s share of income from the Saudi British Bank increased as a result of higher fee income from cards, account management and trade-related businesses. These were partly offset by higher operating expenditure resulting from branch expansion, increased investment in technology and higher performance-related pay.

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Geographical regions > Middle East > Profit/(loss) before tax

Analysis by customer group and global business
Profit/(loss) before tax

	2009						
Middle East[27]	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination**[50] **US$m**	**Total US$m**
Net interest income	**644**	**464**	**330**	**1**	**46**		**1,485**
Net fee income	**203**	**219**	**198**	**3**	**2**		**625**
Trading income excluding net interest income	**55**	**75**	**235**	**1**	**3**		**369**
Net interest income on trading activities			**20**		**5**		**25**
Net trading income[42]	**55**	**75**	**255**	**1**	**8**		**394**
Gains less losses from financial investments	**12**	**(2)**	**1**		**5**		**16**
Dividend income			**3**				**3**
Other operating income/(expense)	**35**	**39**	**35**	**(1)**	**39**	**(76)**	**71**
Total operating income	**949**	**795**	**822**	**4**	**100**	**(76)**	**2,594**
Net insurance claims[43]							
Net operating income[16]	**949**	**795**	**822**	**4**	**100**	**(76)**	**2,594**
Loan impairment charges and other credit risk provisions	**(588)**	**(573)**	**(173)**				**(1,334)**
Net operating income	**361**	**222**	**649**	**4**	**100**	**(76)**	**1,260**
Total operating expenses	**(508)**	**(269)**	**(255)**	**(6)**	**(39)**	**76**	**(1,001)**
Operating profit/(loss)	**(147)**	**(47)**	**394**	**(2)**	**61**		**259**
Share of profit in associates and joint ventures	**21**	**68**	**73**	**8**	**26**		**196**
Profit/(loss) before tax	**(126)**	**21**	**467**	**6**	**87**		**455**
	%	%	%	%	%		%

Share of HSBC s profit before tax	**(1.8)**	**0.3**	**6.6**	**0.1**	**1.2**		**6.4**
Cost efficiency ratio	**53.5**	**33.8**	**31.0**	**150.0**	**39.0**		**38.6**

Balance sheet data[41]

	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**5,979**	**10,281**	**6,554**	**28**	**2**		**22,844**
Total assets	**6,810**	**11,861**	**28,189**	**96**	**4,952**	**(3,801)**	**48,107**
Customer accounts	**15,074**	**10,122**	**5,752**	**1,172**	**409**		**32,529**

For footnotes, see page 149.

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Middle East[27]	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
				2008			
Net interest income	652	510	362	3	46	(17)	1,556
Net fee income	227	241	217	6			691
Trading income excluding net interest income	47	65	244		24		380
Net interest income/(expense) on trading activities			20		(15)	17	22
Net trading income[42]	47	65	264		9	17	402
Gains less losses from financial investments	14		(6)				8
Dividend income			2				2
Other operating income	21	8	11	3	26	(60)	9
Total operating income	961	824	850	12	81	(60)	2,668
Net insurance claims[43]							
Net operating income[16]	961	824	850	12	81	(60)	2,668
Loan impairment (charges)/ recoveries and other credit risk provisions	(223)	(45)	(12)		1		(279)
Net operating income	738	779	838	12	82	(60)	2,389
Total operating expenses	(511)	(264)	(212)	(8)	(24)	60	(959)
Operating profit	227	515	626	4	58		1,430
Share of profit in associates and joint ventures	62	43	190		21		316
Profit before tax	289	558	816	4	79		1,746
	%	%	%	%	%		%
Share of HSBC s profit before tax	3.1	6.0	8.9		0.8		18.8
Cost efficiency ratio	53.2	32.0	24.9	66.7	29.6		35.9
Balance sheet data[41]							
	US$m	US$m	US$m	US$m	US$m		US$m

Loans and advances to customers (net)	7,226	13,221	6,649	29	170		27,295
Total assets	8,168	14,672	27,975	46	5,754	(5,663)	50,952
Customer accounts	13,753	10,978	7,628	1,762	1,044		35,165

For footnotes, see page 149.

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Geographical regions > Middle East > Profit/(loss) before tax // North America > 2009

Profit/(loss) before tax (continued)

	2007						
Middle East[27]	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	458	381	260	1	18	(24)	1,094
Net fee income	172	164	132	3			471
Trading income/(expense) excluding net interest income	30	43	183				256
Net interest income/(expense) on trading activities			(1)		18	24	41
Net trading income/(expense)[42]	30	43	182		18	24	297
Gains less losses from financial investments	2						2
Dividend income			2				2
Other operating income	22	12	9	1	1	(28)	17
Total operating income	684	600	585	5	37	(28)	1,883
Net insurance claims[43]							
Net operating income[16]	684	600	585	5	37	(28)	1,883
Loan impairment charges and other credit risk provisions	(66)	11					(55)
Net operating income	618	611	585	5	37	(28)	1,828
Total operating expenses	(418)	(207)	(171)	(2)	(3)	28	(773)
Operating profit	200	404	414	3	34		1,055
Share of profit in associates and joint ventures	45	78	81		48		252
Profit before tax	245	482	495	3	82		1,307
	%	%	%	%	%		%

Share of HSBC s profit before tax	1.0	2.0	2.1		0.3		5.4
Cost efficiency ratio	61.1	34.5	29.2	40.0	8.1		41.1

Balance sheet data[41]

	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	5,173	10,762	5,630	42			21,607
Total assets	6,045	12,219	26,548	49	4,390	(3,582)	45,669
Customer accounts	11,078	9,585	8,347	1,625	302		30,937

For footnotes, see page 149.

North America

Profit/(loss) before tax by country within customer groups and global businesses

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Total US$m
2009						
US	**(5,292)**	**158**	**505**	**(49)**	**(3,626)**	**(8,304)**
Canada	**17**	**347**	**159**		**(100)**	**423**
Bermuda	**49**	**37**	**47**	**(2)**	**10**	**141**
Other		**1**	**1**	**1**	**(1)**	**2**
	(5,226)	**543**	**712**	**(50)**	**(3,717)**	**(7,738)**
2008						
US[52]	(17,364)	226	(2,899)	67	3,427	(16,543)
Canada	106	380	252	5	96	839
Bermuda	31	51	72	11	9	174
Other	(1)	1			2	2
	(17,228)	658	(2,575)	83	3,534	(15,528)
2007						
US	(1,824)	377	(1,243)	156	1,468	(1,066)
Canada	265	466	239	8	5	983
Bermuda	13	77	39	10	34	173
Other					1	1
	(1,546)	920	(965)	174	1,508	91

For footnote, see page 149.

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m

US	**156,638**	208,834	233,706
Canada	**47,158**	44,866	53,891
Bermuda	**3,057**	2,514	2,263
	206,853	256,214	289,860

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
US	**99,371**	101,963	100,034
Canada	**41,565**	33,905	37,061
Bermuda	**8,221**	7,664	8,078
	149,157	143,532	145,173

2009 compared with 2008

Economic briefing

Economic conditions remained extremely difficult in the **US** during the early months of 2009 before some signs of recovery appeared as the year progressed, limiting the decline in full year GDP to 2.4 per cent after a 0.4 per cent increase during 2008. Housing sales and residential construction activity showed some improvement from very depressed levels and this, along with the introduction of tax incentives,
drove a reduction in the rate of decline of house prices in some states as the year progressed. Labour market conditions weakened throughout the year as the unemployment rate rose to a 26-year high of 10.1 per cent in October 2009, contributing to concerns around the trend of delinquencies on both secured and unsecured debt within the household sector. The annual CPI rate remained negative during the second and third quarters of the year before rising to 2.7 per cent by December 2009, although this trend was largely reflective of the

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Geographical regions > North America > 2009

Profit/(loss) before tax

North America	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**13,670**	15,218	14,847
Net fee income	**4,817**	5,227	5,810
Net trading income/(expense)	**331**	(3,135)	(542)
Changes in fair value of long-term debt issued and related derivatives	**(3,497)**	3,736	1,750
Net income from other financial instruments designated at fair value	**1**	1	
Net income/(expense) from financial instruments designated at fair value	**(3,496)**	3,737	1,750
Gains less losses from financial investments	**296**	(120)	245
Dividend income	**53**	77	105
Net earned insurance premiums	**309**	390	449
Other operating income	**566**	23	360
Total operating income	**16,546**	21,417	23,024
Net insurance claims incurred and movement in liabilities to policyholders	**(241)**	(238)	(241)
Net operating income before loan impairment charges and other credit risk provisions	**16,305**	21,179	22,783
Loan impairment charges and other credit risk provisions	**(15,664)**	(16,795)	(12,156)
Net operating income	**641**	4,384	10,627
Operating expenses (excluding goodwill impairment)	**(8,391)**	(9,359)	(10,556)
Goodwill impairment		(10,564)	
Operating profit/(loss)	**(7,750)**	(15,539)	71
Share of profit in associates and joint ventures	**12**	11	20

Profit/(loss) before tax	**(7,738)**	(15,528)	91
	%	%	%
Share of HSBC s profit before tax	**(109.3)**	(166.8)	0.4
Cost efficiency ratio	**51.5**	94.1	46.3
Year-end staff numbers (full-time equivalent)	**35,458**	44,725	52,722

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**206,853**	256,214	289,860
Loans and advances to banks (net)	**15,386**	11,458	16,566
Trading assets, financial assets designated at fair value, and financial investments[49]	**123,288**	119,634	133,998
Total assets	**475,014**	596,302	574,318
Deposits by banks	**13,970**	18,181	16,618
Customer accounts	**149,157**	143,532	145,173

For footnotes, see page 149.

All commentaries on North America are on an underlying basis unless stated otherwise.

earlier volatility of energy prices. Measures of consumer confidence improved during the year, but remained consistent with a weak overall level of household expenditure. The Standard & Poor s S&P 500 stock market index recovered from a weak start to 2009 to eventually record a gain of 23 per cent in the year. Having already lowered the Fed funds target rate to within a narrow range of between zero and 25 basis points, the Federal Reserve maintained their efforts to improve the availability of credit across the economy by purchasing a range of financial instruments, while a substantial fiscal stimulus package provided additional support to economic activity from the middle of the year.

Canadian GDP fell by 3.2 per cent during the first eleven months of 2009 compared with the equivalent period of 2008, led by a sharp contraction

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of output within the manufacturing sector. Labour market conditions deteriorated as the unemployment rate rose from a level of 6.8 per cent in December 2008 to an eleven year high of 8.7 per cent in August 2009, before then declining slightly in the final months of the year. In common with many other economies, the headline CPI rate turned negative around the middle of 2009, largely reflecting the trend of energy prices, and the core rate of inflation displayed a more pronounced downward trend as 2009 progressed. Responding to this deteriorating economic outlook, the Bank of Canada cut its overnight interest rate from 1.5 per cent in December 2008 to 0.25 per cent in April 2009, and provided a conditional commitment to maintain this level of interest rates until the end of the second quarter of 2010.

Reconciliation of reported and underlying profit/(loss) before tax

	2009 compared with 2008								
North America	**2008 as reported US$m**	**2008 adjust-ments[10] US$m**	**Currency translation[11] US$m**	**2008 at 2009 exchange rates[12] US$m**	**2009 adjust-ments[10] US$m**	**Under-lying change US$m**	**2009 as reported US$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**15,218**		**(79)**	**15,139**		**(1,469)**	**13,670**	**(10)**	**(10)**
Net fee income	**5,227**		**(33)**	**5,194**		**(377)**	**4,817**	**(8)**	**(7)**
Changes in fair value[14]	**3,444**	**(3,444)**			**(3,688)**		**(3,688)**	**(207)**	
Other income/(expense)[15]	**(2,710)**		**(4)**	**(2,714)**		**4,220**	**1,506**	**156**	**155**
Net operating income[16]	**21,179**	**(3,444)**	**(116)**	**17,619**	**(3,688)**	**2,374**	**16,305**	**(23)**	**13**
Loan impairment charges and other credit risk provisions	**(16,795)**		**(8)**	**(16,803)**		**1,139**	**(15,664)**	**7**	**7**
Net operating income	**4,384**	**(3,444)**	**(124)**	**816**	**(3,688)**	**3,513**	**641**	**(85)**	**431**
Operating expenses (excluding goodwill impairment)	**(9,359)**		**58**	**(9,301)**		**910**	**(8,391)**	**10**	**10**
	(10,564)			**(10,564)**		**10,564**		**100**	**100**

Goodwill impairment									
Operating loss	**(15,539)**	**(3,444)**	**(66)**	**(19,049)**	**(3,688)**	**14,987**	**(7,750)**	**50**	**79**
Income from associates	**11**		**(1)**	**10**		**2**	**12**	**9**	**20**
Loss before tax	**(15,528)**	**(3,444)**	**(67)**	**(19,039)**	**(3,688)**	**14,989**	**(7,738)**	**50**	**79**

For footnotes, see page 149.

Review of business performance

In North America, HSBC reported a loss before tax of US$7.7 billion in 2009 compared with a loss of US$15.5 billion in 2008. On an underlying basis, excluding US$3.7 billion of fair value movements on HSBC s own debt, and also excluding an impairment charge of US$10.6 billion in 2008 to fully write-off goodwill in respect of North America Personal Financial Services, the pre-tax loss fell by 52 per cent to US$4.1 billion. This improved performance was largely due to a marked reduction in write-downs and losses in Global Banking and Markets, lower loan impairment charges in Personal Financial Services and lower operating expenses following the closure of the Consumer Lending branch network at the beginning of 2009, partly offset by higher loan impairment charges and other credit risk provisions in the corporate and commercial, and Private Banking, books.

Net interest income in 2009 declined by 10 per cent, mainly reflecting reduced asset balances in the legacy consumer finance portfolios, increases in average delinquencies and modified loans (which generate lower yields), the compression of deposit spreads and lower revenue from Balance Sheet Management activities. These effects were partly offset by lower funding costs from the decline in interest rates and higher credit card yields which were driven by the effects of re-pricing initiatives, interest rate floors and lower levels of promotional balances.

Loans and advances to customers declined, mainly in HSBC Finance, following decisions taken to cease new originations and run off the residual balances in Mortgage Services, Consumer Lending and vehicle finance. HSBC Bank USA sold US$4.5 billion of prime mortgages in 2009 in addition to normal sale activity. In Card and Retail

Services, balances declined due to lower consumer spending and steps taken by management to mitigate risk and reduce originations, including tightening initial credit-line sales authorisation criteria, closing inactive accounts, decreasing credit lines, restricting underwriting criteria, restricting cash access and reducing marketing expenditure. In the second half of the year, direct marketing mailings and new customer account originations were resumed for portions of the sub-prime credit card portfolio which had held up well through the economic downturn.

In November 2009, HSBC entered into an agreement to sell the vehicle finance loan servicing operation and US$1.0 billion of associated loans. This transaction is expected to close in the first quarter of 2010.

On an underlying basis and excluding goodwill impairment in 2008, the pre-tax loss in North America halved.

In December 2009, HSBC Finance revised the write-off period for its real estate secured and other personal lending portfolios in order to reflect changed customer behaviour, aligning it with the policy used across the Group. As a consequence of this, real estate secured loan balances are now written down to net realisable value generally no later than the end of the month in which the account becomes 180 days delinquent, and personal lending products balances are now written off no later than the end of the month in which the account becomes 180 days delinquent. This change did not have a material effect on financial results as write-offs were offset with releases of related impairment allowances. However, the write-offs resulted in a US$3.3 billion reduction in gross balances in Mortgage Services and Consumer Lending.

Asset spreads narrowed slightly in the Mortgage Services and Consumer Lending portfolios as the effect of credit quality deterioration and increased loan modifications were partly offset by lower funding costs. Vehicle finance spreads widened due to lower funding costs. In Card and Retail Services, spreads widened due to lower funding costs, re-pricing initiatives, lower levels of promotional balances and interest rate floors on portions of the portfolio. In Global Banking and Markets and Commercial Banking, asset spreads widened, primarily due to loan repricing and lower funding costs.

Customer deposit balances were broadly unchanged. In Global Banking and Markets, reduced deposits reflected the decline in assets being funded. This reduction was partly offset in both Personal Financial Services and Commercial Banking, which were successful in increasing deposits through Premier, the expanded branch network and various internet-based propositions. Liability spreads tightened as base rates declined, although spreads widened in the second half of 2009 as rates paid to customers decreased in line with major competitors.

Net interest income from Balance Sheet Management fell, despite strong performance in the first half of the year, affected by risk management initiatives which included selling higher yielding assets and reinvesting the proceeds in assets with a reduced risk profile, resulting in lower yield.

Net fee income declined by 7 per cent to US$4.8 billion, driven by lower late, overlimit, interchange and cash advance fees in the US credit cards business. This was mainly due to a reduction in cards in issue, lower transaction volumes and changes in customer behaviour. Fee income from enhancement services also decreased due to lower balances and fewer accounts, and the discontinuance of all but one partner relationship and a change in product mix to lower revenue products led to a decline in fee income from Taxpayer Financial Services. In Global Banking and Markets, fee income from underwriting increased, driven by higher debt origination volumes.

Net trading income of US$331 million compared with a net trading loss of US$3.1 billion in 2008, primarily due to significantly lower write-downs on exposures in Global Banking and Markets, as the effect of downgrades of monoline insurers and mortgage-backed securities were far less marked than in 2008. Revenue from foreign exchange fell, following a record performance in 2008 in which there had been unprecedented levels of market volatility and wider spreads. In Global Banking, fair value losses were recorded on certain credit default swap transactions used to hedge corporate loan exposures following the tightening of credit spreads, compared with gains in 2008.

Net income from financial instruments designated at fair value declined by 35 per cent to US$192 million, as income from ineffective interest rate hedges related to long-term debt issued by the Group s subsidiaries in North America reduced.

Gains less losses from financial investments were US$296 million, compared with a net loss of US$123 million in 2008. Gains in the current year were largely attributable to the sale of mortgage-backed securities, compared with losses on the sale of US government agency securities in 2008. Gains from the sale of Visa shares in 2008 did not recur.

Net earned insurance premiums declined by 21 per cent as lower loan balances and the discontinuation of real estate originations in HSBC Finance led to lower premiums from payment protection insurance products.

Other operating income was US$566 million compared with US$26 million in 2008 due to lower losses on sales of repossessed properties during 2009. House prices began to stabilise during the second half of the year and this resulted in less deterioration in value in the time between taking title and selling the property. Also, there were further delays in the foreclosure process in 2009, resulting in lower inventory levels and fewer sales. In addition, HSBC Finance recognised gains from the refinement of the income recognition methodology of long-term insurance contracts, and gains on the sale of prime mortgages in HSBC Bank USA increased.

Net insurance claims incurred and movements in liabilities to policyholders increased marginally to US$241 million as higher claims and an increase in liabilities for credit protection policies written against the US prime mortgage book were largely offset by reduced life insurance and disability claims due to a decline in the number of policies underwritten.

Loan impairment charges and other credit risk provisions decreased by 7 per cent to US$15.7 billion. Lower loan impairment charges in HSBC Finance were partly offset by increases in loan impairment charges and other credit risk provisions in Global Banking and Markets, Commercial Banking, the US prime mortgage book and Private Banking. Loan impairment charges in US consumer finance fell by 12 per cent to US$13.5 billion.

Loan impairment charges in US consumer finance decreased by 12 per cent to US$13.5 billion, due to a stabilisation in delinquency trends. In the Mortgage Services portfolio, loan impairment charges fell by 40 per cent to US$2.1 billion as the portfolio progressed further into run-off. By contrast, there was a 4 per cent rise in loan impairment charges in Consumer Lending, primarily in the unsecured portfolio due to a deterioration in the 2006 and 2007 vintages and, to a lesser extent, first lien real estate secured loans. This was partly offset by lower loan impairment charges for second lien real estate secured loans, reflecting a reduction in portfolio risk factors as delinquency trends stabilised and the outlook for current inherent losses on certain first lien real estate secured vintages improved. The change in write-off period referred above had no significant effect on loan impairment charges.

In Card and Retail Services, loan impairment charges decreased by 4 per cent, due to lower loan balances, reflecting lower consumer spending and actions taken to manage risk, and stable credit conditions. In addition, the outlook for future loss estimates improved: the effect of higher unemployment on losses was not as severe as had been predicted, in part due to tighter underwriting; fuel prices declined; and government stimulus activities helped household cashflow. These developments occurred despite the continued deterioration of the US economy and higher levels of unemployment and personal bankruptcy filings.

In Personal Financial Services in HSBC Bank USA, loan impairment charges rose by 18 per cent to US$616 million, mainly in the prime residential mortgage portfolios. Higher delinquencies and losses were experienced due to credit quality deterioration and continued weakness in house prices in certain markets.

Loan impairment charges and other credit risk provisions in Global Banking and Markets rose from US$198 million to US$621 million, driven by deterioration in the credit position of certain corporate clients and additional impairments recognised in respect of certain ABSs held in the available-for-sale portfolio which reflected mark-to-market losses. In Commercial Banking, loan impairment charges rose by 15 per cent to US$519 million as the recession adversely affected the commercial real estate and construction portfolios in the US, and the commercial real estate, manufacturing, trade and service sectors in Canada. In Private Banking, higher loan impairment charges were attributable to a single specific charge.

Further commentary on delinquency trends in the US Personal Financial Services portfolios is provided in Areas of special interest personal lending on page 215.

Operating expenses declined to US$8.4 billion. Apart from the non-recurrence of a US$10.6 billion charge for the impairment of the goodwill of the North American Personal Financial Services business, savings from the decision to discontinue originations and close branches in the Consumer Lending business and other cost reduction initiatives drove expense reduction. Restructuring costs associated with the closure of the branch network amounted to US$150 million. Staff costs decreased as a result of lower staff numbers, offsetting higher performance-related costs in Global Banking and Markets. General and administrative costs declined with lower marketing costs in Card and Retail Services as a significant element as origination

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activity was curtailed. Deposit insurance expenses increased by US$143 million following a Federal Deposit Insurance Corporation special assessment in response to the bail out of a number of regional banks.

2008 compared with 2007

Economic briefing

Economic conditions proved very difficult in the **US** during 2008 as the economy entered a period of recession. Overall GDP growth slowed to just 1.1 per cent for the year, down from 2 per cent in 2007. In common with many other economies, much of this weakness was concentrated in the final months of 2008 as fourth quarter GDP registered the largest quarterly decline for 26 years. Economic weakness proved broad-based across most areas of the economy, with the notable exception of net exports. Housing sales and residential construction activity both declined from already depressed levels, with house prices continuing to fall in most regions and mortgage delinquencies continuing to rise. Labour market conditions weakened throughout the course of the year as the unemployment rate rose from 4.9 per cent in January to a 15-year high of 7.2 per cent in December 2008. The annual CPI rate reached a 17-year high of 5.6 per cent in July 2008 before moderating sharply to stand at just 0.1 per cent by the year-end. A combination of falling asset values and weak employment conditions undermined consumer confidence and household spending growth turned negative during the second half of 2008. The Standard & Poor s S&P 500 stock market index fell by 38 per cent during the year. Faced with this deterioration in economic activity and financial conditions, the Federal Reserve lowered short-term interest rates by 425 basis points during the course of 2008, leaving the Funds target rate within a narrow range of between zero and 25 basis points, while a number of liquidity initiatives were also introduced.

Canadian GDP increased by 0.4 per cent during the first eleven months of 2008 compared with the equivalent period of 2007, with growth slowing markedly during the second half of the year, due predominantly to weaker external demand. Labour market conditions deteriorated as the unemployment rate rose from a historical low of 5.8 per cent in January 2008 to finish the year at 6.6 per cent. After rising to a level of 3.5 per cent in August 2008, the headline rate of consumer price inflation slowed to 1.2 per cent by the year-end. The core rate of inflation remained below 2.0 per cent throughout the year. Responding to the deteriorating economic outlook, the Bank of Canada cut its overnight interest rate from 4.25 per cent at the end of 2007 to 1.5 per cent in December 2008.

Reconciliation of reported and underlying profit/(loss) before tax

	2008 compared with 2007								
North America	2007 as reported US$m	2007 adjustments and dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 adjustments[10] US$m	Underlying change US$m	2008 as reported US$m	Reported change[13] %	Underlying change[13] %
Net interest income	14,847	1	7	14,855		363	15,218	2	2
Net fee income	5,810	(105)	1	5,706		(479)	5,227	(10)	(8)
Changes in fair value[14]		1,760	(1,760)			3,444		3,444	96

Other income/(expense)[15]	366	(18)		348		(3,058)	(2,710)	(840)	(879)
Net operating income[16]	22,783	(1,882)	8	20,909	3,444	(3,174)	21,179	(7)	(15)
Loan impairment charges and other credit risk provisions	(12,156)		12	(12,144)		(4,651)	(16,795)	(38)	(38)
Net operating income	10,627	(1,882)	20	8,765	3,444	(7,825)	4,384	(59)	(89)
Operating expenses (excluding goodwill impairment)	(10,556)	98	(6)	(10,464)		1,105	(9,359)	11	11
Goodwill impairment						(10,564)	(10,564)		
Operating profit/(loss)	71	(1,784)	14	(1,699)	3,444	(17,284)	(15,539)	(21,986)	(1,017)
Income from associates	20			20		(9)	11	(45)	(45)
Profit/(loss) before tax	91	(1,784)	14	(1,679)	3,444	(17,293)	(15,528)	(17,164)	(1,030)

For footnotes, see page 149.

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Review of business performance

HSBC s operations in North America reported a pre-tax loss of US$15.5 billion in 2008, compared with a pre-tax profit of US$91 million in 2007. On an underlying basis, the loss before tax was US$17.3 billion worse at US$19.0 billion.

Net interest income in North America increased by 2 per cent to US$15.2 billion, driven by Balance Sheet Management activities in Global Banking and Markets which more than offset the decline in Personal Financial Services as lending reduced.

The significant increase in net interest income in the Balance Sheet Management business resulted from correct positioning in anticipation of lower interest rates. Net interest income was also boosted by higher balances within certain loan portfolios in Global Banking and Markets.

Net interest income fell in Personal Financial Services as asset balances declined and deposit spreads narrowed. Deposit spread compression was driven by the competitive environment for retail deposits in which HSBC refrained from passing on the full effects of interest rate cuts to customers. Asset spreads widened, particularly in vehicle finance and credit cards and, to a lesser extent, the real estate secured portfolios as yields declined by less than funding costs in the lower interest rate environment, and the credit card portfolio benefited from APR floors. This was partly offset by a rise in non-performing loans, lower loan prepayments, increased volumes of loan modifications, and lower fees from reduced loan origination volumes. Funding costs declined as a result of lower base rates during the year.

Lending balances declined as the mortgage services portfolio continued to run-off, originations ceased during the year within the dealer and direct-to-consumer channels in vehicle finance, and tighter underwriting criteria in consumer lending constrained customer eligibility for finance. In addition, US$8.2 billion of mortgages were sold from the US real estate secured portfolios during the year. These factors were partly offset by a change in mix towards higher-yielding credit card loans and reduced levels of prepayments that resulted in loans remaining on the balance sheet longer. At the end of February 2009, HSBC authorised the discontinuation as soon as practicable of all new receivable originations of all products by the branch-based consumer lending business of HSBC Finance in North America (see page 215).

Net fee income declined by 8 per cent, driven by reductions in US credit card fees following changes in fee practices implemented since the fourth quarter of 2007 and lower cash advance and interchange fees as a result of reduced volumes. Partly offsetting the decline were increased income from enhancement services due to higher customer acceptance rates of Account Secure Plus and Identity Protection Plan, a rise in syndication, credit and service fees in Commercial Banking and increased fees from asset management.

Trading losses were dominated by write-downs in Global Banking and Markets on legacy exposures as continuing turmoil in credit markets adversely affected valuations of credit and structured credit trading positions, monoline exposures and leveraged and acquisition finance loans. Continued deterioration in the fair value of the run-off portfolio of sub-prime residential mortgage loans held for sale also contributed to the loss. US$3.6 billion in leveraged loans, high yield notes and securities held for balance sheet management were reclassified in 2008 under revised IFRS rules from trading assets to loans and receivables and available for sale, preventing any further mark-to-market trading losses on these assets. If these reclassifications had not been made, the loss before tax would have been US$0.9 billion higher.

The losses on legacy assets were partly offset by strong performances in other trading areas as foreign exchange trading benefited from pronounced market volatility, Rates trading correctly anticipated central bank rate cuts and gains were generated on credit default swaps in Global Banking. Revenues from emerging markets trading and precious metals trading also rose as a result of ongoing market volatility and increased transaction volumes as prices of gold and platinum rose during 2008. Losses on non-qualifying hedge positions in interest rate swaps generated further trading losses. In 2007, the Decision One business, which was closed that year, recorded trading losses of US$263 million.

Net income from financial instruments designated at fair value rose by US$304 million to US$293 million due to income from ineffective hedges related to long-term debt issued by the Group s subsidiaries in North America.

Gains less losses from financial investments declined, mainly due to losses on US government agency securities in 2008 and the non-recurrence of the sale of MasterCard shares, partly offset by gains from the Visa IPO in 2008.

Net earned insurance premiums decreased by 13 per cent to US$390 million, driven by lower credit related premiums in HSBC Finance due to declining loan volumes.

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Other operating income declined due to losses on sale of the Canadian vehicle finance businesses and other loan portfolios in 2008, in addition to the non-recurrence of gains on disposal of fixed assets and a small portfolio of private equity investments in 2007.

Net insurance claims incurred and movement in liabilities to policyholders were broadly in line with 2007 at US$238 million.

Loan impairment charges and other credit risk provisions rose sharply, by 38 per cent to US$16.8 billion, reflecting substantially higher impairment charges in HSBC Finance across all portfolios and, in HSBC USA, the deterioration of credit quality in prime residential mortgages, second lien portfolios and private label cards. The main factors driving this deterioration were the continued weakening of the US economy, which led to rising levels of unemployment and personal bankruptcy filings: higher early-stage delinquency and increased roll rates in consumer lending: the ageing of portfolios: and further declines in house prices which increased loss severity and reduced customers ability to refinance and access equity in their homes. Partly offsetting these factors was a reduction in overall lending as HSBC continued to actively reduce its balance sheet and lower its risk profile in the US.

In the Mortgage Services business, loan impairment charges rose by 14 per cent to US$3.5 billion as the 2005 and 2006 vintages continued to season and experience rising delinquency. Run-off of the portfolio slowed in light of continued house price depreciation which, along with the constrained credit environment, restricted refinancing options for personal customers. In consumer lending, loan impairment charges rose by 39 per cent to US$5.7 billion. In the second half of 2008, delinquency rates began to accelerate particularly in the first lien portfolios in the parts of the country most affected by house price depreciation and rising unemployment rates. In HSBC USA, loan impairment charges rose by 76 per cent to US$2.6 billion driven by credit quality deterioration across the Home Equity line of credit, Home Equity loan, prime first lien residential mortgage and private label card portfolios.

Loan impairment charges in US card and retail services rose, driven by portfolio seasoning and rising unemployment, particularly in the second half of 2008, higher levels of personal bankruptcy filings and lower recovery rates. As with mortgages, this was most notable in parts of the country most affected by house price falls and unemployment.

Vehicle finance loan impairment charges rose as delinquencies rose and lower prices resulted in lower recoveries when repossessed vehicles were sold at auction.

Loan impairment charges in Commercial Banking grew to US$449 million from a low base, primarily driven by higher impairment losses due to deterioration across the middle market, commercial real estate and corporate banking portfolios in the US and among firms in the manufacturing, export and commercial real estate sectors in Canada. Higher loan impairment charges and other credit risk provisions in Global Banking and Markets reflected weaker credit fundamentals in the US in 2008.

Operating expenses increased by 90 per cent, driven by US$10.6 billion of impairment charge recognised in respect of North America Personal Financial Services in 2008 to fully write off goodwill. Excluding the goodwill impairment charge, expenses were US$1.1 billion or 11 per cent lower. Staff costs declined, primarily in HSBC Finance, following decisions taken in 2007 to close the acquisition channels for new business in Mortgage Services and a number of consumer lending branches, and integrate the operations of the card businesses. HSBC USA made the decision to close its wholesale and third-party correspondent mortgage business in November 2008, while HSBC Finance took the decision to cease originations in the dealer and direct-to-consumer channels in the vehicle finance business in July 2008. Staff costs in Global Banking and Markets also fell as performance-related compensation and staff numbers both declined.

Other administrative costs decreased as origination activity declined, marketing costs in card and retail services reduced and branch costs in consumer lending fell as tightened underwriting criteria curtailed business and led to branch closures. This was partly offset by higher marketing and occupancy costs in the retail bank reflecting a continued expansion of the branch network, increased community investment activities and higher deposit insurance, collection, payments and cash management and asset management costs in support of business growth.

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Analysis by customer group and global business

Profit/(loss) before tax

North America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
	2009						
Net interest income/(expense)	**11,244**	**1,391**	**999**	**178**	**(84)**	**(58)**	**13,670**
Net fee income	**3,174**	**453**	**1,045**	**142**	**3**		**4,817**
Trading income/(expense) excluding net interest income	**257**	**(10)**	**(179)**	**(3)**	**(30)**		**35**
Net interest income/(expense) on trading activities	**60**	**3**	**175**	**(1)**	**1**	**58**	**296**
Net trading income/(expense)[42]	**317**	**(7)**	**(4)**	**(4)**	**(29)**	**58**	**331**
Changes in fair value of long-term debt issued and related derivatives					**(3,497)**		**(3,497)**
Net income from other financial instruments designated at fair value					**1**		**1**
Net expense from financial instruments designated at fair value					**(3,496)**		**(3,496)**
Gains less losses from financial investments	**16**	**3**	**277**				**296**
Dividend income	**21**	**5**	**27**	**2**	**(2)**		**53**
Net earned insurance premiums	**309**						**309**
Other operating income	**9**	**162**	**317**	**11**	**1,828**	**(1,761)**	**566**
Total operating income/(expense)	**15,090**	**2,007**	**2,661**	**329**	**(1,780)**	**(1,761)**	**16,546**
Net insurance claims[43]	**(241)**						**(241)**

Net operating income/(expense)[16]	**14,849**	**2,007**	**2,661**	**329**	**(1,780)**	**(1,761)**	**16,305**
Loan impairment charges and other credit risk provisions	**(14,424)**	**(519)**	**(621)**	**(98)**	**(2)**		**(15,664)**
Net operating income/(expense)	**425**	**1,488**	**2,040**	**231**	**(1,782)**	**(1,761)**	**641**
Operating expenses	**(5,651)**	**(958)**	**(1,328)**	**(281)**	**(1,934)**	**1,761**	**(8,391)**
Operating profit/(loss)	**(5,226)**	**530**	**712**	**(50)**	**(3,716)**		**(7,750)**
Share of profit/(loss) in associates and joint ventures		**13**			**(1)**		**12**
Profit/(loss) before tax	**(5,226)**	**543**	**712**	**(50)**	**(3,717)**		**(7,738)**
	%	*%*	*%*	*%*	*%*		*%*
Share of HSBC s profit before tax	**(73.8)**	**7.7**	**10.1**	**(0.7)**	**(52.6)**		**(109.3)**
Cost efficiency ratio	**38.1**	**47.7**	**49.9**	**85.4**	**(108.7)**		**51.5**
Balance sheet data[41]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**151,671**	**31,292**	**18,654**	**5,236**			**206,853**
Total assets	**179,597**	**38,232**	**260,131**	**6,572**	**2,071**	**(11,589)**	**475,014**
Customer accounts	**74,228**	**42,900**	**19,095**	**12,834**	**100**		**149,157**

For footnotes, see page 149.

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Geographical regions > North America > Profit/(loss) before tax by customer group

Profit/(loss) before tax (continued)

	2008						
North America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income	12,632	1,480	1,064	224	22	(204)	15,218
Net fee income/(expense)	3,896	391	818	181	(59)		5,227
Trading income/(expense) excluding net interest income	(250)	5	(3,516)	10	(128)		(3,879)
Net interest income/(expense) on trading activities	66		584		(110)	204	744
Net trading income/(expense)[42]	(184)	5	(2,932)	10	(238)	204	(3,135)
Changes in fair value of long-term debt issued and related derivatives					3,736		3,736
Net income/(expense) from other financial instruments designated at fair value	(2)		(1)		4		1
Net income/(expense) from financial instruments designated at fair value	(2)		(1)		3,740		3,737
Gains less losses from financial investments	65	5	(209)		19		(120)
Dividend income	36	11	27	3			77
Net earned insurance premiums	390						390
Other operating income/(expense)	(426)	140	240	20	1,419	(1,370)	23
Total operating income/(expense)	16,407	2,032	(993)	438	4,903	(1,370)	21,417
Net insurance claims[43]	(238)						(238)

Net operating income/(expense)[16]	16,169	2,032	(993)	438	4,903	(1,370)	21,179
Loan impairment charges and other credit risk provisions	(16,132)	(449)	(198)	(16)			(16,795)
Net operating income/(expense)	37	1,583	(1,191)	422	4,903	(1,370)	4,384
Operating expenses (excluding goodwill impairment)	(6,701)	(937)	(1,384)	(339)	(1,368)	1,370	(9,359)
Goodwill impairment	(10,564)						(10,564)
Operating profit/(loss)	(17,228)	646	(2,575)	83	3,535		(15,539)
Share of profit/(loss) in associates and joint ventures		12			(1)		11
Profit/(loss) before tax	(17,228)	658	(2,575)	83	3,534		(15,528)
	%	%	%	%	%		%
Share of HSBC s profit before tax	(185.1)	7.1	(27.7)	0.9	38.0		(166.8)
Cost efficiency ratio	106.8	46.1	(139.4)	77.4	27.9		94.1

Balance sheet data[41]

	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	179,663	35,725	35,583	5,243			256,214
Total assets	205,722	42,211	348,347	7,054	3,323	(10,355)	596,302
Customer accounts	65,830	39,105	23,844	14,657	96		143,532

For footnotes, see page 149.

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North America	2007 Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income/(expense)	13,175	1,558	378	273	(17)	(520)	14,847
Net fee income/(expense)	4,571	338	701	279	(79)		5,810
Trading income/(expense) excluding net interest income	(349)	(2)	(871)	11	(78)		(1,289)
Net interest income/(expense) on trading activities	134		137		(44)	520	747
Net trading income/(expense)[42]	(215)	(2)	(734)	11	(122)	520	(542)
Changes in fair value of long-term debt issued and related derivatives					1,750		1,750
Net income/(expense) from other financial instruments designated at fair value			11		(11)		
Net income from financial instruments designated at fair value			11		1,739		1,750
Gains less losses from financial investments	176	(1)	65	2	3		245
Dividend income	47	1	57				105
Net earned insurance premiums	449						449
Other operating income/(expense)	(5)	88	167	34	1,480	(1,404)	360
Total operating income	18,198	1,982	645	599	3,004	(1,404)	23,024
Net insurance claims[43]	(241)						(241)

Net operating income[16]	17,957	1,982	645	599	3,004	(1,404)	22,783
Loan impairment charges and other credit risk provisions	(11,909)	(191)	(46)	(10)			(12,156)
Net operating income	6,048	1,791	599	589	3,004	(1,404)	10,627
Total operating expenses	(7,594)	(893)	(1,562)	(415)	(1,496)	1,404	(10,556)
Operating profit/(loss)	(1,546)	898	(963)	174	1,508		71
Share of profit/(loss) in associates and joint ventures		22	(2)				20
Profit/(loss) before tax	(1,546)	920	(965)	174	1,508		91
	%	%	%	%	%		%
Share of HSBC s profit before tax	(6.4)	3.8	(4.0)	0.7	6.3		0.4
Cost efficiency ratio	42.3	45.1	242.2	69.3	49.8		46.3

Balance sheet data[41]

	US$m	US$m	US$m	US$m	US$m		US$m
Loans and advances to customers (net)	218,676	38,930	26,186	6,068			289,860
Total assets	252,304	46,247	263,008	20,073	1,095	(8,409)	574,318
Customer accounts	61,824	36,306	30,732	16,187	124		145,173

For footnotes, see page 149.

Geographical regions > Latin America > 2009

Latin America

Profit/(loss) before tax by country within customer groups and global businesses

	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Total US$m
2009						
Argentina	**24**	**86**	**122**			**232**
Brazil	**(224)**	**211**	**515**	**5**	**3**	**510**
Mexico	**(31)**	**66**	**230**	**7**		**272**
Panama	**69**	**55**	**24**			**148**
Other	**(54)**	**(19)**	**40**	**(1)**	**(4)**	**(38)**
	(216)	**399**	**931**	**11**	**(1)**	**1,124**
2008						
Argentina		111	113			224
Brazil	250	348	298	8	6	910
Mexico	360	157	190	7		714
Panama	51	37	33			121
Other	7	53	7	1		68
	668	706	641	16	6	2,037
2007						
Argentina	36	75	90			201
Brazil	293	286	297	9	(6)	879
Mexico	514	333	113	11	9	980
Panama	45	18	16	7		86
Other	5	28	1	(2)		32
	893	740	517	25	3	2,178

Loans and advances to customers (net) by country

	At 31 December		
	2009	2008	2007

	US$m	US$m	US$m
Argentina	**2,319**	2,356	2,485
Brazil	**22,765**	18,255	18,491
Mexico	**12,114**	12,211	18,059
Panama	**5,989**	4,538	4,158
Other	**4,442**	4,927	4,730
	47,629	42,287	47,923

Customer accounts by country

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Argentina	**3,083**	2,988	2,779
Brazil	**39,022**	27,857	26,231
Mexico	**18,195**	17,652	22,307
Panama	**6,996**	5,185	5,062
Other	**5,593**	5,761	4,913
	72,889	59,443	61,292

Profit before tax

Latin America	**2009 US$m**	2008 US$m	2007 US$m
Net interest income	**5,573**	6,458	5,576
Net fee income	**1,729**	2,167	2,153
Net trading income	**848**	701	548
Changes in fair value of long-term debt issued and related derivatives			
Net income from other financial instruments designated at fair value	**495**	364	320
Net income from financial instruments designated at fair value	**495**	364	320
Gains less losses from financial investments	**168**	176	253
Gains arising from dilution of interests in associates			11
Dividend income	**11**	20	9
Net earned insurance premiums	**1,900**	1,717	1,594
Other operating income	**133**	300	228
Total operating income	**10,857**	11,903	10,692
Net insurance claims incurred and movement in liabilities to policyholders	**(1,833)**	(1,390)	(1,427)
Net operating income before loan impairment charges and other credit risk provisions	**9,024**	10,513	9,265
Loan impairment charges and other credit risk provisions	**(2,526)**	(2,492)	(1,697)
Net operating income	**6,498**	8,021	7,568
Total operating expenses	**(5,375)**	(5,990)	(5,402)
Operating profit	**1,123**	2,031	2,166

Share of profit in associates and joint ventures	**1**	6	12
Profit before tax	**1,124**	2,037	2,178
	%	%	%
Share of HSBC s profit before tax	**15.9**	21.9	9.0
Cost efficiency ratio	**59.6**	57.0	58.3
Year-end staff numbers (full-time equivalent)	**54,288**	58,559	64,404

Balance sheet data[41]

	At 31 December		
	2009	2008	2007
	US$m	US$m	US$m
Loans and advances to customers (net)	**47,629**	42,287	47,923
Loans and advances to banks (net)	**18,608**	14,572	12,675
Trading assets, financial assets designated at fair value, and financial investments	**28,779**	18,753	24,715
Total assets	**115,967**	102,946	102,649
Deposits by banks	**5,421**	5,598	4,092
Customer accounts	**72,889**	59,443	61,292

For footnote, see page 149.

All commentaries on Latin America are on an underlying basis unless stated otherwise.

2009 compared with 2008

Economic briefing

A mixture of weak external demand and the disruption caused by the H1N1 virus contributed to a substantial deterioration in economic conditions in **Mexico** during the first half of 2009. The period of recession ended decisively as the economy improved strongly during the third quarter of the year, but the previous sharp decline in activity had left GDP some
6.2 per cent below the comparable figure in 2008. The annual CPI rate continued to moderate, falling from 6.5 per cent in December 2008 to 3.6 per cent in December 2009. In response to the deterioration in economic conditions, the Bank of Mexico cut its overnight interest rate by 375 basis points during the first seven months of 2009 to 4.5 per cent by the end of the year.

The **Brazilian** economy experienced a mild contraction during the early months of 2009 but

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Geographical regions > Latin America > 2009

returned to growth during the second quarter of the year, helped by a recovery in household consumption and a broader stabilisation of external demand and commodity prices. Starting the year at unusually low levels, the unemployment rate increased during the early months of 2009 relative to the comparable period of 2008, before declining to the historically low level of 6.8 per cent in December 2009. The annual CPI rate moderated from 5.9 per cent in December 2008 to a level slightly below the central banks targeted rate of 4.5 per cent at the year end. Faced with this softening of economic conditions and diminishing inflationary pressures,
the central bank of Brazil reduced the policy Selic target rate by a cumulative 500 basis points during the first seven months of 2009, placing the rate at 8.75 per cent at the end of the period.
In **Argentina**, economic activity was adversely affected by the decline in external demand during 2009, with a very weak level of growth being reported around the middle of the year. Industrial production is reported to have risen by 0.4 per cent during 2009. The improving global and regional outlook during the second half of 2009 and a recovery in commodity prices provided some relief to the economy, enabling interest rates to ease.

Reconciliation of reported and underlying profit before tax

	2009 compared with 2008								
Latin America	**2008 as reported US\$m**	**2008 acquisitions and disposals[10] US\$m**	**Currency translation[11] US\$m**	**2008 at 2009 exchange rates[12] US\$m**	**2009 acquisitions and disposals[10] US\$m**	**Under-lying change US\$m**	**2009 as reported US\$m**	**Re-ported change[13] %**	**Under-lying change[13] %**
Net interest income	**6,458**		**(783)**	**5,675**		**(102)**	**5,573**	**(14)**	**(2)**
Net fee income	**2,167**		**(291)**	**1,876**		**(147)**	**1,729**	**(20)**	**(8)**
Other income[15]	**1,888**	**(71)**	**(220)**	**1,597**		**125**	**1,722**	**(9)**	**8**
Net operating income[16]	**10,513**	**(71)**	**(1,294)**	**9,148**		**(124)**	**9,024**	**(14)**	**(1)**
Loan impairment charges and other credit risk provisions	**(2,492)**		**294**	**(2,198)**		**(328)**	**(2,526)**	**(1)**	**(15)**
Net operating income	**8,021**	**(71)**	**(1,000)**	**6,950**		**(452)**	**6,498**	**(19)**	**(7)**
	(5,990)		**709**	**(5,281)**		**(94)**	**(5,375)**	**10**	**(2)**

Operating expenses									
Operating profit	**2,031**	**(71)**	**(291)**	**1,669**		**(546)**	**1,123**	**(45)**	**(33)**
Income from associates	**6**		**(2)**	**4**		**(3)**	**1**	**(83)**	**(75)**
Profit before tax	**2,037**	**(71)**	**(293)**	**1,673**		**(549)**	**1,124**	**(45)**	**(33)**

For footnotes, see page 149.

Review of business performance

HSBC s operations in Latin America reported pre-tax profits of US$1.1 billion, compared with US$2.0 billion in 2008. On an underlying basis, pre-tax profits decreased by 33 per cent, primarily attributable to significantly higher loan impairment charges in Personal Financial Services and Commercial Banking and lower revenues in Personal Financial Services. Global Banking and Markets performance improved driven by strong results in trading and Balance Sheet Management.

2009 was a year of consolidating risk policies and strongly emphasising cost control. Additional capital was injected into Brazil and Mexico during the fourth quarter of 2009, in line with the Group strategy of focusing on emerging markets. In both Panama and Argentina, strong results were achieved in spite of the challenging economic environment.

However, performance in Honduras, Costa Rica and El Salvador was significantly affected by higher loan impairment charges and lower income. One HSBC and Group systems were implemented in Chile and the operations in Panama were fully integrated.

Net interest income remained broadly in line with 2008 excluding the one-off interest income which arose on recovery of transactional taxes on insurance transactions in Brazil in 2008. Net interest income decreased in Personal Financial Services as average customer lending volumes declined, primarily driven by actions taken to tighten credit criteria and manage down existing higher risk portfolios including credit cards, personal loans and vehicle finance. The effect was partly offset by higher income on increased lending to commercial customers, primarily in Brazil. Repricing initiatives taken during 2008 and early 2009 drove increased spreads on lending products.

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Average customer deposit balances rose, resulting from an increase in commercial and Global Banking balances. In Mexico, Personal Financial Services launched new deposit products to mitigate the fall in deposits. Deposits Spreads narrowed due to falling interest rates, also primarily in Mexico.

Interest income rose in Balance Sheet Management, primarily in Brazil.

Net fee income declined by 8 per cent. Tighter credit origination criteria resulted in lower credit card fees in Mexico. Account service fees also fell, primarily due to lower transaction volumes. Weak equity market performance in Brazil led to lower assets under management and related fee income. This was partly offset by growth in restructuring fees in Global Banking and Markets.

Below inflation increase in operating expenses reflected significant cost control measures in Latin America.

Net trading income rose by 42 per cent due to a strong performance in Global Banking and Markets, particularly in the first half of the year in Brazil. This resulted from increased foreign exchange and Rates trading income, which benefited from early positioning against interest rate movements in a volatile market.

Net income from financial instruments designated at fair value rose by 36 per cent, primarily from higher insurance-related assets. This resulted from business growth and a recovery of the Brazilian equity markets as well as an increase in the fair value of fixed income securities held in support of personal pension portfolios in the country. An offsetting increase was recorded in net insurance claims incurred and movement in liabilities to policyholders.

Net earned insurance premiums rose by 24 per cent, driven by higher sales of pension and life assurance products. In addition, a number of customers in Brazil switched their personal pension annuities to HSBC. These gains were partially offset by the impact of the 2008 nationalisation of the pension system in Argentina on the annuities business there.

Net insurance claims incurred and movement in liabilities to policyholders rose, primarily as a result of the fair value movement on financial instruments referred to above and insurance business growth.

Other operating income fell by 29 per cent, largely due to the non-recurrence of gains arising in 2008 on a refinement of the income recognition methodology used in respect of long-term insurance contracts in Brazil. In 2009, a one-off gain was realised on the sale of the head office in Argentina.

Loan impairment charges and other credit risk provisions rose by 15 per cent as economic conditions deteriorated across the region. In the first half of 2009, delinquencies rose as GDP fell and unemployment increased. The situation was exacerbated by the H1N1 virus in Mexico and the related economic shutdown. With the introduction of enhanced credit risk management techniques and gradual economic recovery, loan impairment charges in the second half of 2009 decreased by 11 per cent compared with the second half of 2008 and by 27 per cent on the first half of 2009.

In Personal Financial Services, the combination of portfolio seasoning, which followed expansion in market share in previous years, and increased delinquencies in secured and unsecured personal lending products such as personal loans and payroll loans in Brazil and cards and mortgages in Mexico, resulted in higher loan impairment charges, mainly in the first half of 2009. Some payroll loan portfolios were run down in Brazil, as were several consumer finance and unsecured portfolios in Mexico. Loan impairment charges in Personal Financial Services fell by 8 per cent in the second half of the year compared with the same period in 2008 and by 27 per cent compared with the first half of 2009.

Loan impairment charges rose in commercial lending portfolios, primarily in Business Banking and mid-market business segments in Brazil, as trade levels fell as a consequence of the global economic slowdown. This was partly offset by net releases in loan impairment charges in Global Banking and Markets when compared with a net charge in 2008.

Operating expenses increased slightly by 2 per cent, well below the inflation rates of the main economies in which HSBC operates, reflecting significant cost control measures. The benefit from the reduction in staff numbers, which began in 2008 and continued in 2009, was partially offset by union-agreed pay rises. Savings in general and administrative costs were offset by investment expenditure on regional initiatives to centralise certain back office processes, and the implementation of One HSBC and Group systems intended to drive future operational efficiencies. Costs also increased in the form of higher litigation expenses and transactional taxes, the latter partly from the non-recurrence of a recovery of transactional taxes in the insurance business in 2008.

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Geographical regions > Latin America > 2008

2008 compared with 2007

Economic briefing

Inflationary pressures developed in **Mexico** during the course of 2008, mostly due to rising commodity prices, as consumer price inflation accelerated from 3.7 per cent in January to 6.5 per cent by the year-end. In response, the Bank of Mexico raised its overnight interest rate by 75 basis points to 8.25 per cent by the end of the year, although a variety of economic indicators pointed to a sharp loss of momentum during the final quarter as global growth slowed.

The **Brazilian** economy performed strongly during the first half of 2008, driven by domestic demand, with the annual rate of consumer price inflation rising from 4.6 per cent in January to 6.4 per cent in July, towards the upper limit of the central banks   tolerance range. Conditions within the labour market improved, with the rate of unemployment well below levels observed a year earlier. In line with many other economies within the region, however, conditions weakened markedly towards the end of 2008, with industrial production falling by close to 20 per cent during the fourth quarter.

In **Argentina**, economic activity held at a reasonably robust level for much of the year, although measures of industrial production growth slowed noticeably during the final months of 2008. Declines in commodity prices during the second half of 2008 and the reduced value of exports raised concerns over the level of capital outflow from the country, while domestic currency interest rates increased sharply. The official headline rate of consumer price inflation rose during the first half of 2008, reaching 9.3 per cent in June 2008 before slowing to 7.2 per cent in December, although methodological changes make comparisons over year difficult.

Reconciliation of reported and underlying profit before tax

	2008 compared with 2007								
Latin America	2007 as reported US$m	2007 acquisitions, disposals & dilution gains[10] US$m	Currency translation[11] US$m	2007 at 2008 exchange rates[17] US$m	2008 acquisitions and disposals[10] US$m	Under-lying change US$m	2008 as reported US$m	Re-ported change[13] %	Under-lying change[13] %
Net interest income	5,576		155	5,731		727	6,458	16	13
Net fee income	2,153		58	2,211		(44)	2,167	1	(2)
Other income[15]	1,536	(11)	23	1,548	71	269	1,888	23	17
Net operating income[16]	9,265	(11)	236	9,490	71	952	10,513	13	10
Loan impairment charges and other	(1,697)		(64)	(1,761)		(731)	(2,492)	(47)	(42)

credit risk provisions									
Net operating income	7,568	(11)	172	7,729	71	221	8,021	6	3
Operating expenses	(5,402)		(190)	(5,592)		(398)	(5,990)	(11)	(7)
Operating profit	2,166	(11)	(18)	2,137	71	(177)	2,031	(6)	(8)
Income from associates	12			12		(6)	6	(50)	(50)
Profit before tax	2,178	(11)	(18)	2,149	71	(183)	2,037	(6)	(9)

For footnotes, see page 149.

Review of business performance

In Latin America, HSBC reported a pre-tax profit of US$2.0 billion compared with US$2.2 billion in 2007, a decrease of 6 per cent. On an underlying basis, pre-tax profits decreased by 9 per cent as increased revenues were offset by higher loan impairment charges, largely in Mexico and Brazil, and increased operating costs across the region.

Net interest income increased by 13 per cent. Growth in average personal lending volumes was mainly driven by vehicle finance and payroll loans
in Brazil, and credit cards and personal loans in Mexico. Average credit card balances increased as a result of significant organic growth in 2007 which was not repeated in 2008. Commercial loan volume growth was driven by increased lending for working capital and trade finance loans in Brazil, and medium-sized businesses and the real estate sector in Mexico. Increased income on customer liabilities, which was driven by volume growth, particularly in time deposits, was largely offset by a contraction in deposit spreads, primarily on US dollar denominated accounts. Active repricing strategies were deployed

to mitigate spread compression in the region and to better reflect the credit risk on the loan portfolio. Lower overall spreads on lending products were partly offset by increases in cards in the region, small business loans in Mexico and overdrafts in Brazil. In Argentina, spreads on most products widened.

Net fee income decreased by 2 per cent following a ruling by the Brazilian Central Bank reducing or eliminating certain fees such as charges on early loan repayments and returned cheques. Lower transaction volumes in Personal Financial Services in Brazil also reduced fee income. These were partly offset by product repricing, the introduction of new fees and volume growth, particularly in cards, personal loans, packaged deposit products and payments and cash management.

Trading income rose by 22 per cent largely reflecting favourable positioning against foreign exchange movements and increased foreign exchange sales volumes. Trading losses were registered on certain transactions where an offsetting benefit is reported in *net income from financial instruments designated at fair value*. Losses from defaults on derivative contracts were registered, primarily in Mexico.

Gains less losses from financial investments declined by 24 per cent as gains on the redemption of VISA shares, following its global IPO, and the sale of shares in both Brazil and Mexico were lower than the gains achieved on the sale of shares in a number of companies in Brazil in 2007.

Net earned insurance premiums rose, driven by higher prices and increased sales in the general insurance business, primarily in Argentina. Sales of life assurance products remained strong.

Increased *net insurance claims incurred and movements in liabilities to policyholders* in Argentina were more than offset by a decrease in liabilities to policyholders in Brazil following a decline in the equity market where the investment losses were passed on to unit-linked policyholders. This was compensated for by a similar decrease in *net income from financial instruments designated at fair value.*

Other operating income was broadly in line with 2007. A refinement of the income recognition methodology used in respect of long-term insurance contracts in Brazil in 2008 was offset by a similar adjustment in Mexico in 2007.

Loan impairment charges and other credit risk provisions rose by 42 per cent, mainly relating to credit cards, as organically grown portfolios in Mexico seasoned following market share growth and credit quality deteriorated in Mexico and Brazil. The personal unsecured, vehicle finance and small and medium-sized commercial loan portfolios in Brazil also experienced increased levels of loan impairment. Specific focus was placed on improving the quality of new business, based on underwriting experience and relationship management, and steps were taken to improve collection strategies.

Operating expenses increased by 7 per cent. An increase in staff costs was primarily driven by higher salaries following union-agreed pay rises and redundancy payments following reductions in staff numbers, partly offset by cost savings from the reduced headcount. Administrative expenses rose following an increase in the use of a credit card cashback promotional facility in Mexico which was terminated at the end of 2008. Costs also grew in support of improved operational processes in the region. HSBC benefited in 2008 from the recognition of a tax credit following a court ruling in Brazil granting the right to recover excess taxes paid on insurance transactions and changes in transactional tax legislation. As economic conditions weakened towards the second half of 2008, strategic cost saving measures were implemented throughout the region.

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Geographical regions > Latin America > Profit/(loss) before tax by customer group

Analysis by customer group and global business
Profit/(loss) before tax

	2009						
Latin America	**Personal Financial Services US$m**	**Commercial Banking US$m**	**Global Banking & Markets US$m**	**Private Banking US$m**	**Other US$m**	**Inter-segment elimination[50] US$m**	**Total US$m**
Net interest income/(expense)	**3,736**	**1,544**	**590**	**19**	**(5)**	**(311)**	**5,573**
Net fee income	**948**	**490**	**251**	**28**	**12**		**1,729**
Trading income excluding net interest income	**25**	**38**	**573**	**3**			**639**
Net interest income/(expense) on trading activities	**4**	**2**	**(108)**			**311**	**209**
Net trading income[42]	**29**	**40**	**465**	**3**		**311**	**848**
Changes in fair value of long-term debt issued and related derivatives							
Net income/(expense) from other financial instruments designated at fair value	**510**	**12**	**(38)**		**11**		**495**
Net income/(expense) from financial instruments designated at fair value	**510**	**12**	**(38)**		**11**		**495**
Gains less losses from financial investments	**91**		**77**				**168**
Dividend income	**9**	**1**	**1**				**11**
Net earned insurance premiums	**1,752**	**105**	**43**				**1,900**
Other operating income/(expense)	**170**	**35**	**24**	**2**	**(1)**	**(97)**	**133**
Total operating income	**7,245**	**2,227**	**1,413**	**52**	**17**	**(97)**	**10,857**
Net insurance claims[43]	**(1,750)**	**(58)**	**(25)**				**(1,833)**

Net operating income[16]	**5,495**	**2,169**	**1,388**	**52**	**17**	**(97)**	**9,024**
Loan impairment (charges)/ recoveries and other credit risk provisions	**(2,046)**	**(534)**	**57**		**(3)**		**(2,526)**
Net operating income	**3,449**	**1,635**	**1,445**	**52**	**14**	**(97)**	**6,498**
Total operating expenses	**(3,666)**	**(1,236)**	**(514)**	**(41)**	**(15)**	**97**	**(5,375)**
Operating profit/(loss)	**(217)**	**399**	**931**	**11**	**(1)**		**1,123**
Share of profit in associates and joint ventures	**1**						**1**
Profit/(loss) before tax	**(216)**	**399**	**931**	**11**	**(1)**		**1,124**
	%	%	%	%	%		%
Share of HSBC s profit before tax	**(3.1)**	**5.6**	**13.2**	**0.2**			**15.9**
Cost efficiency ratio	**66.7**	**57.0**	**37.0**	**78.8**	**88.2**		**59.6**
Balance sheet data [41]							
	US$m	**US$m**	**US$m**	**US$m**	**US$m**		**US$m**
Loans and advances to customers (net)	**19,748**	**18,205**	**9,645**	**31**			**47,629**
Total assets	**35,236**	**23,212**	**57,491**	**328**	**281**	**(581)**	**115,967**
Customer accounts	**30,628**	**19,775**	**20,142**	**2,344**			**72,889**

For footnotes, see page 149.

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	2008						
Latin America	Personal Financial Services US$m	Commercial Banking US$m	Global Banking & Markets US$m	Private Banking US$m	Other US$m	Inter-segment elimination[50] US$m	Total US$m
Net interest income/(expense)	4,582	1,637	579	22	(35)	(327)	6,458
Net fee income	1,339	536	248	35	9		2,167
Trading income excluding net interest income	123	27	200	3	4		356
Net interest income/(expense) on trading activities	7	4	8		(2)	327	345
Net trading income[42]	130	31	208	3	2	327	701
Changes in fair value of long-term debt issued and related derivatives							
Net income from other financial instruments designated at fair value	187		139		38		364
Net income from financial instruments designated at fair value	187		139		38		364
Gains less losses from financial investments	132	21	21	2			176
Dividend income	16	1	3				20
Net earned insurance premiums	1,547	82	88				1,717
Other operating income	244	57	39	3	8	(51)	300
Total operating income	8,177	2,365	1,325	65	22	(51)	11,903
Net insurance claims[43]	(1,281)	(42)	(68)		1		(1,390)
Net operating income[16]	6,896	2,323	1,257	65	23	(51)	10,513

Loan impairment charges and other credit risk provisions	(2,120)	(340)	(29)		(3)		(2,492)
Net operating income	4,776	1,983	1,228	65	20	(51)	8,021
Total operating expenses	(4,114)	(1,277)	(587)	(49)	(14)	51	(5,990)
Operating profit	662	706	641	16	6		2,031
Share of profit in associates and joint ventures	6						6
Profit before tax	668	706	641	16	6		2,037
	%	%	%	%	%		%
Share of HSBC s profit before tax	7.2	7.6	6.9	0.2			21.9
Cost efficiency ratio	59.7	55.0	46.7	75.4			