

HSBC HOLDINGS PLC
Form 20-F
March 10, 2008

As filed with the Securities and Exchange Commission on March 10, 2008.

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 20-F

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

or

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2007

or

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

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

(Translation of Registrant's name into English)

United Kingdom

(Jurisdiction of incorporation or organisation)

8 Canada Square
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
New York Stock Exchange*

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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 Depository 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

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	11,829,052,317
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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes

No

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

Yes

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.

Yes

No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

US GAAP

International Financial Reporting
Standards as issued by the
International Accounting Standards
Board

Other

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

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Item 18

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

Yes

No

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

HSBC HOLDINGS PLC

Annual Report and Accounts 2007

Headquartered in London, HSBC is one of the largest banking and financial services organisations in the world. Its international network comprises some 10,000 properties in 83 countries and territories in Europe; Hong Kong; Rest of Asia-Pacific, including the Middle East and Africa; 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 about 200,000 shareholders in over 100 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 128 million customers through four customer groups and global businesses: Personal Financial Services (including consumer finance); Commercial Banking; Global Banking and Markets; and Private Banking.

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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.

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HSBC HOLDINGS PLC

Financial Highlights

For the year

- Total operating income up 25.0 per cent to US\$87,601 million (2006: US\$70,070 million).
- Net operating income up 12.7 per cent to US\$61,751 million (2006: US\$54,793 million).
- Group pre-tax profit up 9.6 per cent to US\$24,212 million (2006: US\$22,086 million).
- Profit attributable to shareholders of the parent company up 21.2 per cent to US\$19,133 million (2006: US\$15,789 million).
- Return on average invested capital of 15.3 per cent (2006: 14.9 per cent).
- Earnings per ordinary share up 17.9 per cent to US\$1.65 (2006: US\$1.40).

At the year-end

- Total equity up 17.8 per cent to US\$135,416 million (2006: US\$114,928 million).
- Customer accounts and deposits by banks up 23.3 per cent to US\$1,228,321 million (2006: US\$996,528 million).
- Risk-weighted assets up 19.7 per cent to US\$1,123,782 million (2006: US\$938,678 million).

Dividends and capital position

- Total dividends declared in respect of 2007 of US\$0.90 per share, an increase of 11.1 per cent over dividends for 2006; fourth interim dividend for 2007 of US\$0.39 per share, an increase of 8.3 per cent.
- Tier 1 capital ratio of 9.3 per cent and total capital ratio of 13.6 per cent.

Dividends per share¹
(US dollars)

**Return on average
invested capital**
(per cent)

Earnings per share
(US dollars)

Cost efficiency ratio
(per cent)

1 Dividends declared in the year per ordinary share.

Data for 2004 to 2007 are presented based on financial statements prepared in accordance with IFRSs; data for 2003 in accordance with UK GAAP. Further information about the results is given in the consolidated income statement on page 337.

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HSBC HOLDINGS PLC

Financial Highlights (continued)

Ratios / 5-year comparison

Capital and performance ratios

	2007 %	2006 %
Capital ratios		
Tier 1 capital	9.3	9.4
Total capital	13.6	13.5
Performance ratios		
Return on average invested capital ¹	15.3	14.9
Return on average total shareholders' equity ²	15.9	15.7
Post-tax return on average total assets	0.97	1.00
Post-tax return on average risk-weighted assets	1.95	1.93
Credit coverage ratios		
Loan impairment charges as a percentage of total operating income	19.61	15.05
Loan impairment charges as a percentage of average gross customer advances	1.97	1.39
Total impairment allowances outstanding as a percentage of impaired loans at the year-end	104.9	98.5
Efficiency and revenue mix ratios		
Cost efficiency ratio ³	49.4	51.3
As a percentage of total operating income:		
□ net interest income	43.1	49.2
□ net fee income	25.1	24.5
□ net trading income	11.2	11.7
Financial ratio		
Average total shareholders' equity to average total assets	5.69	5.97

Share information at the year-end

	2007	2006
US\$0.50 ordinary shares in issue (million)	11,829	11,572
Market capitalisation (billion)	US\$198	US\$212
Closing market price per ordinary share:		
□ London	£8.42	£9.31
□ Hong Kong	HK\$131.70	HK\$142.40
Closing market price per American Depositary Share ⁴	US\$83.71	US\$91.65

	Over 1 year	Over 3 years	Over 5 years
HSBC total shareholder return to 31 December 2007 ⁵	95.6	111.3	158.8
Benchmarks:			
□ FTSE 100	107.4	148.4	194.6
□ MSCI World	108.1	140.8	182.0

For footnotes, see page 4.

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 endorsed by the European Union (EU). EU-endorsed IFRSs may differ from IFRSs as published by the International Accounting Standards Board (IASB) if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2007, there were no unendorsed standards effective for the year ended 31 December 2007 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 2007 are prepared in accordance with IFRSs as issued by the IASB.

Information for 2003 has been prepared under previous HSBC policies in accordance with UK Generally Accepted Accounting Principles (UK GAAP), which are not comparable with IFRSs.

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 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 131) and adjusted for the effects of acquisitions and disposals. A reconciliation of reported and underlying profit before tax is presented on page 15.

[Back to Contents](#)**Five-year comparison**

	Amounts in accordance with IFRSs ⁸				Amounts in accordance with UK GAAP ⁹
	2007 US\$m	2006 US\$m	2005 US\$m	2004 US\$m	2003 US\$m
For the year					
Net interest income	37,795	34,486	31,334	31,099	25,598
Other operating income	49,806	35,584	30,370	24,889	15,474
Loan impairment charges and other credit risk provisions	(17,242)	(10,573)	(7,801)	(6,191)	□
Provisions for bad and doubtful debts	□	□	□	□	(6,093)
Total operating expenses	(39,042)	(33,553)	(29,514)	(26,487)	(22,532)
Profit before tax	24,212	22,086	20,966	18,943	12,816
Profit attributable to shareholders of the parent company	19,133	15,789	15,081	12,918	8,774
Dividends	10,241	8,769	7,750	6,932	6,532
At the year-end					
Called up share capital	5,915	5,786	5,667	5,587	5,481
Total shareholders' equity	128,160	108,352	92,432	85,522	□
Shareholders' funds	□	□	□	□	74,473
Capital resources ¹⁰	152,640	127,074	105,449	90,780	74,042
Customer accounts	1,096,140	896,834	739,419	693,072	573,130
Undated subordinated loan capital	2,922	3,219	3,474	3,686	3,617
Preferred securities and dated subordinated loan capital ¹¹	49,472	42,642	35,856	32,914	17,580
Loans and advances to customers ^{12,13}	981,548	868,133	740,002	672,891	528,977
Total assets	2,354,266	1,860,758	1,501,970	1,279,974	1,034,216
	US\$	US\$	US\$	US\$	US\$
Per ordinary share					
Basic earnings	1.65	1.40	1.36	1.18	0.84
Diluted earnings	1.63	1.39	1.35	1.17	0.83
Dividends ¹⁴	0.87	0.76	0.69	0.63	0.60
Net asset value at year-end	10.72	9.24	8.03	7.66	6.79
Share information					
US\$0.50 ordinary shares in issue (millions)	11,829	11,572	11,334	11,172	10,960
	%	%	%	%	%
Financial ratios					
Dividend payout ratio ¹⁵	52.7	54.3	50.7	53.4	60.6
Post-tax return on average total assets	0.97	1.00	1.06	1.14	1.01
Return on average total shareholders' equity	15.9	15.7	16.8	16.3	□
Return on average shareholders' funds	□	□	□	□	13.0
Average total shareholders' equity to average total assets	5.69	5.97	5.96	6.35	□
Average shareholders' funds to average total assets	□	□	□	□	7.06
Capital ratios					
Tier 1 capital	9.3	9.4	9.0	8.9	8.9

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Total capital	13.6	13.5	12.8	12.0	12.0
Foreign exchange translation rates to US\$					
Closing □ £:US\$1	0.498	0.509	0.581	0.517	0.560
□ □:US\$1	0.679	0.759	0.847	0.733	0.793
Average □ £:US\$1	0.500	0.543	0.550	0.546	0.612
□ □:US\$1	0.731	0.797	0.805	0.805	0.885

For footnotes, see page 4.

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HSBC HOLDINGS PLC

Financial Highlights (continued)

Cautionary statements

Footnotes to Financial Highlights

- 1 *The definition of return on average invested capital and a reconciliation to the equivalent GAAP measures are set out on page 12.*
- 2 *The return on average total shareholders' equity is defined as profit attributable to shareholders of the parent company divided by average total shareholders' equity.*
- 3 *The cost efficiency ratio is defined as total operating expenses divided by net operating income before loan impairment charges and other credit risk provisions.*
- 4 *Each American Depositary Share (ADS) represents five ordinary shares.*
- 5 *Total shareholder return is defined on page 12.*
- 6 *The Financial Times Stock Exchange 100 Index.*
- 7 *The Morgan Stanley Capital International World Index.*
- 8 *Data for 2004 exclude the provisions of IAS 32, IAS 39 and IFRS 4, which were adopted for the first time with effect from 1 January 2005.*
- 9 *Data for 2003 were prepared in accordance with previous HSBC accounting policies under UK GAAP. HSBC's accounting policies under UK GAAP are stated in Note 2 on the Financial Statements in the Annual Report and Accounts 2004.*
- 10 *Capital resources are total regulatory capital, the calculation of which is set out on page 286.*
- 11 *Includes perpetual preferred securities, details of which can found in Note 32 on the Financial Statements .*
- 12 *Net of suspended interest and provisions for bad and doubtful debts (UK GAAP).*
- 13 *Net of impairment allowances (IFRSs).*
- 14 *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. First, second and third interim dividends for 2007, each of US\$0.17 per ordinary share, were paid on 6 July 2007, 4 October 2007 and 18 January 2008 respectively. Note 12 on the Financial Statements provides more information on the dividends declared in 2007. On 3 March 2008 the Directors declared a fourth interim dividend for 2007 of US\$0.39 per ordinary share in lieu of a final dividend, which will be payable to ordinary shareholders on 7 May 2008 in cash in US dollars, or in pound sterling or Hong Kong dollars at exchange rates to be determined on 28 April 2008, with a scrip dividend alternative. The reserves available for distribution at 31 December 2007 were US\$15,551 million. Quarterly dividends of US\$15.50 per 6.20 per cent non-cumulative US dollar preference share, Series A (Series A 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 15 March 2007, 15 June 2007, 15 September 2007 and 15 December 2007.*
- 15 *Dividends per share expressed as a percentage of earnings per share (2003: excluding goodwill amortisation).*

Cautionary Statement Regarding Forward-Looking Statements

The Annual Report and Accounts 2007 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", "potential" and "reasonably possible", variations of these words and similar expressions are intended to identify forward-looking statements. These statements are based on current plans, estimates and projections, and

therefore undue reliance should not be placed on them. Forward-looking statements speak only as of the date they are made, and it should not be assumed that they have been revised or updated in the light of new information or 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 employment fluctuations;
 - 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);
 - volatility in interest rates;
 - volatility in equity markets, including in the smaller and less liquid trading markets in Asia and Latin America;

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- lack of liquidity in wholesale funding markets;
- illiquidity and downward price pressure in national real estate markets, particularly consumer-owned real estate markets;
- the emergence of structural inflationary pressures from rising energy, raw material, food and labour costs particularly in emerging economies experiencing strong domestic growth and capacity constraints;
- 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 governmental 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;
 - expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership;
 - initiatives by local, state and national regulatory agencies or legislative bodies to revise the practices, pricing or responsibilities of financial institutions serving their consumer markets;
 - changes in bankruptcy legislation in the principal markets in which HSBC operates and the consequences thereof;
 - general changes in governmental policy that may significantly influence investor decisions, in particular markets in which HSBC operates;
 - 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 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.

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HSBC HOLDINGS PLC

Report of the Directors: Business Review

Group Chairman's statements

Group Chairman's statement

2007 was a year when large parts of the international financial system came under extraordinary strain. For HSBC to achieve another new high in earnings, despite these conditions and the exceptionally weak performance of our US business, underscores the value of the strategic focus we announced early last year to drive sustainable growth by concentrating on the faster growing markets of the world.

Pre-tax profits in 2007 increased by 10 per cent to US\$24 billion and earnings per share rose by 18 per cent to US\$1.65. Excluding the dilution gains arising from our strategic investments in mainland China, which I highlighted at the interim stage, profits grew by 5 per cent. Consistent with our strategy of focusing on emerging markets where we are the world's leading international bank, profits from those businesses, excluding dilution gains, grew by 41 per cent to US\$15 billion.

Our return on shareholders' equity exceeded 15 per cent, revenue growth was in double digits for the fifth year running, our cost efficiency ratio improved and our capital ratios remained strong. HSBC's financial strength in terms of both capital and liquidity is a powerful driver of sustainable growth and helps ensure continued resilience.

Strong operating performance in 2007

We produced exceptionally strong results in Asia-Pacific, Latin America and the Middle East while facing considerable business challenges in North America. In our customer groups, we also achieved record results in Commercial Banking and Private Banking, and a strong performance in Global Banking and Markets, despite write-downs arising from market turbulence in the second half of the year. In addition, Personal Financial Services produced record profits in emerging markets. Within

these customer groups, our insurance operations made further progress.

Our North American results continue to be adversely affected by high loan impairment charges as we respond to the impact on our portfolio of credit deterioration arising largely from housing market weakness in the US. The management team has taken vigorous action to address and mitigate the problem. In Europe, excluding the

positive effect of movements in the fair value of HSBC's own debt, performance was broadly in line with 2006. In the UK, Commercial Banking generated pre-tax profits of over US\$2 billion for the first time and, in Turkey, further expansion of the branch network helped drive strong organic growth in numbers of personal and business customers.

Financial strength underpins our progressive dividend policy

The Directors have declared a fourth interim dividend for 2007 of US\$0.39 per ordinary share (in lieu of a final dividend) which, together with the first three interim dividends for 2007 of US\$0.17 already paid, will make a total distribution in respect of the year of US\$0.90 per share (US\$0.81 per share in respect of 2006), an increase of 11.1 per cent. The dividend will be payable on 7 May 2008 with a scrip dividend alternative, to shareholders on the register on 25 March 2008. HSBC's dividend has increased by 10 per cent or more every year for 15 years.

A clear and compelling strategy playing to our strengths

At the beginning of 2007, we refreshed our strategy, considering how we should shape HSBC for the future. Our deliberations were influenced by some fundamental long-term trends that will shape tomorrow's world: emerging markets will continue to grow faster than mature ones; world trade will continue to grow faster than world output; and people are living longer than ever before with all the implications that has for long-term savings and pensions.

Our thinking was also informed by a clear appreciation of HSBC's strengths. We believe that the global leadership we have built in emerging markets and in trade, and our international perspective, are compelling advantages that set HSBC apart for our customers, our shareholders and our people.

As we explained in March 2007, our conclusion was that the Group should place renewed emphasis on investing in fast moving emerging markets in Asia-Pacific, the Middle East and Latin America. We

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believe we can grow strongly and sustainably. We achieved our position as the number one international bank in Asia-Pacific and the Middle East over many years; by contrast, we have built one of Latin America's largest financial services businesses in little more than a decade.

In mature markets, we are determined to focus our businesses on areas where we can build on our unique global franchise, so as to benefit from the long-term trend of increasing international connectivity. We have international customer bases across many of our businesses, from the largest corporates, through to small or medium-sized enterprises, to the internationally mobile mass affluent and other personal customers with specific international requirements. We have developed a clear approach which is enabling our business to focus strongly on these groups of customers now and in the years ahead.

Where opportunities arise, we shall seek to redeploy capital towards emerging markets through divestment of assets of greater strategic value to others. In France, we have received a firm cash offer of US\$3.1 billion for our seven, separately branded, regional banks and have entered into exclusive discussions. This potential transaction, which is subject to necessary approvals and consultation, could complete in mid-2008. We remain committed to France through our HSBC-branded network serving retail and commercial customers and through our activities in Global Banking and Markets, Private Banking, asset management and insurance. During 2007, we acquired the 50 per cent of Erisa, our French insurance business, which we did not own.

We will also build businesses, in both our emerging and mature markets, that help our customers with their long-term savings needs, as demographics and wealth creation trends around the world make this ever more important to them.

Finally, we will shape our business operations so that we use our scale to deliver better, more efficient services to our customers. Their use of technology increasingly dictates how they interact with us. We increasingly employ technology to create better products which we can deliver globally at lower cost. As we grow our direct banking business, we will create opportunities to meet more of our customers' financial needs.

Building on our position as the world's leading international emerging markets bank

During 2007, we continued to build our businesses in emerging markets organically. For example, on a like-for-like basis, risk-weighted assets in these areas grew by 42 per cent compared with 16 per cent for the Group as a whole.

As the leading international bank in the country of our birth, China, we were delighted to be among the first to incorporate locally in the mainland. We have built the largest branch network of any international bank and we have significant and profitable strategic investments in our Chinese associates.

In mainland China, through our own businesses and in conjunction with our associates, we achieved for the first time in our history a profit before tax of over US\$1 billion, in addition to over US\$7 billion generated in Hong Kong.

As China continues to reshape itself as a 21st century powerhouse, HSBC seeks to play a constructive role in its continued progressive economic and social development. We were the first international bank to establish and open a rural bank. Hang Seng Bank has agreed to acquire 20 per cent of Yantai City Commercial Bank in the fast growing Bohai region of China.

Elsewhere in Asia-Pacific, we have sought to further strengthen our position through a series of investments in faster-growing economies. In South Korea, we have agreed to acquire 51 per cent of Korea Exchange Bank for US\$6.5 billion, subject to regulatory approvals. In Taiwan, we acquired Chailease Credit Services, a factoring company serving commercial customers, and agreed to acquire the assets, liabilities and operations of The Chinese Bank, which will extend our network by 39 branches and bring us many new customers.

As foreign investment rules are eased, we have made significant investments to expand our business in Vietnam with the acquisition of a further 5 per cent interest in Techcombank, bringing our stake to 14.4 per cent,

and the purchase for some US\$255 million of a 10 per cent interest in Bao Viet, the leading insurance company in the country.

The latter investment reflects our determination to increase the contribution of insurance to Group earnings. We also entered into agreements to invest in a 26 per cent interest in a new life insurance joint venture in India, in partnership with two of the larger state-owned banks, and to acquire just under 50 per cent of Hana Life Insurance Company in South Korea. We have entered a number of strategic

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HSBC HOLDINGS PLC

Report of the Directors: Business Review

(continued)

Group Chairman's statements

alliances to ensure that we have the best products for our customers and the support to grow our activities.

A fifth consecutive year of rising oil prices facilitated growth in public and private investment in the Middle East. As a result, infrastructure development accelerated and consumption and employment rose. Our businesses in the Middle East were well positioned to benefit from this and have had an excellent year.

Our acquisition of Grupo Banistmo in Central America and Banco Nazionale in Argentina in 2006 strengthened our existing business. 2007 has been a year of integrating these operations. It is a testimony to the strength of our Latin American businesses that we have been able to grow profits by 26 per cent to over US\$2 billion while investing in the integration, and despite the increase in loan impairment charges in Mexico as our loan portfolio began to mature.

A people business

It is people, of course, who define an organisation; and any business's success is dependent on the calibre of its staff. 2007 was a demanding year in many respects and it is testament to the talent and professionalism of my 330,000 colleagues around the world that HSBC successfully met its challenges and excelled in so many areas. I would like to take this opportunity to extend my personal thanks to my colleagues – their commitment and expertise have greatly benefited the Group and our shareholders.

Measuring the results of our strategy

Today we are publishing, for the first time, the key metrics which we will use to measure our performance in future. These include a number of measures that cover financial performance, customer recommendation and employee engagement.

In financial terms we are aiming for a return on equity in a range over the investment cycle of 15-19 per cent; a cost efficiency ratio in the range of 48-52 per cent; Tier 1 capital under the Basel II framework of 7.5 -9.0 per cent; and total shareholder return in the top half of that achieved by our peers.

Financial measures are important but not sufficient: it is our people and our relationship with customers that will drive our business and ultimately determine our success. For the first time, in 2007, 290,000 HSBC colleagues completed our new global people survey, allowing us to benchmark ourselves and, over time, raise our game. Similarly, we have established customer engagement metrics which enable us to measure and improve our service to them. We have set ourselves challenging targets to

increase both employee and customer engagement. They will help us build on our position as the world's number one global banking brand.

Changes to your Board

Independent oversight of our company and of the execution of strategy is the responsibility of one of the most experienced and international Boards in the world. I am delighted that we will benefit from international business leaders of the calibre of José Luis Durán and Sam Laidlaw, who joined the Board as independent non-executive Directors on 1 January 2008. We also welcome two other global business leaders, Safra Catz and Narayana

Murthy, who will join as independent non-executive Directors on 1 May 2008.

The Board will be further strengthened by the appointment of three executive directors: Vincent Cheng, effective 1 February 2008; and Sandy Flockhart and Stuart Gulliver, who will join the Board, effective 1 May 2008. These are three of our most talented and experienced executives - all emerging market specialists.

Baroness Dunn, Sir Brian Moffat and Lord Butler will retire as non-executive Directors at HSBC's Annual General Meeting on 30 May 2008 and will not seek re-election. I should like to pay tribute to their tremendous contribution to HSBC. We have been privileged to enjoy their counsel and stewardship for so many years.

HSBC's core strength in uncertain times

The outlook for the rest of 2008 is uncertain. The economic slowdown and the credit outlook in the US may well get worse before they get better. With significant parts of the international financial system in developed markets still in difficulty, HSBC's emphasis on faster growing emerging markets means that we are better positioned than many of our competitors.

Emerging markets have only partly decoupled from the US. Hence, while these economies are exhibiting more domestic momentum, they will not be entirely immune from the impact of a US slowdown. However, the major long-term trends are still intact. Emerging markets will continue to outperform mature economies; and world growth, even in this year of relative weakness for the US economy, will be reasonable - albeit slower than in 2007. Meanwhile, trade and investment patterns will continue to evolve to reflect a more interconnected world, notwithstanding some signs of protectionist sentiment in several key mature markets. In particular, we will see further strategic investments

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from emerging markets into mature markets, as well as into other emerging markets, a trend from which we are well placed to benefit.

2008 is likely to be a year of caution in the financial sector until liquidity, transparency and the proper pricing of risk return to financial markets. We expect to be able to improve margins on the use of our capital and we will continue to invest in building market presence at a time when others with weaker capital positions are constrained.

The fundamentals of HSBC are very strong. The deleveraging of the financial system clearly plays to HSBC's strengths, given our conservative balance sheet and international presence. There can be few banks in the world that are better positioned to withstand market turbulence and grasp strategic opportunities. We will continue to focus HSBC on the parts of the global economy that promise the best prospects for higher growth over the long term. We will continue to invest for profitable growth in line with our strategy, and we will do so while maintaining HSBC's financial strength, which is at the heart of our success.

S K Green, *Group Chairman*
3 March 2008

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Principal activities

HSBC is one of the largest banking and financial services organisation in the world, with a market capitalisation of US\$198 billion at 31 December 2007.

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 10,000 properties in 83 countries and territories in five geographical regions: Europe; Hong Kong; Rest of Asia-Pacific, including the Middle East and Africa; North America and Latin America. 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 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 principal acquisitions made during the year are described on page 415. There were no significant disposals.

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 key trends which are shaping the global economy. In particular, HSBC recognises that, over the long-term, emerging markets are growing faster than developed economies, world trade is expanding at a greater rate than GDP and life expectancy is lengthening everywhere. Against this backdrop, 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 established a longstanding presence in many countries. This local knowledge and international breadth is supported by a substantial financial capability founded on balance sheet strength.

HSBC is, therefore, reshaping its business by investing primarily in the faster growing emerging markets and, in developed markets, focusing on businesses which have international connectivity. Central to these activities is the maintenance of HSBC's financial strength and continued investment in the business.

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 emerging markets connectivity is crucial – Global Banking and Markets, and Private Banking;
- businesses with local customers where efficiency can be enhanced through global scale – the small business segment of Commercial Banking and the mass affluent segment of Personal Financial Services; and
- products where global scale is possible through building efficiency, expertise and brand – global product platforms such as cards and direct banking.

The means of executing the strategy, and further integrating the company, are clear:

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

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- efficiency will be enhanced by taking full advantage of local, regional and global economies of scale in particular by adopting a common systems architecture; and
- appropriate objectives and incentives will be adopted to motivate and reward staff for being fully engaged in delivering the strategy.

Key performance indicators

The Board of Directors and the Group Management Board monitors 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's financial performance has shown a sustained improvement in the period since the award date. In determining this, the Remuneration Committee takes into account HSBC's financial performance with regard to the financial key performance indicators (KPIs) described below. For awards made since 2005, the financial KPIs are

compared with the same group of 28 comparator banks as for the total shareholder return (TSR) performance condition.

Financial KPIs

To support the Group's strategy and ensure that HSBC's performance can be monitored, management utilises a number of financial KPIs. The table below presents these KPIs for the period from 2004 to 2007. At a business level, the KPIs are complemented by a range of benchmarks which are relevant to the planning process and to reviewing business performance.

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

Financial KPIs – trend analysis

	2007 %	2006 %	2005 %	2004 ¹⁰ %
Revenue growth ¹	20.8	13.4	12.2	□
Revenue mix ²				
Net interest income	47.8	52.8	54.4	60.6
Net fee income	27.9	26.3	25.1	25.2
Other income ³	24.3	20.9	20.5	14.2
Cost efficiency ⁴	49.4	51.3	51.2	51.6
Credit performance as measured by risk adjusted margin ⁵	6.0	6.3	6.3	6.8
Return on average invested capital ⁶	15.3	14.9	15.9	15.0
Dividends per share growth ⁷	11.1	11.0	10.6	10.0
Earnings per ordinary share ⁸ (US\$)	1.65	1.40	1.36	1.18

Return on average total shareholders' equity	15.9	15.7	16.8	16.3
	Over 1 year	Over 3 years	Over 5 years	
Total shareholder return				
HSBC TSR	95.6	111.3	158.8	
Benchmarks:				
□ FTSE 100	107.4	148.4	194.6	
□ MSCI World	108.1	140.8	182.0	

- 1 *The percentage increase in net operating income before loan impairment and other credit risk charges since the previous year.*
- 2 *As a percentage of net operating income before loan impairment charges and other credit risk provisions.*
- 3 *Other income comprises net operating income before loan impairment charges and other credit risk provisions less net interest income and net fee income.*
- 4 *Total operating expenses divided by net operating income before loan impairment and other credit risk charges.*
- 5 *Net operating income divided by average risk-weighted assets.*
- 6 *Profit attributable to ordinary shareholders divided by average invested capital.*
- 7 *The percentage increase in dividends per share since the previous year, based on the dividends paid in respect of the year to which the dividend relates.*
- 8 *Basic earnings per ordinary share is defined in Note 13 on the Financial Statements.*
- 9 *The return on average total shareholders' equity is defined as profit attributable to shareholders of the parent company divided by the average total shareholders' equity.*
- 10 *Presentational changes introduced under IFRSs on 1 January 2005 distort comparison of 2004 data with succeeding years.*

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KPIs

Revenue growth provides an important guide to the Group's success in generating business. In 2007, total revenue grew by 20.8 per cent to US\$79.0 billion, 13.5 per cent on an underlying basis, reflecting HSBC's expansion into new products and markets, improved brand recognition and refinements in segmentation to better meet customer needs. The trend maintained the strong performance in 2006 when the underlying increase was 10.5 per cent. Higher revenue was largely driven by balance sheet growth and strong contributions from faster-growing economies. Fair value gains also helped revenue growth. These gains were primarily driven by a widening of credit spreads on debt issued by HSBC Holdings and its subsidiaries and designated at fair value. The movements will reverse over the life of the debt unless it is repaid before its contractual maturity.

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 loan facilities. This understanding assists management in making business investment decisions. Comparison of the revenue mix since 2005 shows a clear trend of net fee income increasing at a faster rate than net interest income. The percentage of revenue attributable to net interest income fell from 52.8 per cent in 2006 to 47.8 per cent in 2007. Net fee income grew by 1.6 percentage points to 27.9 per cent.

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. The cost efficiency ratio for 2007 improved over the previous two years notwithstanding the continued investment in HSBC's businesses, particularly in emerging markets, and in improving the Group's distribution and technology platforms.

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. The ratio for 2007 was 6.0 per cent, showing a decrease of 0.3 percentage points over 2006. The marginal decrease arose from the significant credit losses in the US, partly offset by the increase in income mainly generated from the faster-growing economies.

Return on average invested capital measures the return on the capital investment made in the business, enabling management to benchmark HSBC against competitors. In 2007, the ratio of 15.3 per cent was 0.4 percentage points higher than that reported in 2006. This increase reflected the fact that profitability grew faster than the capital utilised in generating the profit. The main drivers were the higher income generated, mainly in the faster-growing economies, which was not consumptive of capital, and the fair value adjustment on the widening of credit spreads on debt issued by HSBC Holdings and its subsidiaries. Dilution gains of US\$1.1 billion made on investments in HSBC's associates also made a positive contribution towards the return on average invested capital ratio.

HSBC aims to deliver sustained **dividend per share growth** for its shareholders. The dividend growth for 2007, which is based on the year to which the dividends relate (rather than when they were paid), amounts to 11.1 per cent, a marginal increase of 0.1 percentage points over 2006. This basis differs from the disclosure in the five-year comparison on page 3. HSBC has delivered a compound rate of increase in dividends of 11.2 per cent per annum over the past five years.

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 325. EPS for 2007 was US\$1.65, an increase of 17.9 per cent on 2006. This

demonstrated the benefit of diversified earnings as the losses in the US consumer finance business were more than compensated for by strong growth in other markets and products. In 2006, EPS grew by 2.9 per cent over that reported in 2005.

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 2007, the ratio was 15.9 per cent or 0.2 percentage points higher than in 2006. This is in line with management's target of achieving a range of between 15 and 19 per cent.

Total shareholder return (TSR) 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.

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In calculating TSR, dividend income is assumed to be invested in the underlying shares. 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 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 reflect HSBC's range and breadth of activities. The TSR levels at the end of 2007 were 95.6, 111.3, and 158.8 over one, three and five years respectively. HSBC's TSR over all above mentioned periods has underperformed the benchmark. This is attributed largely to the impact on the share price of the current weakness in the US sub-prime mortgage business and investor preference over this time for companies with smaller market values, particularly those for which there is the possibility of participating in domestic or regional consolidation.

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 currently reported internally within HSBC on a local basis.

Employee engagement

Employee engagement is a measure of employees' emotional and rational attachment to HSBC.

In 2007, HSBC conducted its first Global People Survey. This comprised questions designed to measure employee engagement levels consistently across the Group. The survey covers HSBC's entire permanent global workforce, and responses were received from almost 290,000 employees, a response rate of 88 per cent.

The overall employee engagement index score was 60 per cent. The 2008 target is 62 per cent. Survey questions were grouped into twelve dimensions. Employees rated HSBC above the external global norms in all these dimensions. In two dimensions, reputation and corporate responsibility, employees rated HSBC as achieving the external best in class norm. The survey results have been shared with all employees and action plans are being developed at all levels of the organisation.

Brand perception

The score for brand perception is set by data from surveys that are conducted by accredited, independent, third party organisations. A weighted score card is used to produce an overall score on a 100 point scale which is then benchmarked against HSBC's main competitors. The scores from each market are weighted according to the risk adjusted revenues earned in that market to obtain the overall company score.

The 2007 brand scores for Personal Financial Services and Commercial Banking were ahead of the competitor averages by 6 and 7 points, respectively, on a 100 point scale. The 2008 brand perception target is to increase the gap to 9 points and 8 points, respectively.

Customer satisfaction

HSBC has regularly conducted customer satisfaction surveys in its main markets over many years. HSBC now uses a consistent measure of customer recommendation to gauge customer satisfaction with the services provided by the Group's Personal Financial Services business. This survey is also conducted by accredited, independent, third party organisations and the resulting recommendation scores are benchmarked against competitors.

The 2007 customer recommendation score for Personal Financial Services was ahead of the competitor average by 1 point on a 100 point scale. The 2008 target is to increase that gap to 2.5 points.

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 is a reflection of the increasing usage of IT in each of the delivery channels used to service customers. Its aim is to manage the rate of increase in customer transaction costs effectively and ensure that customer growth is enabled in the appropriate channels. The transition of customer transactions from labour intensive (branch, call centre and others) to automated (credit card, internet, self-service and other e-channels) is occurring. The following chart shows the 2005, 2006 and 2007 volumes per delivery channel:

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KPIs / Reconciliation of reported and underlying profit before tax

Customer transactions

The call centre, internet and self-service transaction numbers for 2006 have been restated to align them with the definition of customer transactions adopted in 2007.

Percentage of IT services meeting or exceeding targets

HSBC's IT function establishes with its end-users agreed service levels for systems performance, such as systems running 99.9 per cent of the time and credit card authorisations within two seconds, and monitors the achievement of each of these commitments. The following chart reflects the percentage of IT services meeting and/or exceeding the agreed service targets. Overall results in Europe, Hong Kong and Latin America were each affected by a single month's service issue, which skewed a trend of flat or improving service performance.

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, eliminating the effects of Group currency translation gains and losses, acquisitions and disposals and gains from the dilution of the Group's interests in associates, which distort the year-on-year comparison. HSBC refers to this as its underlying performance.

The tables below show the underlying performance of HSBC for the year ended 31 December 2007 compared with the year ended 31 December 2006. Comparative information comparing the years ended 31 December 2006 and 2005 is also set out below. Equivalent tables are provided for each of HSBC's customer groups and geographical segments in their respective sections below.

The main differences between HSBC's reported and underlying financial performances were:

- Foreign currency translation differences, mainly due to the weakening of the US dollar, most significantly in Europe due to the size of HSBC's operations in the UK. The Group's profit before tax for 2007 compared with 2006 increased by 10 per cent, of which the effect of the change in foreign currency translation rates accounted for 4 percentage points. The equivalents for 2006 compared with 2005 were 5 per cent and 1 per cent, respectively.
- There were a number of acquisitions and disposals that affected both comparisons. The most significant were the acquisitions of Metris Companies Inc. (Metris) in North America in December 2005; in Latin America, the Argentine operations of Banca Nazionale del Lavoro SpA (Banca Nazionale) in May 2006 and Grupo Banistmo (now HSBC Bank Panama) in November 2006; and HSBC's partner's share in life insurer, Erisa S.A., and property and casualty insurer, Erisa I.A.R.D. (together now renamed HSBC Assurances) in France in March 2007; and the deemed disposals of the stakes in Ping An Insurance (Group) Company of China, Limited (Ping An Insurance), Bank of Communications Limited (Bank of Communications) and Industrial Bank Co. Limited (Industrial Bank), as a consequence of their making share offerings on the domestic A share market in mainland China.

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Year ended 31 December 2007 compared with year ended 31 December 2006

HSBC	2006	Currency translation ¹ US\$m	2006	Acquisitions, disposals and dilution gains ² US\$m	Underlying change US\$m	2007	Reported change %	Underlying change %
	as reported US\$m		at 2007 exchange rates US\$m			as reported US\$m		
Net interest income	34,486	1,086	35,572	791	1,432	37,795	10	4
Net fee income	17,182	750	17,932	6	4,064	22,002	28	23
Other income ³	13,698	733	14,431	1,060	3,705	19,196	40	26
Net operating income⁴	65,366	2,569	67,935	1,857	9,201	78,993	21	14
Loan impairment charges and other credit risk provisions	(10,573)	(243)	(10,816)	(133)	(6,293)	(17,242)	(63)	(58)
Net operating income	54,793	2,326	57,119	1,724	2,908	61,751	13	5
Operating expenses	(33,553)	(1,536)	(35,089)	(395)	(3,558)	(39,042)	(16)	(10)
Operating profit	21,240	790	22,030	1,329	(650)	22,709	7	(3)
Income from associates	846	20	866	(41)	678	1,503	78	78
Profit before tax	22,086	810	22,896	1,288	28	24,212	10	

Year ended 31 December 2006 compared with year ended 31 December 2005

HSBC	2005	Currency translation ¹ US\$m	2005	Acqui- sitions and disposals ² US\$m	Underlying change US\$m	2006	Reported change %	Underlying change %
	as reported US\$m		at 2006 exchange rates US\$m			as reported US\$m		
Net interest income	31,334	263	31,597	605	2,284	34,486	10	7
Net fee income	14,456	159	14,615	263	2,304	17,182	19	16
	11,847	273	12,120	27	1,551	13,698	16	13

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Other income ³								
Net operating income ⁴	57,637	695	58,332	895	6,139	65,366	13	11
Loan impairment charges and other credit risk provisions	(7,801)	(88)	(7,889)	(309)	(2,375)	(10,573)	(36)	(30)
Net operating income	49,836	607	50,443	586	3,764	54,793	10	8
Operating expenses	(29,514)	(392)	(29,906)	(383)	(3,264)	(33,553)	(14)	(11)
Operating profit	20,322	215	20,537	203	500	21,240	5	2
Income from associates	644	10	654	144	48	846	31	7
Profit before tax	20,966	225	21,191	347	548	22,086	5	3

For footnotes, see page 130.

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HSBC HOLDINGS PLC

Report of the Directors: Business Review (continued)[Customer groups](#)>[Summary](#)>[Business highlights](#)**Customer groups and global businesses**

Summary

HSBC manages its business through two customer groups, Personal Financial Services and Commercial Banking, and two global businesses, Global Banking and Markets (previously Corporate, Investment Banking and Markets), and Private Banking.

Personal Financial Services incorporates the Group's consumer finance businesses, reflecting their increasing integration within mainstream financial services around the world. The largest of these is HSBC Finance Corporation (HSBC Finance), one of the leading consumer finance companies in the US.

Profit before tax

	Year ended 31 December					
	2007		2006		2005	
	US\$m	%	US\$m	%	US\$m	%
Personal Financial Services	5,900	24.4	9,457	42.8	9,904	47.2
Commercial Banking	7,145	29.5	5,997	27.2	4,961	23.7
Global Banking and Markets	6,121	25.3	5,806	26.3	5,163	24.6
Private Banking	1,511	6.2	1,214	5.5	912	4.4
Other ¹	3,535	14.6	(388)	(1.8)	26	0.1
	24,212	100.0	22,086	100.0	20,966	100.0

¹ [Other] includes gains arising from dilution of interests in associates of US\$1,092 million (2006 and 2005: nil) and fair value gains of US\$2,893 million (2006: US\$81 million expense; 2005: US\$406 million income) on HSBC's own debt designated at fair value. The remainder of the Group's gain on own debt is included in Global Banking and Markets.

Total assets

	At 31 December			
	2007		2006	
	US\$m	%	US\$m	%
Personal Financial Services	588,473	25.0	546,568	29.4

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Commercial Banking	261,893	11.1	213,450	11.5
Global Banking and Markets	1,375,240	58.4	994,436	53.4
Private Banking	88,510	3.8	73,026	3.9
Other	40,150	1.7	33,278	1.8
	2,354,266	100.0	1,860,758	100.0

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 head office 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.

[Back to Contents](#)**Personal Financial Services**

Profit before tax

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
Net interest income	29,069	26,076	23,351
Net fee income	11,742	8,762	7,313
Trading income excluding net interest income	38	391	360
Net interest income on trading activities	140	220	214
Net trading income ⁵	178	611	574
Net income from financial instruments designated at fair value	1,333	739	574
Gains less losses from financial investments	351	78	19
Dividend income	55	31	16
Net earned insurance premiums	8,271	5,130	4,864
Other operating income	387	782	729
Total operating income	51,386	42,209	37,440
Net insurance claims ⁶	(8,147)	(4,365)	(3,716)
Net operating income⁴	43,239	37,844	33,724
Loan impairment charges and other credit risk provisions	(16,172)	(9,949)	(7,537)
Net operating income	27,067	27,895	26,187
Total operating expenses	(21,757)	(18,818)	(16,427)
Operating profit	5,310	9,077	9,760
Share of profit in associates and joint ventures	590	380	144
Profit before tax	5,900	9,457	9,904
By geographical region			
Europe	1,581	1,909	1,932
Hong Kong	4,212	2,880	2,628
Rest of Asia-Pacific	760	477	377
North America	(1,546)	3,391	4,181
Latin America	893	800	786
	5,900	9,457	9,904
	%	%	%
Share of HSBC's profit before tax	24.4	42.8	47.2
Cost efficiency ratio	50.3	49.7	48.7
Balance sheet data ⁷			
	US\$m	US\$m	US\$m
Loans and advances to customers (net)	464,726	448,545	398,884
Total assets	588,473	546,568	484,314
Customer accounts	450,071	388,468	321,240

For footnotes, see page 130.

Strategic direction

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HSBC's strategic direction in Personal Financial Services is to use its global scale and local knowledge to grow profitably in selected markets. The strategy focuses on growth in:

- markets where HSBC has or can build or acquire scale, particularly in Asia-Pacific, Latin America, Turkey and the Middle East;
- markets where HSBC has scale, such as the UK and Hong Kong;
- HSBC Premier customers, who appreciate the benefits of a bank with strong international connectivity; and
- consumer finance, cards, direct banking and other product families where HSBC has global scale and competitive advantages.

Business highlights in 2007

- Pre-tax profits in Personal Financial Services declined by 38 per cent to US\$5.9 billion in 2007, 41 per cent on an underlying basis. This was due to a US\$6.2 billion increase in loan impairment charges, of which US\$5.2 billion arose in the US, substantially all from the consumer finance business. Excluding US consumer finance, profit before tax increased by 18 per cent, 12 per cent on an underlying basis, driven by exceptionally strong net operating income growth in Asia and, to a lesser extent, Latin America.
- As Asian stock markets grew in value during 2007, HSBC delivered a wider array of products and services to meet demand. The increase in activity was considerable; retail securities transaction volumes in Hong Kong increased by more than 160 per cent and income from investment products in Asia by 150 per cent.
- HSBC Premier (Premier), a global banking and wealth management service for affluent customers, was relaunched in September 2007 with a high-profile advertising campaign. Premier offers a comprehensive and consistent service to customers in 35 markets supported by over 280 international Premier centres. Customer reaction to the relaunch was very positive with a net 340,000 joining the Premier service in 2007, of which more than 50 per cent were new to HSBC. At the end of the year there were more than 2.1 million Premier customers across the Group and gross revenue generated per customer during 2007 averaged in excess of US\$2,000 per year.

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HSBC HOLDINGS PLC

Report of the Directors: Business Review

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Business highlights

- HSBC Direct, the Group's online banking and savings offering launched in the US in 2005, continued to grow strongly in 2007. Now also established in Taiwan, South Korea and Canada, HSBC Direct will be introduced into further markets in 2008. In the US, deposits reached US\$11.5 billion from over 620,000 customers, an increase of 60 and 80 per cent, respectively, since the end of 2006. In Asia, over 240,000 customers had deposited US\$1.2 billion by the end of 2007. Additional services were introduced in South Korea in October, including online overdrafts and time deposits. The most recent launch of HSBC Direct was in Canada in June 2007, with an enhanced local online savings account. 45,000 customers, three quarters of whom were new to HSBC, had deposited over US\$800 million by the end of the year.
- The consequences of the downturn in the US housing market, which began in 2006 and accelerated during 2007, continued to affect HSBC's business in North America. It is now clear that the US is experiencing one of the deepest housing market corrections since the Second World War, and the effects have spread beyond their origins in the sub-prime mortgage sector to the wider economy. Restricted refinancing opportunities in a market of falling house prices, negligible investor demand for non-prime asset-backed securities and the tightening of underwriting criteria by lenders will continue to delay any recovery.
- In 2006, HSBC was one of the first lenders in North America to identify a problem in the US mortgage sector. Consequently, in the second half of 2006, HSBC began to contact customers who were facing increased payments on their adjustable-rate mortgages, tighten underwriting criteria and, as credit conditions in the US deteriorated further in 2007, HSBC took the decision to cease correspondent mortgage acquisitions and close Decision One Mortgage Corporation (Decision One), its wholesale business. The size and value of the mortgage services portfolio which encompasses both the wholesale and correspondent businesses, is now decreasing. Weaker credit conditions also affected the consumer lending business and, in the second half of 2007, HSBC stopped underwriting certain products and reduced the branch network to better align it with anticipated demand.
- In 2007, HSBC announced a strategy to accelerate growth in the Group's insurance businesses. The HSBC Insurance brand was launched along with several insurance initiatives across Asia; these are discussed below.
- HSBC's cards in force globally exceeded 120 million at the end of 2007, an increase of 6 per cent. 26 per cent were in emerging markets compared with 20 per cent in 2006, reflecting HSBC's strategic focus there. Around three quarters of HSBC's cards in force are now on a single global system, part of the One HSBC suite of common Group IT systems.
- HSBC continued to expand its consumer finance business in Asia. In India, the Group opened an additional 18 consumer finance branches and loan centres, more than doubling customer numbers. In Indonesia, HSBC opened 36 new consumer finance centres in 2007, taking the total to 64.

Europe

- In the UK, HSBC invested significantly in its distribution network to meet changing customer demands for service. 52 new-style branches were either opened or refurbished in a programme which included both the relocation of branches and the opening of new sites across the country. 25 per cent of all face-to-face customer contact occurred at these new-style branches. This was supported by a significant investment in self-service devices.
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HSBC's focus on innovative competitive liability products, together with consumer confidence in the strength of the HSBC brand, led to a 15 per cent rise in UK average savings balances in 2007.

- In March 2007, HSBC acquired its partner's share of insurer, HSBC Assurances, in France. Integration began in the second half of the year, and there was early evidence of good progress. Sales of life-wrapped investment products increased by 9 per cent year on year, outperforming the market.
- In Turkey, HSBC opened 45 new branches, taking the total to 195. Strong organic growth was driven by excellent customer acquisition, with new customers rising by over 600,000. Encouragingly, the cross-sell ratio continued to improve, driven by a systematic after sale follow-up process.

Hong Kong

- Personal Financial Services had an outstanding year in Hong Kong, with pre-tax profits rising

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by 46 per cent. HSBC provided its customers with an array of products and services, and with the local stock exchange performing strongly in 2007, fee income from investment products grew by 144 per cent and securities turnover by 167 per cent.

- Insurance and retirement products were also a significant driver of growth in Hong Kong. HSBC launched a number of new products during the year and became the leading provider of single-premium life policies.
- As the popularity of internet banking continued in Hong Kong, the proportion of all transactions that were conducted outside the branch network in 2007 was 96 per cent.
- HSBC consolidated its position as the largest credit card issuer in Hong Kong. Cards in force rose by 6 per cent to 4.9 million.

Rest of Asia-Pacific

- In April 2007, HSBC was one of four foreign banks to incorporate in mainland China. This allowed HSBC to start providing a full range of retail banking products, including local currency services to domestic individuals, paving the way for Personal Financial Services to become an increasingly important part of HSBC's business in mainland China.
- HSBC nearly doubled its branch network in mainland China during 2007. The new outlets also included the first ever rural branch opened by a foreign bank. At the end of the year HSBC had more than 80 outlets in mainland China.
- During 2007, HSBC announced several insurance initiatives in India, Vietnam, Taiwan, mainland China, South Korea and the Middle East. HSBC agreed to form a joint venture with two local banks in India, and it entered into an agreement to acquire almost 50 per cent of Hana Life in South Korea. HSBC also acquired 10 per cent of Bao Viet, a leading insurance company in Vietnam. HSBC launched insurance operations in Taiwan and an Islamic insurance business in the Middle East.
- HSBC launched an online savings product in the United Arab Emirates (UAE) at the end of the first quarter of 2007. By the end of the year, almost 10,000 accounts had been opened and more than US\$500 million of deposits placed.

North America

- HSBC continued to address the problems in the US sub-prime mortgage market by contacting, throughout 2007, customers facing increased payments on adjustable-rate mortgages. Since inception of this programme in 2006, HSBC has contacted over 41,000 customers and modified 10,300 loans with a value of US\$1.6 billion. The Group reduced the mortgage services portfolio by US\$13.3 billion in 2007, or 27 per cent, to US\$36.2 billion.
- HSBC Insurance launched a US direct channel at the end of 2006, offering term life insurance directly to consumers, which increased the Group's market share to 7 per cent of annualised premiums.
- HSBC Direct continued to be an effective alternative channel for gathering deposits and reaching new customers, with more than 70 per cent resident outside New York State. By the end of the year, HSBC Direct in the US had attracted US\$11.5 billion of deposits. During 2007, two new complementary products were launched, certificates of deposit and an online payment account.
- The US retail bank opened 26 branches in 2007, taking the total to 465, of which 17 per cent are now outside the bank's original geographic base. The new branches helped aid the growth of Premier in California, Florida and Connecticut.

Latin America

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- HSBC continued to integrate HSBC Bank Panama. Its acquisition in 2006 provided HSBC with access to a market of 83 million people across Central America and northern South America. Investment in re-branding the acquired branch network has begun.
- A buoyant market, combined with attentive customer service and an expanded network in Brazil, helped HSBC gain market share and scale in core products. For example, credit cards in force rose by 28 per cent and, in HSBC Pension Funds, contributions grew by 39 per cent compared with the market average of 23 per cent, positioning HSBC among the top six in the market.

Tu Cuenta, HSBC's packaged account in Mexico, continued to be successful with 1.3 million accounts at the end of 2007, a rise of 29 per cent. Additionally, HSBC increased its market share of credit cards in Mexico by 3.5 percentage points to 10 per cent.

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HSBC HOLDINGS PLC

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Business highlights

Reconciliation of reported and underlying profit before tax

Year ended 31 December 2007 compared with year ended 31 December 2006

Personal Financial Services	2006 as reported US\$m	Currency translation¹ US\$m	2006 at 2007 exchange rates US\$m	Acquisitions, disposals and dilution gains² US\$m	Underlying change US\$m	2007as reported US\$m	Reported change %	Underly cha
Net interest income	26,076	746	26,822	650	1,597	29,069	11	
Net fee income	8,762	322	9,084	(24)	2,682	11,742	34	
Other income ³	3,006	87	3,093	(91)	(574)	2,428	(19)	
Net operating income⁴	37,844	1,155	38,999	535	3,705	43,239	14	
Loan impairment charges and other credit risk provisions	(9,949)	(205)	(10,154)	(72)	(5,946)	(16,172)	(63)	
Net operating income	27,895	950	28,845	463	(2,241)	27,067	(3)	
Operating expenses	(18,818)	(753)	(19,571)	(283)	(1,903)	(21,757)	(16)	
Operating profit	9,077	197	9,274	180	(4,144)	5,310	(42)	
Income from associates	380	13	393	6	191	590	55	
Profit before tax	9,457	210	9,667	186	(3,953)	5,900	(38)	
By geographical region								
Europe	1,909	172	2,081	144	(644)	1,581	(17)	
Hong Kong	2,880	(12)	2,868	□	1,344	4,212	46	
Rest of Asia-Pacific	477	26	503	□	257	760	59	
	3,391	6	3,397	(6)	(4,937)	(1,546)	(146)	

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North America								
Latin America	800	18	818	48	27	893	12	
	9,457	210	9,667	186	(3,953)	5,900	(38)	

Year ended 31 December 2006 compared with year ended 31 December 2005

	2005 as reported	Currency translation ¹	2005 at 2006 exchange rates	Acqui- sitions and disposals ²	Underlying change	2006as reported	Reported change	Underlying change
Personal Financial Services	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	23,351	252	23,603	560	1,913	26,076	12	8
Net fee income	7,313	78	7,391	247	1,124	8,762	20	15
Other income ³	3,060	15	3,075	25	(94)	3,006	(2)	(3)
Net operating income ⁴	33,724	345	34,069	832	2,943	37,844	12	9
Loan impairment charges and other credit risk provisions	(7,537)	(80)	(7,617)	(301)	(2,031)	(9,949)	(32)	(27)
Net operating income	26,187	265	26,452	531	912	27,895	7	3
Operating expenses	(16,427)	(229)	(16,656)	(347)	(1,815)	(18,818)	(15)	(11)
Operating profit	9,760	36	9,796	184	(903)	9,077	(7)	(9)
Income from associates	144	1	145	157	78	380	164	54
Profit before tax	9,904	37	9,941	341	(825)	9,457	(5)	(8)
By geographical region								
Europe	1,932	24	1,956	(6)	(41)	1,909	(1)	(2)
Hong Kong	2,628	7	2,635	□	245	2,880	10	9
Rest of Asia-Pacific	377	□	377	159	(59)	477	27	(16)
North America	4,181	3	4,184	184	(977)	3,391	(19)	(23)

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Latin America	786	3	789	4	7	800	2	1
	<u>9,904</u>	<u>37</u>	<u>9,941</u>	<u>341</u>	<u>(825)</u>	<u>9,457</u>	<u>(5)</u>	<u>(8)</u>

For
footnotes,
see page 130.

[Back to Contents](#)**Commercial Banking**

Profit before tax

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
Net interest income	9,055	7,514	6,310
Net fee income	3,972	3,207	2,876
Trading income excluding net interest income	265	204	150
Net interest income/ (expense) on trading activities	31	20	(3)
Net trading income ⁵	296	224	147
Net income/(expense) from financial instruments designated at fair value	22	(22)	(12)
Gains less losses from financial investments	90	44	9
Dividend income	8	6	9
Net earned insurance premiums	733	258	236
Other operating income	165	250	327
Total operating income	14,341	11,481	9,902
Net insurance claims ⁶	(391)	(96)	(118)
Net operating income⁴	13,950	11,385	9,784
Loan impairment charges and other credit risk provisions	(1,007)	(697)	(547)
Net operating income	12,943	10,688	9,237
Total operating expenses	(6,252)	(4,979)	(4,453)
Operating profit	6,691	5,709	4,784
Share of profit in associates and joint ventures	454	288	177
Profit before tax	7,145	5,997	4,961
By geographical region			
Europe	2,516	2,234	1,939
Hong Kong	1,619	1,321	955
Rest of Asia-Pacific	1,350	1,034	818
North America	920	957	892
Latin America	740	451	357
	7,145	5,997	4,961
	%	%	%
Share of HSBC's profit before tax	29.5	27.2	23.7
Cost efficiency ratio	44.8	43.7	45.5

Balance sheet data⁷

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	US\$m	US\$m	US\$m
Loans and advances to customers (net)	220,068	172,976	142,041
Total assets	261,893	213,450	175,120
Customer accounts	237,987	190,853	148,106

For footnotes, see page 130.

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 support customers' trading and investing across borders; and
- to be the best bank for small businesses in target markets, building global scale and creating efficiencies by sharing best practices, including in marketing and credit scoring, and selectively rolling-out the direct banking model.

Commercial Banking enhances the customer experience through a strong multi-channel approach to customer relationships, leveraging HSBC's IT platforms and operational processing capabilities. Additional value is captured through strong connectivity with each of the other customer groups.

Business highlights in 2007

- Pre-tax profit increased by 19 per cent to US\$7.1 billion, with considerable growth in both net interest income and net fee income. On an underlying basis, pre-tax profit increased by 13 per cent.
- Growth was driven by strong results in Hong Kong (up by 23 per cent on 2006), mainland China (65 per cent), Mexico (69 per cent) and the UAE (29 per cent). As a result, the share of profits from faster-growing economies increased from 47 per cent in 2006 to 52 per cent in 2007.
- Total customer numbers grew faster than in previous years, by 8 per cent to 2.8 million, driven by growth in the small business segment, particularly in Turkey, Mexico, the UAE, the UK and Hong Kong. The rise in customer numbers helped drive an increase of 25 per cent in deposits, particularly in Hong Kong and the Rest of Asia-Pacific region.
- Lending growth of 27 per cent was also robust, while loan impairment charges remained low at less than 0.5 per cent of average assets.
- Notwithstanding the investment which underpinned the substantial expansion in Asia and Latin America, the cost efficiency ratio was broadly stable at 44.8 per cent. The number of full-time equivalent employees in commercial banking grew by 14 per cent to 26,000, including nearly 7,400 relationship managers.

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HSBC HOLDINGS PLC

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Business highlights

- HSBC continued to improve its capacity to meet customers' cross-border business requirements. International Banking Centres covering a further 38 countries and territories were opened, increasing their coverage to 54 countries and nearly all of the customer base. Customer experience was improved with the launch of SmartForms (electronic account opening forms) in 16 countries, the appointment of specialist corporate international teams in the UK and France and the creation of new country desks in mainland China.
- The effect of these initiatives was demonstrated by growth of 125 per cent in the number of successful referrals through the Global Links system, with aggregate transaction values doubling to US\$6 billion.
- HSBC's success in its strategy to be the best bank for small business was recognised with awards in Hong Kong and the UK for the Business Internet Banking (BIB) platform, and HSBC's service quality was recognised with multiple 'Best Partner' awards in Hong Kong and the top ranking for overall satisfaction in the Canadian Federation of Independent Business survey.
- Direct channel capabilities were improved through the upgrade of BIB platforms in Hong Kong and in six countries in the Rest of Asia-Pacific region, and the enhancement of HSBCnet. A total of 800,000 customers are now active users of BIB, an increase of 24 per cent in 2007, while the number of transactions on HSBCnet grew during the year by 157 per cent to 27 million.
- Commercial Banking continued to make progress in meeting customers' insurance needs with product launches in Hong Kong (FlexiCommercial, Privileged Term and Capital Protection Plan) and the UK (Motor Fleet, Professional Indemnity and High Risk Liability). A number of further projects with strategic partners are currently under development for launch in 2008 in other countries, including Brazil, France and Mexico.
- Commercial Banking continued to grow its cross-referrals to and from other customer groups. In the first half of 2007, over 50 per cent of new small business customers in key markets had existing Personal Financial Services relationships. Referrals of Commercial Banking customers to Private Banking resulted in US\$1.8 billion of assets under management.

Sales of Global Banking and Markets products increased strongly, particularly in treasury products which had revenue increases of over 30 per cent on an underlying basis and more than 50 per cent in Asia.

Europe

- Expansion in Europe continued with the broadening of product capabilities and geographical reach. Receivables Finance was launched in four countries and International Banking Centres in a further seven. Investment continued within Central and Eastern Europe, especially in Poland, where HSBC now offers services in six cities. Following receipt of a retail banking licence in Russia in July 2007, HSBC opened offices in two cities in addition to Moscow.

- In Turkey, rapid expansion continued with the opening of a further 29 branches serving small business customers and the ongoing recruitment of experienced relationship managers. This contributed to a 48 per cent rise in customer numbers, particularly in small and micro businesses. A number of investment banking advisory and structured finance transactions were referred to Global Banking and Markets from Commercial Banking's corporate and mid-market business.
- Further segmentation was applied in the UK with the expansion of multicultural banking, including the UK's first dedicated Polish commercial banking unit. Following the realignment of the relationship management and distribution approach in commercial centres, customer satisfaction improved by 8 percentage points.
- In the UK, 25 per cent more start-up businesses chose HSBC for their banking than in 2006 and nearly a quarter of all new small and micro customers chose Business Direct accounts. Improvements in internet banking led to a 30 per cent increase in the number of users and resulted in recognition from independent surveys for both customer usage and functionality.

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Hong Kong

- HSBC's service excellence was recognised by a number of awards, notably "Best Bank" in the *Euromoney* 2007 Awards for Excellence and "Best SME (small and medium-sized enterprise Partner)" by three organisations.
- HSBC built on its longstanding reputation for trade services with the launch of EasyTrade for the small business segment. Other product launches included FlexiInsurance and Green Equipment Financing.
- The number of SME centres expanded from eight to 10, and there was an increase in the number of dedicated SME relationship managers to nearly 100.
- New functionality was added to BIB, such as forward contract booking and cheque status enquiries. The number of active BIB users increased by 43 per cent and the BIB service was recognised with two awards, the "Best Integrated Corporate Site for Asia" from *Global Finance* 2007 World's Best Internet Banks awards, and the "Best SME e-banking" award from *SMB World* magazine.

Rest of Asia-Pacific

- Trade and payments and cash management revenues grew strongly, particularly in the UAE, India and Vietnam, as HSBC positioned itself in growing economies to benefit from the even faster growth of intra-Asian trade flows. The Greater China regional model was advanced by the acquisition of Chailease Credit Services Company Ltd ("Chailease") in Taiwan, which expanded HSBC's receivables finance business and strengthened both domestic and international trade capabilities. The integration of branches from The Chinese Bank Co., Ltd. ("The Chinese Bank") announced in December 2007, is expected to provide HSBC with a presence in every major city in Taiwan, contributing to the strategy for growth across Greater China.
- In the Middle East, new business banking units were established in the UAE, Bahrain, Jordan, Lebanon, Oman and Qatar, contributing to a 30 per cent growth in customers.
- Cross-sales of investment banking products were strong in India and the Middle East, including *sukuk* deals and two initial public offerings ("IPOs"). HSBC Amanah trade products were introduced in Malaysia.

North America

- In the US, HSBC's payments and cash management services won *Euromoney*'s "Best Cash Management in North America" award for the second year running. The appointment of dedicated resources underpinned strong growth in cross-sales of treasury and debt products to Commercial Banking customers.
- Increased customer segmentation and the reorganisation of branch roles in Canada enabled larger mid-market and real estate relationships to be managed centrally. Combined with product enhancements in the payments and cash management arena, such as six new product launches and functionality improvements across HSBCnet and BIB, Commercial Banking grew strongly. For example, fee income from cross-border payments increased by 27 per cent.

Latin America

- International Banking Centres now provide services to all countries in Latin America, with Mexico providing a regional hub for Central America and Brazil for smaller South American countries.

- In Mexico, trade services revenues increased by 33 per cent and the number of customers grew by 123 per cent. The receivables finance product range was expanded and relaunched using Group IT systems.
- In Brazil, sales of products through electronic and telephone channels increased by 95 per cent, as new products were launched and the number of customers using internet banking rose to 117,000. The Segmento Empreendedor product (local BusinessDirect) was launched in Sao Paulo and Curitiba.

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HSBC HOLDINGS PLC

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Business highlights

Reconciliation of reported and underlying profit before tax

Year ended 31 December 2007 compared with year ended 31 December 2006

	2006 as reported	Currency translation ¹	2006 at 2007 exchange rates	Acquisitions, disposals and dilution gains ²	Underlying change	2007as reported	Reported change	Underly cha
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	
Commercial Banking								
Net interest income	7,514	382	7,896	114	1,045	9,055	21	
Net fee income	3,207	189	3,396	17	559	3,972	24	
Other income ³	664	27	691	48	184	923	39	
Net operating income⁴	11,385	598	11,983	179	1,788	13,950	23	
Loan impairment charges and other credit risk provisions	(697)	(47)	(744)	(61)	(202)	(1,007)	(44)	
Net operating income	10,688	551	11,239	118	1,586	12,943	21	
Operating expenses	(4,979)	(291)	(5,270)	(73)	(909)	(6,252)	(26)	
Operating profit	5,709	260	5,969	45	677	6,691	17	
Income from associates	288	9	297	1	156	454	58	
Profit before tax	5,997	269	6,266	46	833	7,145	19	
By geographical region								
Europe	2,234	196	2,430	□	86	2,516	13	
Hong Kong	1,321	(6)	1,315	□	304	1,619	23	
	1,034	29	1,063	□	287	1,350	31	

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Rest of Asia-Pacific							
North America	957	25	982	□	(62)	920	(4)
Latin America	451	25	476	46	218	740	64
	<u>5,997</u>	<u>269</u>	<u>6,266</u>	<u>46</u>	<u>833</u>	<u>7,145</u>	<u>19</u>

Year ended 31 December 2006 compared with year ended 31 December 2005

	2005 as reported	Currency translation ¹	2005 at 2006 exchange rates	Acqui- sitions and disposals ²	Underlying change	2006as reported	Reported change	Underlying change
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	%
Commercial Banking								
Net interest income	6,310	123	6,433	24	1,057	7,514	19	16
Net fee income	2,876	43	2,919	14	274	3,207	12	9
Other income ³	598	(2)	596	10	58	664	11	10
Net operating income ⁴	9,784	164	9,948	48	1,389	11,385	16	14
Loan impairment charges and other credit risk provisions	(547)	(16)	(563)	(7)	(127)	(697)	(27)	(23)
Net operating income	9,237	148	9,385	41	1,262	10,688	16	13
Operating expenses	(4,453)	(80)	(4,533)	(27)	(419)	(4,979)	(12)	(9)
Operating profit	4,784	68	4,852	14	843	5,709	19	17
Income from associates	177	3	180	(6)	114	288	63	63
Profit before tax	4,961	71	5,032	8	957	5,997	21	19
By geographical region								
Europe	1,939	18	1,957	(6)	283	2,234	15	14
Hong Kong	955	(1)	954	□	367	1,321	38	38
Rest of Asia-Pacific	818	7	825	□	209	1,034	26	25
North America	892	30	922	□	35	957	7	4

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Latin America	357	17	374	14	63	451	26	17
	<u>4,961</u>	<u>71</u>	<u>5,032</u>	<u>8</u>	<u>957</u>	<u>5,997</u>	21	19

For footnotes, see page 130.

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Profit before tax

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
Net interest income	4,430	3,168	3,001
Net fee income	4,901	3,718	2,967
Trading income excluding net interest income	3,503	4,890	2,919
Net interest income/ (expense) on trading activities	(236)	(379)	306
Net trading income ⁵	3,267	4,511	3,225
Net income from financial instruments designated at fair value	(164)	20	67
Gains less losses from financial investments	1,313	534	475
Dividend income	222	235	79
Net earned insurance premiums	93	73	76
Other operating income	1,218	1,378	1,621
Total operating income	15,280	13,637	11,511
Net insurance claims ⁶	(70)	(62)	(54)
Net operating income⁴	15,210	13,575	11,457
Loan impairment (charges)/ recoveries and other credit risk provisions	(38)	119	272
Net operating income	15,172	13,694	11,729
Total operating expenses	(9,358)	(7,991)	(6,838)
Operating profit	5,814	5,703	4,891
Share of profit in associates and joint ventures	307	103	272
Profit before tax	6,121	5,806	5,163
By geographical region			
Europe	2,527	2,304	2,114
Hong Kong	1,578	955	922
Rest of Asia-Pacific	2,464	1,649	1,207
North America	(965)	423	573
Latin America	517	475	347
	6,121	5,806	5,163
	%	%	%
Share of HSBC's profit before tax	25.3	26.3	24.6
Cost efficiency ratio	61.5	58.9	59.7

For footnotes, see page 130.

Strategic direction

In 2007, the implementation of the "emerging markets-led and financing-focused" strategy was completed and Corporate, Investment Banking and Markets was renamed Global Banking and Markets. HSBC's strategy is to be a leading wholesale bank by:

– utilising HSBC'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.

Business highlights in 2007

- Pre-tax profit increased by 5 per cent to US\$6.1 billion, despite a total of US\$2.1 billion of write-downs on credit trading, leveraged and acquisition financing positions, and monoline credit exposures resulting from disruption and deterioration in the credit markets. In North America, the mortgage-backed securities operation was closed to new business and was downsized. Strong results were reported across most other businesses with record revenues from foreign exchange, equities, securities services, payments and cash management, and HSBC Global Asset Management. Pre-tax profit in Hong Kong, Rest of Asia-Pacific and Latin America rose by 48 per cent. The rise in operating expenses reflected increased volumes in payments and cash management and securities services. On an underlying basis, pre-tax profits were broadly in line with 2006.
- HSBC's leading position in emerging markets and financing was recognised by various industry awards, including being named "Middle East Mergers and Acquisitions Adviser of the Year" and "Middle East Loan House of the Year" by *Acquisitions Monthly* and *International Financing Review*, respectively. In the *Euromoney* 2007 Awards for Excellence, HSBC was named global "Best Risk Management House", "Best Foreign Exchange House in Asia" and, for the tenth consecutive year "Best Risk Management House in Asia".

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HSBC HOLDINGS PLC

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Business highlights

Management view of total operating income

	Year ended 31 December		
	2007 US\$m	2006 ⁹ US\$m	2005 ⁹ US\$m
Global Markets	5,074	5,533	3,982
Foreign exchange	2,178	1,552	1,233
Credit and Rates	(419)	1,334	947
Structured derivatives	647	874	511
Equities ¹⁰	742	397	336
Securities services	1,926	1,376	955
Global Banking	4,836	3,907	3,437
Financing and capital markets	2,832	2,249	2,179
Payments and cash management	1,632	1,257	907
Other transaction services	372	401	351
Balance sheet management	1,226	713	1,246
HSBC Global Asset Management ¹¹	1,336	1,066	775
Principal Investments	1,253	686	715
Other ¹²	1,555	1,732	1,356
Total operating income	15,280	13,637	11,511

Balance sheet data⁷

Loans and advances to:

□ customers (net)	250,464	210,220	169,435
□ banks (net)	199,506	156,548	106,123
Total assets	1,375,240	994,436	755,056
Customer accounts	299,879	235,965	202,361
Trading assets, financial instruments designated at fair value, and financial investments	674,647	487,943	373,787
Deposits by banks	126,395	92,954	65,853

For footnotes, see page 130.

- In Global Markets, structured derivatives continued to benefit from investment made in technical expertise and systems in previous years, notwithstanding the decline in income from structured credit products. Foreign exchange reported strong growth across all regions. Positive revenue trends reflected higher customer volumes against the backdrop of a weakening US dollar and greater market volatility, particularly in

the second half of 2007. Equities recorded a significant increase especially in Europe and particularly due to HSBC's differentiation in emerging markets products. Securities services benefited from new mandates and increased volumes in higher value products, particularly in Asia, as clients rebalanced their investment portfolios. Assets under custody rose by 30 per cent.

- In Global Banking, the credit market dislocation led to a fair value write-down in respect of loan commitments outstanding when credit spreads widened in the second half of 2007, though robust growth in fees resulting from a greater transaction volume more than offset this. Asset and structured finance also benefited from a small number of significant transactions, while revenues in the capital markets businesses were boosted by greater market activity in Europe and Hong Kong. The continued growth in payments and cash management revenues reflected a rise in deposit balances and higher transaction volumes across most regions.
- HSBC advised on several notable cross-border transactions, including Singapore Telecommunications' US\$758 million acquisition of a 30 per cent stake in Warid Telecom of Pakistan; National Titanium Dioxide of Saudi Arabia's S\$1.2 billion acquisition of Lyondell Chemical's inorganic chemicals business in the US; and Dubai Drydocks' S\$650 million acquisition of Pan-United Marine of Singapore.
- HSBC was lead arranger of US\$9.2 billion of facilities for the acquisition of GE Plastics by Saudi Basic Industries; 2.25 billion for the acquisition of Mölnlycke Health Care by Investor AB; and £3.4 billion for the acquisition of National Grid Wireless by Macquarie.
- In debt capital markets, HSBC ranked first in the Asian local currency bond league table compiled by Bloomberg, first in the sterling bond league table and fifth in the international bond league table.
- The increase in balance sheet management revenues was driven by higher spreads, and arose principally from the recovery in Asia.
- Group Investment Businesses was rebranded as HSBC Global Asset Management following a closer alignment with other businesses within Global Banking and Markets. A rise in income was driven by continuing strong revenue growth from emerging market products across all regions and a notable increase in funds under management. Successes included the development of the global liquidity and multi-manager businesses, established in late 2006 and early 2007, both of which have reported strong inflows of new business. Funds under management rose by 16 per cent to US\$380 billion.
- Principal Investments reported significant gains from a small number of realisations benefiting from higher exit multiples.

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Reconciliation of reported and underlying profit before tax

Year ended 31 December 2007 compared with year ended 31 December 2006

Global Banking and Markets	2006 as reported	Currency translation ¹	2006 at 2007 exchange rates	Acquisitions, disposals and dilution gains ²	Underlying change	2007 as reported	Reported change	Underlying change
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	3,168	175	3,343	25	1,062	4,430	40	
Net fee income	3,718	182	3,900	9	992	4,901	32	
Other income ³	6,689	360	7,049	10	(1,180)	5,879	(12)	
Net operating income⁴	13,575	717	14,292	44	874	15,210	12	
Loan impairment (charges)/recoveries and other credit risk provisions	119	6	125	□	(163)	(38)	(132)	
Net operating income	13,694	723	14,417	44	711	15,172	11	
Operating expenses	(7,991)	(406)	(8,397)	(35)	(926)	(9,358)	(17)	
Operating profit	5,703	317	6,020	9	(215)	5,814	2	
Income from associates	103	(4)	99	2	206	307	198	
Profit before tax	5,806	313	6,119	11	(9)	6,121	5	
By geographical region								
Europe	2,304	202	2,506	□	21	2,527	10	
Hong Kong	955	(1)	954	□	624	1,578	65	
Rest of Asia-Pacific	1,649	67	1,716	□	748	2,464	49	
North America	423	21	444	□	(1,409)	(965)	(328)	
Latin America	475	24	499	11	7	517	9	
	5,806	313	6,119	11	(9)	6,121	5	

Year ended 31 December 2006 compared with year ended 31 December 2005

Global Banking and Markets	2005 as reported	Currency translation ¹	2005 at 2006 exchange rates	Acquisitions and disposals ²	Underlying change	2006 as reported	Reported change	Underlying change
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	%

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Net interest income	3,001	34	3,035	21	112	3,168	6	4
Net fee income	2,967	31	2,998	2	718	3,718	25	24
Other income ³	5,489	108	5,597	3	1,089	6,689	22	19
Net operating income ⁴	11,457	173	11,630	26	1,919	13,575	18	17
Loan impairment recoveries and other credit risk provisions	272	9	281	(1)	(161)	119	(56)	(57)
Net operating income	11,729	182	11,911	25	1,758	13,694	17	15
Operating expenses	(6,838)	(63)	(6,901)	(9)	(1,081)	(7,991)	(17)	(16)
Operating profit	4,891	119	5,010	16	677	5,703	17	14
Income from associates	272	7	279	(4)	(172)	103	(62)	(62)
Profit before tax	5,163	126	5,289	12	505	5,806	12	10
By geographical region								
Europe	2,114	86	2,200	(4)	108	2,304	9	5
Hong Kong	922	2	924	□	31	955	4	3
Rest of Asia-Pacific	1,207	19	1,226	□	423	1,649	37	35
North America	573	14	587	□	(164)	423	(26)	(28)
Latin America	347	5	352	16	107	475	37	30
	5,163	126	5,289	12	505	5,806	12	10

For footnotes, see page 130.

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HSBC HOLDINGS PLC

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*Business highlights***Private Banking**

Profit before tax

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
Net interest income	1,216	1,011	848
Net fee income	1,615	1,323	1,080
Trading income excluding net interest income	525	362	317
Net interest income on trading activities	9	2	□
Net trading income ⁵	534	364	317
Net income/(expense) from financial instruments designated at fair value	(1)	1	(1)
Gains less losses from financial investments	119	166	45
Dividend income	7	5	9
Other operating income	58	61	68
Total operating income	3,548	2,931	2,366
Net insurance claims ⁶	□	□	□
Net operating income⁴	3,548	2,931	2,366
Loan impairment (charges)/recoveries and other credit risk provisions	(14)	(33)	12
Net operating income	3,534	2,898	2,378
Total operating expenses	(2,025)	(1,685)	(1,466)
Operating profit	1,509	1,213	912
Share of profit in associates and joint ventures	2	1	□
Profit before tax	1,511	1,214	912
By geographical region			
Europe	915	805	539
Hong Kong	305	201	190
Rest of Asia-Pacific	92	80	78
North America	174	114	104
Latin America	25	14	1

	1,511	1,214	912
	%	%	%
Share of HSBC's profit before tax	6.2	5.5	4.4
Cost efficiency ratio	57.1	57.5	62.0
	US\$m	US\$m	US\$m
Balance sheet data ⁷			
Loans and advances to customers (net)	43,612	34,297	27,749
Total assets	88,510	73,026	59,827
Customer accounts	106,197	80,303	67,205

For footnotes, see page 130.

Strategic direction

The strategy for Private Banking is to be one of the world's leading international private banks, by providing excellent client service.

- HSBC's global network and brand provides a base from which Private Banking, working in conjunction with HSBC's other customer groups and global businesses, serves the complex international needs of its clients, utilising traditional and innovative ways of managing and preserving the wealth of high net worth individuals while optimising returns.
- Private Banking aims to grow annuity revenue streams through product leadership in areas such as credit, hedge funds, emerging markets, investment advice and estate planning. This will be achieved by attracting, retaining and motivating talented individuals, by close communication with clients and employees and by increasing expenditure targeted on IT, marketing and brand awareness initiatives. Private Banking's onshore business and intra- group partnerships will also be strengthened.

Business highlights in 2007

- Pre-tax profits increased by 24 per cent or 22 per cent on an underlying basis to US\$1.5 billion, primarily due to an outstanding performance in Hong Kong, and strong growth in Switzerland and throughout the Americas.
- Approximately 3,500 inward referrals from other customer groups in HSBC in 2007 resulted in US\$6 billion of net new money. In addition, Global Banking and Markets mandated or completed 34 transactions that originated in Private Banking, on which fees for the Group are expected to be US\$70 million.
- HSBC Private Banking was awarded third best "Global Private Bank" in the *Euromoney* survey, for the third year running.
- Client assets increased by 26 per cent to US\$421.0 billion, of which US\$35.9 billion related to net new money, reflecting strong investment performance and increased marketing expenditure.

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	2007	2006
	US\$bn	US\$bn
At 1 January	333	273
Net new money	36	34
Value change	19	21
Exchange and other	33	5
	<hr/>	<hr/>
At 31 December	421	333
	<hr/>	<hr/>

Client assets by investment class

	2007	2006
	US\$bn	US\$bn
Equities	81	62
Bonds	64	55
Structured products	12	16
Funds	123	83
Cash, fiduciary deposits and other	141	117
	<hr/>	<hr/>
At 31 December	421	333
	<hr/>	<hr/>

- Total client assets, including some non-financial assets held in client trusts, amounted to US\$494.1 billion at 31 December 2007. This represented a 21 per cent increase over the previous year. This measure is equivalent to competitors' assets under management figures.
- In response to client demand, a number of new investment products were launched in 2007 with particular emphasis on private equity in emerging markets. Amanah Investment Solutions, a shariah (Islamic law)-compliant fund, was added to the successful range of multi-manager fund solutions.
- Hedge fund services performed well. HSBC Alternative Investments Ltd successfully launched the HSBC Special Opportunities Fund and earned a number of awards in 2007, including [Hedge Fund of the Year] at the UK Pension Awards, and was shortlisted by the Financial Times as the [Best Client Services] provider.

Europe

- Private Banking further expanded its business in the UK and Ireland with offices established in Edinburgh and Dublin, taking the total number of offices in Private Banking to 93.
- Client assets increased by 19 per cent to US\$258.4 billion, of which US\$20.2 billion related to net new money. This was driven by an accumulation of wealth by entrepreneurs in the region, a private banking franchise in most of the major markets and expertise in Switzerland, which remains a centre of excellence for private wealth management.

Asia

- Private Banking in Asia had an excellent year in 2007 on the back of strong equity markets, wealth creation in the region and continued recruitment of relationship managers. Client assets increased by 38 per cent to US\$93.0 billion, of which US\$12.9 billion related to net new money.

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- Private Banking clients were significant investors in new offerings from HSBC including the HSBC Multi-Alpha China Fund and HSBC Nan Fung China Infrastructure Fund aimed at taking advantage of strong economic growth in mainland China.
- Onshore private banking in mainland China received regulatory approval in December 2007, and was launched in January 2008. The first branches will be opened in Shanghai, Beijing and Guangzhou.
- A savings product with returns linked to the Hong Kong Stock Exchange (the Forward Accumulator) was introduced by HSBC in Asia.

Americas

- HSBC continued to expand and improve its business in North America. In January 2007, Private Banking services were launched in Canada, since when the business has contributed US\$8 million to Private Banking's pre-tax profits. In addition, a new Private Banking office was opened in Washington.
- A strategic decision was made to exit the Wealth and Tax Advisory Services business in order to focus on core Private Banking activities. The management buyout was completed on 31 December 2007.
- The domestic businesses in Brazil and Mexico experienced strong growth as local entrepreneurs launched IPOs and invested in local markets. The acquisition of HSBC Bank Panama facilitated the establishment of Private Banking operations there.
- As a result of new operations in Canada and Panama and client acquisition by the enlarged franchise in the region, client assets increased by 42 per cent to US\$69.6 billion.

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Business highlights

Reconciliation of reported and underlying profit before tax

Year ended 31 December 2007 compared with year ended 31 December 2006

	2006 as reported	Currency translation ¹	2006 at 2007 exchange rates	Acquisitions, disposals and dilution gains ²	Underlying change	2007 as reported	Reported change	Underlying change
Private Banking	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	
Net interest income	1,011	24	1,035	2	179	1,216	20	
Net fee income	1,323	32	1,355	4	256	1,615	22	
Other income ³	597	7	604	1	112	717	20	
Net operating income⁴	2,931	63	2,994	7	547	3,548	21	
Loan impairment charges and other credit risk provisions	(33)	□	(33)	□	19	(14)	58	
Net operating income	2,898	63	2,961	7	566	3,534	22	
Operating expenses	(1,685)	(40)	(1,725)	(4)	(296)	(2,025)	(20)	
Operating profit	1,213	23	1,236	3	270	1,509	24	
Income from associates	1	□	1	□	1	2	100	
Profit before tax	1,214	23	1,237	3	271	1,511	24	
By geographical region								
Europe	805	22	827	□	88	915	14	
Hong Kong	201	□	201	□	104	305	52	
	80	□	80	□	12	92	15	

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Rest of Asia-Pacific								
North America	114	□	114	□	60	174	53	
Latin America	14	1	15	3	7	25	79	
	<u>1,214</u>	<u>23</u>	<u>1,237</u>	<u>3</u>	<u>271</u>	<u>1,511</u>	<u>24</u>	

Year ended 31 December 2006 compared with year ended 31 December 2005

	2005 as reported	Currency translation ¹	2005 at 2006 exchange rates	Acquisitions and disposals ²	Underlying change	2006 as reported	Reported change	Underlying change
Private Banking	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	848	1	849	□	162	1,011	19	19
Net fee income	1,080	4	1,084	□	239	1,323	23	22
Other income ³	438	4	442	□	155	597	36	35
Net operating income ⁴	2,366	9	2,375	□	556	2,931	24	23
Loan impairment recoveries/ (charges) and other credit risk provisions	12	(1)	11	□	(44)	(33)	(375)	(400)
Net operating income	2,378	8	2,386	□	512	2,898	22	22
Operating expenses	(1,466)	(5)	(1,471)	□	(214)	(1,685)	(15)	(15)
Operating profit	912	3	915	□	298	1,213	33	33
Income from associates	□	□	□	□	1	1	□	□
Profit before tax	912	3	915	□	299	1,214	33	33

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By
geographical
region

Europe	539	4	543	□	262	805	49	48
Hong Kong	190	2	192	□	9	201	6	5
Rest of Asia-Pacific	78	(1)	77	□	3	80	3	4
North America	104	(2)	102	□	12	114	10	12
Latin America	1	□	1	□	13	14	1,300	1,300
	<u>912</u>	<u>3</u>	<u>915</u>	<u>□</u>	<u>299</u>	<u>1,214</u>	<u>33</u>	<u>33</u>

For
footnotes,
see page 130.

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Profit before tax

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
Net interest expense	(542)	(625)	(472)
Net fee income/(expense)	(228)	172	220
Trading income/(expense) excluding net interest income	127	(228)	(90)
Net interest income/(expense) on trading activities	(1)	82	(13)
Net trading income/(expense) ⁵	126	(146)	(103)
Net income/(expense) from financial instruments designated at fair value	2,893	(81)	406
Gains less losses from financial investments	83	147	144
Gains arising from dilution of interests in associates	1,092	□	□
Dividend income	32	63	42
Net earned insurance premiums	(21)	207	260
Other operating income	3,523	3,254	2,634
Total operating income	6,958	2,991	3,131
Net insurance claims ⁶	□	(181)	(179)
Net operating income⁴	6,958	2,810	2,952
Loan impairment charges and other credit risk provisions	(11)	(13)	(1)
Net operating income	6,947	2,797	2,951
Total operating expenses	(3,562)	(3,259)	(2,976)
Operating profit/(loss)	3,385	(462)	(25)
Share of profit in joint ventures and associates	150	74	51
Profit/(loss) before tax	3,535	(388)	26
By geographical region			
Europe	1,056	(278)	(168)
Hong Kong	(375)	(175)	(178)
Rest of Asia-Pacific	1,343	287	94
North America	1,508	(217)	165
Latin America	3	(5)	113
	3,535	(388)	26
	%	%	%

Share of HSBC's profit before tax	14.6	(1.8)	0.1
Cost efficiency ratio	51.2	116.0	100.8
Balance sheet data ⁷			
	US\$m	US\$m	US\$m
Loans and advances to customers (net)	2,678	2,095	1,893
Total assets	40,150	33,278	27,653
Customer accounts	2,006	1,245	507

For footnotes, see page 130.

Notes

- For a description of the main items reported under "Other", see footnote 8 on page 130.
- Dilution gains of US\$1.1 billion were recorded in the first half of 2007 following share offerings made by three of HSBC's associates: Ping An Insurance, Bank of Communications and Industrial Bank. Although HSBC's holding in these entities was diluted, its share of the capital raised resulted in a gain. Similarly, dilution gains of US\$11 million and US\$5 million were recorded following share issues made by Financiera Independencia, a Mexican banking associate, and Techcombank in Vietnam, respectively.
- Net income from financial instruments designated at fair value of US\$2.9 billion was recorded in 2007, primarily driven by the widening of credit spreads on debt issued by HSBC Holdings and its subsidiaries in North America and Europe, and designated at fair value. These movements will reverse over the life of the debt unless it is repaid before its contractual maturity.
- In 2006, the results of HSBC Insurance Brokers were reported within Other. This contributed US\$591 million to net operating income before loan impairment charges and US\$363 million to operating expenses. In 2007, these results were reallocated to other customer groups.
- The number of countries using Group Service Centres ("GSCs") increased to 31 following the opening of six new centres in 2007. The GSCs now have 30,000 employees in five countries in Asia. Operating expenses at HSBC Technology Services increased by 16 per cent, due to increased demand for services from other Group entities. Substantially all service provider costs are recharged to the relevant customer groups and revenue is reported under "Other operating income".
- HSBC made a US\$73 million gain following a change in the embedded value of HSBC Assurances, an associate in France, prior to the acquisition of its remaining share capital by HSBC.

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Reconciliation of reported and underlying profit before tax

Year ended 31 December 2007 compared with year ended 31 December 2006

Other	2006 as reported US\$m	Currency translation ¹ US\$m	2006 at 2007 exchange rates US\$m	Acquisitions, disposals and dilution gains ² US\$m	Underlying change US\$m	2007 as reported US\$m	Reported change %	Underlying change %
Net interest expense	(625)	(22)	(647)	□	105	(542)	13	
Net fee income/(expense)	172	25	197	□	(425)	(228)	(233)	
Other income ³	3,263	77	3,340	1,092	3,296	7,728	137	
Net operating income⁴	2,810	80	2,890	1,092	2,976	6,958	148	
Loan impairment charges and other credit risk provisions	(13)	3	(10)	□	(1)	(11)	15	
Net operating income	2,797	83	2,880	1,092	2,975	6,947	148	
Operating expenses	(3,259)	(90)	(3,349)	□	(213)	(3,562)	(9)	
Operating profit/(loss)	(462)	(7)	(469)	1,092	2,762	3,385	833	
Income from associates	74	2	76	(50)	124	150	103	
Profit/(loss) before tax	(388)	(5)	(393)	1,042	2,886	3,535	1,011	
By geographical region								
Europe	(278)	(24)	(302)	(50)	1,408	1,056	480	
Hong Kong	(175)	2	(173)	□	(202)	(375)	(114)	
Rest of Asia-Pacific	287	17	304	1,081	(42)	1,343	368	
North America	(217)	□	(217)	□	1,725	1,508	795	
Latin America	(5)	□	(5)	11	(3)	3	160	
	(388)	(5)	(393)	1,042	2,886	3,535	1,011	

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Year ended 31 December 2006 compared with year ended 31 December 2005

	2005 as reported US\$m	Currency translation ¹ US\$m	2005 at 2006 exchange rates US\$m	Acqui- sitions and disposals ² US\$m	Underlying change US\$m	2006 as reported US\$m	Reported change %	Underlying change %
Other								
Net interest expense	(472)	(12)	(484)	□	(141)	(625)	(32)	(29)
Net fee income	220	3	223	□	(51)	172	(22)	(23)
Other income ³	3,204	13	3,217	(11)	57	3,263	2	2
Net operating income ⁴	2,952	4	2,956	(11)	(135)	2,810	(5)	(5)
Loan impairment charges and other credit risk provisions	(1)	□	(1)	□	(12)	(13)	(1,200)	(1,200)
Net operating income	2,951	4	2,955	(11)	(147)	2,797	(5)	(5)
Operating expenses	(2,976)	(15)	(2,991)	□	(268)	(3,259)	(10)	(9)
Operating loss	(25)	(11)	(36)	(11)	(415)	(462)	(1,748)	(1,153)
Income from associates	51	(1)	50	(3)	27	74	45	54
Profit/(loss) before tax	26	(12)	14	(14)	(388)	(388)	(1,592)	(2,771)
By geographical region								
Europe	(168)	(4)	(172)	(14)	(92)	(278)	(65)	(53)
Hong Kong	(178)	(5)	(183)	□	8	(175)	2	4
Rest of Asia-Pacific	94	6	100	□	187	287	205	187
North America	165	1	166	□	(383)	(217)	(232)	(231)
Latin America	113	(10)	103	□	(108)	(5)	(104)	(105)
	26	(12)	14	(14)	(388)	(388)	(1,592)	(2,771)

For footnotes, see page 130.

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Profit/(loss) before tax and balance sheet data

Year ended 31 December 2007

Total	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Private Banking US\$m	Other⁸ US\$m	Inter- segment elimination¹⁴ 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 ⁵	178	296	3,267	534	126	5,433	9,834
Net income/(expense) from financial instruments designated at fair value	1,333	22	(164)	(1)	2,893	□	4,083
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 ⁶	(8,147)	(391)	(70)	□	□	□	(8,608)
Net operating	43,239	13,950	15,210	3,548	6,958	(3,912)	78,993

income⁴							
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
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Balance sheet data⁷							
Loans and advances to customers (net)	464,726	220,068	250,464	43,612	2,678		981,548
Total assets	588,473	261,893	1,375,240	88,510	40,150		2,354,266
Customer accounts	450,071	237,987	299,879	106,197	2,006		1,096,140
The following assets and liabilities were significant to Global Banking and Markets:							
loans and advances to banks (net)			199,506				
trading assets, financial assets designated at fair value, and			674,647				

financial
investments

deposits by
□banks **126,395**

*For footnotes,
see page 130.*

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(continued)

Customer groups > Profit before tax

Profit/(loss) before tax and balance sheet data (continued)

Year ended 31 December 2006

Total	Year ended 31 December 2006						Inter-segment elimination ¹⁴ US\$m	Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Private Banking US\$m	Other ⁸ US\$m			
Net interest income/(expense)	26,076	7,514	3,168	1,011	(625)	(2,658)	34,486	
Net fee income	8,762	3,207	3,718	1,323	172	□	17,182	
Trading income/(expense) excluding net interest income	391	204	4,890	362	(228)	□	5,619	
Net interest income/ (expense) on trading activities	220	20	(379)	2	82	2,658	2,603	
Net trading income/(expense) ⁵	611	224	4,511	364	(146)	2,658	8,222	
Net income/(expense) from financial instruments designated at fair value	739	(22)	20	1	(81)	□	657	
Gains less losses from financial investments	78	44	534	166	147	□	969	
Dividend income	31	6	235	5	63	□	340	
Net earned insurance premiums	5,130	258	73	□	207	□	5,668	
Other operating income	782	250	1,378	61	3,254	(3,179)	2,546	
Total operating income	42,209	11,481	13,637	2,931	2,991	(3,179)	70,070	
Net insurance claims ⁶	(4,365)	(96)	(62)	□	(181)	□	(4,704)	
Net operating income⁴	37,844	11,385	13,575	2,931	2,810	(3,179)	65,366	
Loan impairment (charges)/ recoveries and other credit risk	(9,949)	(697)	119	(33)	(13)	□	(10,573)	

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provisions

Net operating income	27,895	10,688	13,694	2,898	2,797	(3,179)	54,793
Total operating expenses	(18,818)	(4,979)	(7,991)	(1,685)	(3,259)	3,179	(33,553)
Operating profit/(loss)	9,077	5,709	5,703	1,213	(462)	□	21,240
Share of profit in associates and joint ventures	380	288	103	1	74	□	846
Profit/(loss) before tax	9,457	5,997	5,806	1,214	(388)	□	22,086
	%	%	%	%	%		%

Share of HSBC's profit before tax	42.8	27.2	26.3	5.5	(1.8)		100.0
Cost efficiency ratio	49.7	43.7	58.9	57.5	116.0		51.3

	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m
Balance sheet data ⁷							
Loans and advances to customers (net)	448,545	172,976	210,220	34,297	2,095		868,133
Total assets	546,568	213,450	994,436	73,026	33,278		1,860,758
Customer accounts	388,468	190,853	235,965	80,303	1,245		896,834

The following assets and liabilities were significant to Global Banking and Markets:

□ loans and advances to banks (net)	156,548
□ trading assets, financial assets designated at fair value, and financial investments	487,943
□ deposits by banks	92,954

For footnotes, see page 130.

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Year ended 31 December 2005

Total	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Private Banking US\$m	Other ⁸ US\$m	Inter- segment elimination ¹⁴ US\$m	Total US\$m
Net interest income/(expense)	23,351	6,310	3,001	848	(472)	(1,704)	31,334
Net fee income	7,313	2,876	2,967	1,080	220	□	14,456
Trading income/(expense) excluding net interest income	360	150	2,919	317	(90)	□	3,656
Net interest income/ (expense) on trading activities	214	(3)	306	□	(13)	1,704	2,208
Net trading income/(expense) ⁵	574	147	3,225	317	(103)	1,704	5,864
Net income/(expense) from financial instruments designated at fair value	574	(12)	67	(1)	406	□	1,034
Gains less losses from financial investments	19	9	475	45	144	□	692
Dividend income	16	9	79	9	42	□	155
Net earned insurance premiums	4,864	236	76	□	260	□	5,436
Other operating income	729	327	1,621	68	2,634	(2,646)	2,733
Total operating income	37,440	9,902	11,511	2,366	3,131	(2,646)	61,704
Net insurance claims ⁶	(3,716)	(118)	(54)	□	(179)	□	(4,067)
Net operating income⁴	33,724	9,784	11,457	2,366	2,952	(2,646)	57,637
Loan impairment (charges)/ recoveries and other credit risk provisions	(7,537)	(547)	272	12	(1)	□	(7,801)
Net operating income	26,187	9,237	11,729	2,378	2,951	(2,646)	49,836
Total operating expenses	(16,427)	(4,453)	(6,838)	(1,466)	(2,976)	2,646	(29,514)
Operating profit/(loss)	9,760	4,784	4,891	912	(25)	□	20,322
Share of profit in associates and joint ventures	144	177	272	□	51	□	644
Profit before tax	9,904	4,961	5,163	912	26	□	20,966

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	%	%	%	%	%	%
Share of HSBC's profit before tax	47.2	23.7	24.6	4.4	0.1	100.0
Cost efficiency ratio	48.7	45.5	59.7	62.0	100.8	51.2
	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m

Balance sheet data⁷

Loans and advances to customers (net)	398,884	142,041	169,435	27,749	1,893	740,002
Total assets	484,314	175,120	755,056	59,827	27,653	1,501,970
Customer accounts	321,240	148,106	202,361	67,205	507	739,419

The following assets and liabilities were significant to Global Banking and Markets:

□ loans and advances to banks (net)			106,123			
□ trading assets, financial assets designated at fair value, and financial investments			373,787			
□ deposits by banks			65,853			

For footnotes, see page 130.

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Report of the Directors: Business Review (continued)*Geographical regions>Summary>Competitive environment***Geographical regions**

Summary of geographical regions

In the analysis of profit by geographical regions that follows, operating income and operating expenses include intra-HSBC items of US\$1,985 million (2006: US\$1,494 million; 2005: US\$938 million).

Profit before tax

Year ended 31 December

	2007		2006		2005	
	US\$m	%	US\$m	%	US\$m	%
Europe	8,595	35.5	6,974	31.5	6,356	30.3
Hong Kong	7,339	30.3	5,182	23.5	4,517	21.5
Rest of Asia-Pacific	6,009	24.8	3,527	16.0	2,574	12.3
North America	91	0.4	4,668	21.1	5,915	28.2
Latin America	2,178	9.0	1,735	7.9	1,604	7.7
	24,212	100.0	22,086	100.0	20,966	100.0

Total assets⁷

At 31 December

	2007		2006	
	US\$m	%	US\$m	%
Europe	1,184,315	50.3	828,701	44.6
Hong Kong	332,691	14.1	272,428	14.6
Rest of Asia-Pacific	228,112	9.7	167,668	9.0
North America	510,092	21.7	511,190	27.5
Latin America	99,056	4.2	80,771	4.3
	2,354,266	100.0	1,860,758	100.0

For footnote, see page 130.

Additional information on results in 2007 may be found in the [Report of the Directors: Financial Review] on pages 131 to 191.

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 Trinkaus & Burkhardt AG and HSBC Gyuertzeller Bank 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 65 per cent by value of banknotes in circulation in 2007.

Rest of Asia-Pacific (including the Middle East)

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"), which was incorporated in March 2007. The bank's network spans 18 major cities, comprising 18 branches and 44 sub-branches. Hang Seng Bank offers personal and commercial banking services and operates 10 branches, 14 sub-branches and one representative office in 10 cities in mainland China. HSBC also participates indirectly in mainland China through its three associates, Bank of Communications (19.01 per cent owned), Ping An Insurance (16.78 per cent) and Industrial Bank (12.78 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 21 countries in the Asia-Pacific region, primarily through branches and subsidiaries of The Hongkong and Shanghai Banking Corporation, with particularly strong coverage in India, Indonesia, South Korea, Singapore and Taiwan. HSBC's presence in the Middle East is led by HSBC Bank Middle East Limited ("HSBC Bank Middle East"), whose network of branches,

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subsidiaries and associates has the widest coverage in the region; in Australia by HSBC Bank Australia Limited; and in Malaysia by HSBC Bank Malaysia Berhad (HSBC Bank Malaysia), which is the largest foreign-owned bank in the country by operating income and pre-tax profits. HSBC's associate in Saudi Arabia, The Saudi British Bank (40 per cent owned), is the Kingdom's sixth 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 Chicago. 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 and the Caribbean 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), formerly Grupo Banistmo S.A., which owns subsidiaries in Costa Rica, Honduras, Colombia, Nicaragua and El Salvador. HSBC is also represented by subsidiaries in Chile, the Bahamas, Peru, Paraguay and Uruguay and by a representative office in Venezuela. 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.

Competitive environment

HSBC believes that open and competitive markets are good for both local economies and their participants. The Group faces very strong competition in the markets it serves. In personal and commercial banking, it competes with a wide range of institutions including commercial banks, consumer finance companies, retail financial service companies, savings and loan associations, credit unions, general retailers, brokerage firms and investment companies. In investment banking,

HSBC faces competition from specialist providers and the investment banking operations of other commercial banks.

Regulators routinely monitor and investigate the competitiveness of the financial services industry (of which HSBC is a part) in a number of areas, particularly in the UK and continental Europe. HSBC's policy is to co-operate and work positively with all its regulators, providing data and perspective on those issues which affect all financial service providers both directly and through industry bodies.

Global factors

Market liquidity

The "credit crunch" disruption in credit markets that began in the latter half of 2007 is resulting in the movement of assets back on to banks' balance sheets, absorbing capital and constraining banks' ability to lend. The disruption has created an imbalance between the supply and demand for many classes of financial assets and has led to the traditional buyers of debt adopting a very cautious approach to the purchase of any securities which are neither fully transparent in risk profile nor of assured liquidity. Although this liquidity strain began in the asset-backed securities markets, it has since spread to more traditional investment classes. In this environment, the scope for a bank to originate assets beyond its capacity to hold them to term is limited by its available capital and funding resources. This environment is less disruptive to banks that fund their lending through deposits than those that rely on the securitisation markets for funding.

Progressive alignment of the capital adequacy framework towards economic capital

As major banks move to the new Basel II capital adequacy framework (see "Basel II" on page 284), their capital requirements will necessarily be more closely matched with their risk profiles. In an environment of economic uncertainty, many banks may need to reduce lending due to forecast increases in capital requirements arising from deterioration in the quality of their credit risk exposures. This reduction in risk appetite may potentially accelerate the deterioration in credit quality as credit availability is restricted during a downturn in the economic cycle. When coupled with a lack of market liquidity, this may lead to polarisation within the banking system. Banks with greater capital and liquidity resources are better placed to meet the ongoing banking requirements of their customers than other banks which are more constrained in this regard.

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Competitive environment

Advances in technology

Customer transaction volumes continue to grow at a rate considerably ahead of the growth in underlying balances or accounts, leading many banks to seek to reduce unit costs per service transaction in order to maintain margins. The deployment of automated secure transaction channels requires significant investment, providing a competitive advantage to banks with larger scale. Despite widespread adoption by both banks and customers of new distribution channels, the expected reduction in volumes of transactions through traditional channels has been slow to materialise and many banking customers continue to prefer to use them. The younger generation of customers, however, tends to be more comfortable with system-aided self-service, particularly for savings accounts, credit cards and simple investments. HSBC expects the sophistication of products sold in direct channels and adoption rates to increase, as the use of 24-hour self-service channels, such as ATMs, internet, mobile, and voice response units becomes increasingly commonplace.

Regulation

Initiatives such as Basel II, together with the increasingly international scope of financial services, have raised the level of cooperation between regulatory authorities in different countries. Enhanced understanding of how risks are originated and dispersed in modern financial markets has reinforced the need to address how best to regulate the increasingly integrated and international nature of banking and financial services; this has been evidenced most recently in coordinated discussions on the global liquidity disruption. In addition, the enlargement of the EU, the introduction of the Markets in Financial Instruments Directive (MIFID) and the continued effort to endorse consistent standards and enforcement has encouraged regulatory bodies to work together more closely. Interaction and cooperation have led to competitive and regulatory issues emerging in one country rapidly being taken up in other jurisdictions. Uniform global standards, however, continue to be complicated by differing local interpretations, or additional local regulation.

Regional factors

Europe

Across Europe, in all sectors, HSBC competes with a growing range of institutions. These markets are characterised by rapid innovation, margin compression through competition and a constant flow of new entrants. Regulators monitor the financial services sector closely and conduct reviews

into the long-term evolution of the industry. Legislators are enforcing legislation with the aim of improving competition and protecting consumers.

In November 2007, the European Commission announced that in order to improve the competitiveness and efficiency of European retail financial services markets, reviews would be undertaken to improve customer choice and mobility within the single market; better facilitate retail insurance markets; achieve progress towards adequate and consistent rules for the distribution of retail investment products; and promote financial education, financial inclusion and adequate redress for consumers.

Following a long running investigation, the Competition Directorate-General determined that MasterCard's multilateral interchange fees for cross-border payment card transactions violate EU competition rules. MasterCard has six months to comply or respond. HSBC is fully engaged in the case through its membership of MasterCard.

A number of key EU measures intended to facilitate development of the single market and increase competition came into effect during the year; principally, transposition of the Markets in Financial Instruments Directive in November 2007. Implementation of phase 1 of the Single Euro Payments Area programme occurred in January 2008.

UK

Financial services, including retail banking, is a highly competitive sector in the UK, led by several national and international institutions which compete on both price and service quality. Domestic acquisitions or mergers are limited. The sector is closely regulated, and a series of investigations with particular relevance to Personal Financial Services remain in progress.

In July 2007, a group of seven banks (including HSBC) and one building society announced that they had agreed with the Office of Fair Trading (OFT) that the legal status and enforceability of certain of the charges applied to their personal customers in relation to unauthorised overdrafts should be tested in the High Court. Certain preliminary issues in the case came before the High Court in a trial starting in January 2008 and this part of the case concluded in February 2008. At the date of this report, judgement in the case is awaited. The OFT is also conducting a market study into competition for personal current accounts.

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The Competition Commission (["CC"]) commenced an investigation into the payment protection insurance (["PPI"]) market in February 2007 and published its Emerging Thinking document in November 2007. Provisional findings are due in May 2008 and the final report towards the end of the year. Similarly, the Financial Services Authority (["FSA"]) conducted the third phase of its review of the sales processes and systems around the sale of PPI policies and is now undertaking further assessment of firms' performance in this area.

In December 2007, the CC announced its decision to lift the price controls imposed in 2003 on HSBC and the other three largest banks providing services to small and medium-sized enterprises in the UK. This is expected to result in greater competition and innovation within the market.

During 2007, the OFT continued to investigate competition issues in connection with the setting of multilateral interchange fees for domestic credit card payments.

France

In 2007, interest rates in the eurozone increased while growth in real estate investment stabilised. Income tax relief on new personal real estate loans was introduced following the presidential elections, though potential benefits to customers were offset by higher interest rates. Real estate mortgage loans remained the primary product by which banks attracted new customers and, as a result, competitive pricing led to decreased margins.

The French government introduced various fiscal incentives in the second half of 2007 which reduced tax on overtime pay and introduced a cap on the total tax paid by households at 50 per cent of income. These measures increased the disposable income of wealthier individuals who qualify for HSBC Premier and Private Banking services.

The commercial treasury bills market contracted and companies had difficulty obtaining facilities in the second half of 2007 due to market uncertainty. This trend is expected to continue in 2008.

Hong Kong

The lending market remained active in 2007, initially driven by investment-related loans and, subsequently, as interest rates declined and market uncertainty increased, by property loans. A robust labour market and rising household wealth supported growth in consumer spending. As a result, demand for personal loans and credit cards rose.

In the middle of 2007, downward pressure on interest rates and an overall improvement in the property market led to increased demand for mortgages. Prices for high-end properties rose, though competition in traditional mortgage products remained fierce.

Rising equity markets stimulated sales of investment products and related loans. After a lull in demand in August and September, when disruption to money markets intensified as the implications for asset-backed securities of the growing credit crisis were reassessed, the market experienced intense volatility, accentuated by the possibility of a recession in the US.

Funds were attracted to Hong Kong during the year in anticipation of sustained appreciation of the renminbi as well as a positive outlook for the mainland Chinese stocks listed in Hong Kong. Deposit growth remained robust throughout the year and the status of Hong Kong as the chief financial centre to service the needs of businesses in Southern China was enhanced.

Rest of Asia-Pacific

(including the Middle East)

The business environment in the region remained highly competitive, notwithstanding increased demand for credit in Asian countries partially resulting from lower interest rates. In particular, short-term interest rates in mainland China, India, Indonesia, Malaysia and Singapore were less than the nominal Gross Domestic Product (["GDP"]) growth rate.

Mainland China

The People's Bank of China indicated that it would continue to apply tight monetary policy to address excess domestic liquidity, to curb lending and to strengthen macro-economic conditions. Loan growth in mainland China remained robust despite this tightening and the benchmark one-year lending rate increased to 7.47 per cent by the end of 2007. The renminbi reserve requirement ratio for depository financial institutions increased to 14.5 per cent.

India

Loan growth in 2007 slowed due to earlier monetary tightening and adverse regulatory policies which restricted the activities of recovery agents. Aggressive growth strategies by several banks compressed margins and reduced overall asset quality.

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Competitive environment

Middle East

The competitive environment in the Middle East intensified during 2007 as the regional economy prospered on the back of record oil prices, which prompted a surge in infrastructure development and construction activities. The Dubai International Finance Centre and the Qatar Financial Centre continued to attract a number of international institutions to set up operations in the region, particularly in the investment and private banking sectors.

Islamic banking activities continued to grow as a percentage of the market with the establishment of two prominent banks during the year. A number of competitor banks introduced innovative products and launched reward programmes to attract and retain customers.

Malaysia, South Korea, Indonesia and Taiwan

Competition in the Malaysian banking sector remained high as average lending rates continued to decline, despite no change to central bank policy. Banks in South Korea faced increased funding costs as they competed for deposits with securities firms who offered competitive rates on cash management accounts. Measures to cool the real estate sector also resulted in deterioration of asset quality for loans associated with real estate and construction. Loan growth in Indonesia increased in late 2007, as the central bank of Indonesia continued to ease monetary policy. In Taiwan, loan demand increased in 2007 although it remained relatively low.

North America

US

The Group's principal US subsidiaries, HSBC Bank USA and HSBC Finance, faced unprecedented shifts and uncertainties in the credit environment as the US housing market continued to deteriorate. This precipitated significant changes in the competitor landscape.

Increased payments on resetting adjustable-rate mortgages (ARMs), together with falling house prices, led to turmoil in the mortgage industry as deteriorating credit quality led to a loss of appetite among buyers of securitised mortgages in the secondary market. The contraction of this important funding source undermined the business models of many market participants and over 100 competitors closed, declared bankruptcy or were taken over in 2007. Influences on the market for securitised mortgages had consequential effects on broader credit markets and resulted in a general tightening

of credit availability, with particular impact on financial institutions exposed to sub-prime residential mortgages. Illiquidity in the markets for related credit derivatives impacted the valuation of such instruments.

The remaining sub-prime mortgage providers tightened underwriting standards and increased rates to reduce volumes, as they were obligated to retain originated loans. Previously, most of these loans had been packaged and sold to third party investors on the secondary market. Major market participants acted to reduce the number of foreclosures resulting from ARMs by offering modified loan terms to customers in financial distress. These initiatives were supported and encouraged by federal and state regulators. HSBC was one of the first institutions to take a lead in this respect.

Regulatory scrutiny of the credit card industry increased in 2007 and, although no new major legislation was announced, a number of institutions, including HSBC, amended credit card terms and changed certain charging practices, benefiting customers but at a cost to lenders. Notwithstanding this, credit card competition remained fierce throughout 2007, with the launch of a number of innovative new products including environmentally-themed initiatives and online substitutes for traditional cards.

Canada

In Canada, the six largest banks retained their significant presence in the country's financial services industry. Markets remained competitive, however, with largely equivalent products being offered by banks, insurance companies and other financial institutions. Canadian financial markets felt the effects of the downturn in US residential property markets as certain asset-backed commercial paper conduits experienced difficulty funding their obligations. A group of Canadian and international banks established accords to support these vehicles.

Latin America

Mexico

In Mexico, the banking industry remained centred around the five largest institutions (including HSBC), which control 80 per cent of the banking system's assets. Penetration of the formal financial system remained low compared with other developing economies in the region, while demographics indicated a young and growing population. Bank financing to the private sector was less than 20 per cent of GDP, indicating significant room for growth. In this context, the overall banking

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system continued to expand credit rapidly and loan growth has exceeded 20 per cent per annum over the last two years.

In 2007, eight new banking licences were granted and over 350 non-bank intermediaries entered the consumer market. An amendment to legislation late in 2007 granted specialised banking licenses with reduced regulatory requirements. This is expected to further boost competitive forces.

Mexican banks faced additional legislation with the imposition of tariff restrictions on deposit account fees and ATM commissions. HSBC continued to increase its market share in core consumer, commercial and corporate banking products, and sought to differentiate itself through customer service. HSBC is well positioned to capitalise on economic growth with its extensive branch and ATM network.

Central America

HSBC has financial services operations in Panama, El Salvador, Costa Rica, Honduras, Colombia and Nicaragua. Central America's banking industry has attracted significant foreign investment in recent years due to its expanding domestic economies. In the last two years, a number of international groups established major retail banking operations through a series of purchases. In El Salvador and Costa Rica, foreign banks and local governments own the majority of banking institutions. Panama, Honduras and Guatemala continued to be served by several large, independent domestic banking institutions.

International banks operating in Central America increased their presence and, hence, the availability of reliable financing sources. These banks are also expected to accelerate the adoption of improved corporate and risk management practices in the region, together with a more efficient allocation of resources.

Brazil

In Brazil, the top ten banking groups accounted for 71 per cent of banking assets and 87 per cent of branches, unchanged from 2006. These groups include local state-owned banks, privately-owned banks and large foreign banks (including HSBC). Privately-owned banks continued to grow their market share (from 57 per cent in 2006 to 62 per cent in 2007), through consolidation and growth in credit operations, due to the positive economic conditions. Further consolidation took place when Banco Santander acquired Banco Real as part of the successful consortium bid for ABN Amro.

Total lending as a percentage of GDP was 35 per cent, remaining relatively low by international standards. Improved access to financial services and increased participation in the formal economy indicate the potential for further growth in the financial services sector.

Argentina

International financial groups and local banks with largely equivalent product and service offerings formed HSBC's major competition in Argentina.

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

	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets¹³ US\$m	Private Banking US\$m	Other US\$m	Total US\$m
Year ended 31 December 2007						
United Kingdom	1,221	2,064	1,214	317	976	5,792
France ¹⁵	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
Year ended 31 December 2006						
United Kingdom	1,496	1,801	1,299	380	(185)	4,791
France ¹⁵	174	236	545	22	(107)	870
Germany	□	29	114	41	16	200
Malta	42	50	29	□	□	121
Switzerland	□	□	□	305	□	305
Turkey	121	50	64	□	(18)	217
Other	76	68	253	57	16	470
	1,909	2,234	2,304	805	(278)	6,974
Year ended 31 December 2005						
United Kingdom	1,475	1,495	1,186	171	(47)	4,280
France ¹⁵	223	278	472	7	(147)	833
Germany	□	42	131	48	16	237
Malta	29	46	31	□	□	106
Switzerland	□	□	□	254	□	254
Turkey	134	39	92	□	□	265
Other	71	39	202	59	10	381
	1,932	1,939	2,114	539	(168)	6,356

Loans and advances to customers (net) by country

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
United Kingdom	326,927	305,758	245,004
France ¹⁵	81,473	55,491	43,772
Germany	6,411	4,439	3,349
Malta	4,157	3,456	2,794
Switzerland	13,789	9,151	7,312
Turkey	7,974	5,233	3,787
Other	11,544	8,971	6,519
	452,275	392,499	312,537

For footnotes, see page 130.

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Customer accounts by country

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
United Kingdom	367,363	318,614	246,723
France ¹⁵	64,905	43,372	39,359
Germany	10,282	11,607	8,393
Malta	5,947	4,529	3,760
Switzerland	41,015	30,062	26,984
Turkey	6,473	4,140	3,493
Other	8,969	7,041	5,488
	504,954	419,365	334,200

Profit before tax

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
Europe			
Net interest income	7,746	8,289	8,221
Net fee income	8,431	7,108	6,299
Net trading income	6,943	4,529	3,036
Net income from financial instruments designated at fair value	1,226	144	362
Gains less losses from financial investments	1,326	624	439
Dividend income	171	183	63
Net earned insurance premiums	4,010	1,298	1,599
Other operating income	1,193	1,428	1,603
Total operating income	31,046	23,603	21,622
Net insurance claims incurred and movement in liabilities to policyholders .	(3,479)	(531)	(818)
Net operating income before loan impairment charges and other credit risk provisions	27,567	23,072	20,804
Loan impairment charges and other credit risk provisions	(2,542)	(2,155)	(1,929)
Net operating income	25,025	20,917	18,875
Total operating expenses	(16,525)	(13,871)	(12,639)
Operating profit	8,500	7,046	6,236
Share of profit/(loss) in associates and joint ventures	95	(72)	120
Profit before tax	8,595	6,974	6,356
	%	%	%
Share of HSBC's profit before tax	35.5	31.5	30.3

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Cost efficiency ratio	59.9	60.1	60.8
Year-end staff numbers (full-time equivalent)	82,166	78,311	77,755

Balance sheet data⁷

	At 31 December		
	2007	2006	2005
	US\$m	US\$m	US\$m
Loans and advances to customers (net)	452,275	392,499	312,537
Loans and advances to banks (net)	104,527	76,830	44,360
Trading assets, financial instruments designated at fair value and financial investments ¹⁶	445,258	242,010	146,777
Total assets	1,184,315	828,701	636,703
Deposits by banks	87,491	67,821	47,202
Customer accounts	504,954	419,365	334,200

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Year ended 31 December 2007 compared with year ended 31 December 2006

Economic briefing

In the **UK**, GDP growth accelerated in 2007 to 3.1 per cent from 2.9 per cent in 2006, mainly as a result of buoyant consumer and investment spending. Net trade depressed GDP growth through 2007, and the current account deficit reached a record 5.7 per cent of GDP in the third quarter of the year. Employment growth was fairly subdued, rising by approximately 0.7 per cent during the year. Consumer Price Index (CPI) inflation reached a decade-long high of 3.1 per cent in March but subsequently fell back to 2.1 per cent by the year-end, close to the Bank of England's 2 per cent target. After a strong start to the year, nominal house prices declined and housing activity diminished in the final months of 2007. The Bank of England raised interest rates by 75 basis points during 2007 to a peak of 5.75 per cent, but subsequently reduced them to 5.5 per cent at the end of 2007.

The expansion of the **eurozone** economy continued steadily in 2007, with GDP growth of 2.7 per cent. As in the UK, much of the momentum

came from strength in business investment and exports as global demand remained strong, particularly from emerging markets. Consumption was relatively subdued, despite declining unemployment, although fiscal reforms (particularly in Germany) are believed to have depressed household expenditure. Eurozone inflation increased steadily during the second half of the year to an annual rate of 3.1 per cent in December, driven largely by rises in food and energy prices. The European Central Bank (ECB) raised interest rates by 50 basis points during 2007, to finish the year at 4 per cent.

In **Turkey**, economic activity softened as the year progressed, with GDP rising by 3.9 per cent during the first three quarters of 2007 against the comparable period of 2006. Headline inflation remained under pressure from increases in energy and food prices, though core indicators improved markedly, prompting Turkey's central bank to cautiously ease monetary policy. The current account deficit stabilised at about 7 per cent of GDP with rising service sector receipts from tourism, although high energy costs may cause the trade balance to deteriorate.

Reconciliation of reported and underlying profit before tax**Year ended 31 December 2007 compared with year ended 31 December 2006**

	2006 as reported US\$m	Currency translation ¹ US\$m	2006 at 2007 exchange rates US\$m	Acquisitions, disposals and dilution gains ² US\$m	Underlying change US\$m	2007 as reported US\$m	Reported change %	Underlying change %
Europe								
Net interest income	8,289	635	8,924	416	(1,594)	7,746	(7)	(18)

Net fee income	7,108	586	7,694	(80)	817	8,431	19	11
Other income ³	7,675	576	8,251	(143)	3,282	11,390	48	40
Net operating income⁴	23,072	1,797	24,869	193	2,505	27,567	19	10
Loan impairment charges and other credit risk provisions	(2,155)	(147)	(2,302)	□	(240)	(2,542)	(18)	(10)
Net operating income	20,917	1,650	22,567	193	2,265	25,025	20	10
Operating expenses	(13,871)	(1,076)	(14,947)	(49)	(1,529)	(16,525)	(19)	(10)
Operating profit	7,046	574	7,620	144	736	8,500	21	10
Income from associates	(72)	(6)	(78)	(50)	223	95	232	280
Profit before tax	6,974	568	7,542	94	959	8,595	23	13

For footnotes, see page 130.

Review of business performance

European operations reported a pre-tax profit of US\$8.6 billion, compared with US\$7.0 billion in 2006, an increase of 23 per cent. On an underlying basis, pre-tax profits improved by 13 per cent.

In March 2007, HSBC acquired its partner's shares in life, property and casualty insurer, HSBC Assurances. The results of HSBC Assurances are excluded from the underlying commentary below.

In Commercial Banking, growth in deposit and lending balances in the UK and ongoing business expansion in Turkey and Malta led to steady growth in revenues. This was partly offset by increased loan impairment charges and higher costs associated with

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business expansion. In Global Banking and Markets, higher income from most businesses was offset by trading losses in Credit and Rates and increased costs. Strong profit growth in Private Banking was driven by an increased client appetite for discretionary portfolios, a rise in lending volumes and further improvements in cross-referrals. In Personal Financial Services, a fall in pre-tax profits reflected 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. The "Other" segment benefited from a US\$1.3 billion fair value gain in HSBC's own debt.

The following commentary is on an underlying basis.

Personal Financial Services reported a pre-tax profit of US\$1.6 billion, a decrease of 31 per cent compared with 2006. Income growth lagged cost growth, principally as a result of ex gratia payments expensed in respect of overdraft fees applied in previous years which are subject to current legal challenge.

In the UK, HSBC continued to concentrate on enhancing services offered to customers, with the intention of making HSBC the "Best Place to Bank". HSBC Premier was relaunched simultaneously in 35 countries, including the UK. All Personal Internet Banking customers now have the ability to send money in over 80 currencies to 234 countries. To make its fees and charges more transparent, HSBC in the UK began to show warning messages on ATMs if the customer's cash withdrawal would cause a fee to be incurred.

In France, successful marketing campaigns continued to improve brand awareness and grow customer numbers, specifically HSBC Premier and Student accounts. The latter benefited from the signing of 120 partnerships with business schools.

In Turkey, the benefit of significant growth from new customer acquisition, boosted by successful cross-sell activities and higher balances, more than offset increased costs incurred in supporting business expansion.

Net interest income was broadly in line with 2006. In the UK, effective deposit pricing, coupled with interest rate rises in the first half of 2007, led to wider deposit spreads and higher balances. This benefit was partly offset by lower margins on mortgages as customers switched to fixed rate products.

Average unsecured lending balances in the UK declined by 5 per cent as HSBC restricted its credit appetite to customers who satisfied tighter underwriting criteria. Spreads narrowed as the portfolio mix shifted towards these better quality, lower-yielding loans.

Savings balances grew by 15 per cent, driven by competitive rates and new products, such as the Online Bonus Savers, a "one click" savings product offering real-time account opening, instantly ready for funding. Together with improved spreads, this contributed to a 29 per cent increase in net interest income on savings products.

Average current account balances in the UK increased to US\$31 billion. Sales of HSBC's premium service, fee-based current accounts (HSBC Premier and Plus) remained major drivers of underlying performance, with significant year-on-year sales growth.

UK credit card balances grew by 4 per cent in a declining market, with growth concentrated in the Partnership card and Marks and Spencer ("M&S Money") portfolios. This benefit was more than offset by pressure on spreads driven by a run-off in higher-yielding accounts in the Partnership cards business. In line with the Group's risk-based concentration on a narrower range of customers, HSBC disposed of part of its non-core credit card portfolio, principally the Marbles brand, in the last quarter of 2007.

In light of changing market conditions, significant investment was made in retraining the mortgages sales force during 2007. Average mortgage balances were broadly in line with last year, while the portfolio mix shifted towards fixed rate products. This, together with base rate rises, caused spreads to tighten.

In France, customer acquisition and the consolidation of existing relationships resulted in an 8 per cent rise in average deposit balances, higher than the overall market increase. Average lending balances grew by 16 per cent, mainly property-related lending. The benefit of these increases in volumes was more than offset by narrower spreads due to competitive pressures and maturing of previously higher-yielding hedging products. As a result, net interest income fell by 11 per cent.

In Turkey, net interest income increased by 17 per cent due to strong balance sheet growth. HSBC added over 600,000 new personal customers during 2007, significantly exceeding its target. Average deposit balances rose by 28 per cent, largely driven by customer recruitment through new branch openings and ongoing efforts to build brand awareness. Deposit spreads remained narrow as

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interest rates started to decline during the second half of 2007 following rate rises earlier in the year. Average lending balances increased by 28 per cent. The income benefit from these increases was partly offset by the impact of market-wide credit calming measures which, together with increased competition, adversely affected margins on lending and credit cards.

Net fee income increased by 13 per cent, largely driven by higher sales of fee-earning packaged current accounts in the UK and credit cards in Turkey, where HSBC recorded significant growth of over 740,000 new cards. This was partly offset by a US\$25 million decrease in credit card default fees in the UK as HSBC reduced its fee following the outcome of an investigation by the OFT in April 2006. In France, fee income grew by 7 per cent through improved transactional commissions, mainly from increased sales of packaged accounts and higher life insurance fees.

In the UK, pensions and life investment sales increased as did home and motor insurance sales, the success of the M&S Money motor insurance campaign led to M&S Money rising to fourth in the market for online sales. However, the insurance results were adversely affected by lower income from payment protection products and flood claims in the summer.

Net trading income largely reflected the fair value measurement of embedded options linked to government regulated home savings products in France. In 2006, there was a large gain; this did not recur in 2007.

Gains on the sale of financial investments in 2007 included a share in HSBC's sale of Marfin Popular Bank, an investment acquired in a share swap agreement with The Cyprus Popular Bank as part of the sale of HSBC's stake in the latter in 2006. In addition, a gain arose from the merger of two payment services providers and there were two further gains on the share of profits from the MasterCard Incorporated IPO, although to a lesser extent than in 2006.

Other operating income declined significantly, due to a fall in the present value of in-force (PVIF) long-term insurance business, following a change in FSA regulations which permitted certain rules relating to the calculation of actuarial liabilities for the long-term insurance business to be relaxed. This was offset by a corresponding reduction in provisions reported in Net insurance claims and movements in liabilities to policyholders. HSBC recorded a loss on the disposal of the Marbles brand cards portfolio, offset by the sale of other card

portfolios at a profit. In 2006, HSBC benefited from a share of the gain on the sale of its stake in The Cyprus Popular Bank.

Loan impairment charges and other credit risk provisions of US\$2.0 billion were 4 per cent higher than in 2006. In the UK consumer finance business, refinements to the methodology used to calculate roll-rate percentages resulted in a higher charge in the first half of the year. Excluding this, loan impairment charges were marginally lower than in 2006. Loan impairment charges in the second half of 2007 were lower than in the first half of the year, as overall credit quality improved following measures taken in the recent past to tighten underwriting standards and improve the credit quality of new business. Although losses from mortgage lending remained low, maximum loan to value ratios were reduced during the year to mitigate the effects of a possible housing market downturn. In France, loan impairment charges remained low, albeit higher than in 2006, as credit quality remained good. In Turkey, credit quality remained stable and growth in loan impairment charges followed increases in lending balances.

Operating expenses were 11 per cent higher than in 2006. In the UK, US\$227 million arose from ex gratia payments expensed in respect of overdraft fees applied in previous years, and a further US\$169 million was provided for reimbursement of certain charges on historic will trusts and other related services.

HSBC concentrated discretionary investment on technology that promotes straight-through processing, allowing customers to purchase products online. This will improve processing time and reduce errors caused by human intervention. As part of the ongoing branch refurbishment programme, a further 52 branches were refurbished during 2007.

In France, operating expenses rose as HSBC made further investments to take advantage of Group synergies. In October 2007, IT systems were successfully migrated onto HSBC's core banking platform. This will enable HSBC France to integrate its branded operations and benefit from the Group's expertise in technology, process and products. In Turkey, ongoing investment in capacity and infrastructure to support business growth, as evidenced by the opening of 45 branches during 2007, contributed to a 17 per cent increase in operating expenses.

Commercial Banking reported a pre-tax profit of US\$2.5 billion, an increase of 4 per cent. Revenues rose by 12 per cent as a result of both balance sheet growth and an increase in fee-based

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product income, driven by customer recruitment and the expansion of the small and mid-market segments in Turkey and Malta. These benefits were partly offset by higher loan impairment charges, principally on corporate relationship managed accounts in the UK and increased operating expenses from ongoing business expansion throughout the region.

HSBC continued to expand the scope of its services in European emerging markets with the recruitment of a further 36 relationship managers. HSBCnet was launched in Armenia, Kazakhstan, Malta, Poland, the Czech Republic and Slovakia during the year. Significant income growth was recorded in Armenia and Poland, countries which offer potential for high GDP growth going forward and demand for conventional trade services.

In support of HSBC's strategy to be the leading international commercial bank, dedicated international corporate teams were established in London and Paris to drive and support cross-border business. Global Links and International Business Centres are now available in 11 European countries, simplifying cross-border account opening for customers and more than tripling successful outward referrals over 2006.

Net interest income increased by 7 per cent in 2007, largely from growth in the UK, Turkey, Germany and Malta. In the UK, a 10 per cent growth in deposit balances was primarily driven by a successful negotiated-rate deposit product launched in 2005. This helped fund lending growth of 14 per cent, which was largely the result of strong growth in corporate and structured banking and customer numbers in commercial centres. These income benefits were partly offset by narrower margins on loans and overdrafts as a result of increasingly competitive market conditions.

In France, HSBC continued to increase its client base, reflecting the ongoing success of initiatives to raise its brand profile and improve customer segmentation. HSBC reinforced its position as the leading international bank and increased the recruitment of new customers, particularly small businesses with high potential. Average lending balances increased by 19 per cent and average deposit balances, boosted by the financial markets crisis in the second half of the year, increased by 22 per cent. The income benefit of this balance sheet growth was more than offset by competitive pressures on margins and the maturity of previously higher-yielding hedging products. As a result, net interest income was slightly lower than 2006.

Net interest income in Turkey increased by 46 per cent, as HSBC continued to develop its

service offerings for its micro, small and mid-market business customers. Income benefited from growth of 108 per cent in small and micro customer lending together with a 114 basis point increase in spreads. This upward trend in lending spreads was driven by new product bundles and growth in Commercial Banking's profitable overdraft account. Average deposit balances rose by 4 per cent in Turkey, in part due to an increase in cash management clients, with wider margins further benefiting income.

Net fee income increased by 18 per cent. Excluding Commercial Banking's share of Insurance Brokers' fees previously reported in the "Other" segment, net fee income rose by 5 per cent. In the UK, a modest increase in net fee income was driven by growth in foreign exchange fees and card activity following the small-business credit card product successfully launched in May 2006. In Turkey, net fee income grew by 42 per cent, driven by investment banking, advisory and structured finance transactions, mainly due to a 15 per cent increase in corporate clients. Trade products also drove fee income and referrals from other HSBC Group offices which further contributed to the increase. In France, net fee income grew by 9 per cent, as customer acquisition and the consolidation of existing relationships led to a 9 per cent increase in transaction fees.

Gains on the sale of financial investments in 2007 reflected Commercial Banking's share of HSBC's sale of Marfin Popular Bank, an investment acquired in a share swap agreement with The Cyprus Popular Bank Limited ("Cyprus Popular Bank"), as part of the sale of HSBC's stake in the latter in 2006. 2007 benefited from further gains on the share of profits from the MasterCard Incorporated IPO, to a similar extent as in 2006.

Other operating income declined significantly, due to a fall in the PVIF long-term insurance business, following a change in FSA regulations. This was offset by a corresponding reduction in provisions reported in "Net

insurance claims and movements in liabilities to policyholders]. The non-recurrence of Commercial Banking's US\$38 million share of the gain on the sale of HSBC's stake in Cyprus Popular Bank also contributed to the fall in other operating income.

Loan impairment charges and other credit risk provisions remained low despite a 23 per cent rise on levels recorded in 2006. In the UK, loan impairment charges increased; this was concentrated in four large corporate accounts. In France, credit quality remained good and loan impairment charges stayed

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low despite balance sheet growth. In Turkey, increased charges reflected growth in lending volumes as general credit quality remained satisfactory.

Excluding Insurance Brokers, operating expenses increased by 7 per cent. Across Europe, costs were higher as a result of sales staff recruitment and other costs to support business development and expansion, particularly in Turkey and Eastern Europe. In addition, France incurred incremental restructuring costs relating to the migration of IT systems onto HSBC's core banking platform.

Global Banking and Markets in Europe reported a pre-tax profit of US\$2.5 billion, broadly in line with 2006 despite write-downs in credit, structured credit derivatives and certain positions in leveraged and acquisition finance, resulting from the challenging credit market in the second half of 2007. Apart from these product lines, the Global Markets and Global Banking businesses reported robust growth complemented by significant gains on principal investments. The cost efficiency ratio deteriorated by 3 percentage points.

Total operating income increased by 7 per cent to US\$7.6 billion. Strong foreign exchange and equities trading income drove revenue growth, enhanced by higher advisory fees and fair value gains in financing and capital markets. Securities services benefited from higher transaction volumes driven by increased market volatility. A rise in revenues from payments and cash management and principal investments further boosted income. This growth was partly offset by significant write-downs in credit and structured derivatives.

In the UK, payments and cash management income grew due to higher customer balances, which rose as the liquidity crisis led customers to increase their cash balances. In Turkey, higher balance sheet management revenues contributed US\$12 million.

Net fee income was 28 per cent higher, with robust growth in income from financing businesses in line with greater market activity in the UK and France in the first half of 2007. In securities services, a rise in volumes and new client mandates drove the increase in revenues. Assets under custody grew by 16 per cent.

Overall, income from trading activities fell due to US\$713 million of write-downs reported in credit, structured credit derivatives and leveraged and acquisition finance in the UK. These were partly offset by strong growth in foreign exchange driven by market volatility and a weakening US dollar. In

equities, strong trading income from core products was supplemented by a gain from the sale of Euronext shares. In France, the continuing trend of higher income from structured derivatives reflected the benefit of investment to enhance capabilities. The credit market dislocation also led to an adverse fair value adjustment in respect of loan commitments outstanding when global credit spreads widened in the second half of 2007.

The UK principal investments business benefited a small number of significant realisations during the year. Gains less losses from financial investments rose to US\$1.1 billion.

A net recovery on loan impairment charges, albeit lower than in 2006, reflected the continued low level of corporate credit defaults.

Operating expenses rose by 12 per cent to US\$5.2 billion. Operational costs rose in Global Markets, particularly in structured derivatives where the French businesses invested to support local revenue growth. Costs also rose in payments and cash management and securities services, driven by the rise in business volumes. Additional staff costs resulted from recruitment in selected businesses during 2006.

HSBC's share of profits from associates recovered due to the non-recurrence of an impairment charge on a private equity investment held by an associate in 2006.

Private Banking reported a pre-tax profit of US\$915 million, an increase of 11 per cent. A strong performance in Switzerland was driven by the promotion of advisory and discretionary mandates, with existing clients further leveraging their portfolios. Profits in the UK declined as a result of lower gains from the partial disposal of the Hermitage Fund. Excluding this transaction, UK revenue increased strongly. The cost-efficiency ratio increased slightly by 0.9 percentage points to 56.9 per cent, affected by lower investment gains in 2007. Despite this, the cost efficiency ratio is one of the strongest in the industry.

Net interest income rose by 14 per cent to US\$793 million. Switzerland contributed the majority of the increase. Loans and advances to customers increased by 31 per cent to US\$13.8 billion, as existing clients further leveraged their portfolios to take advantage of alternative investment opportunities. Monaco and Germany also contributed to the rise in net interest income. In Germany, net interest income increased by 14 per cent due to a large growth in deposits. Similarly, in Monaco, customer accounts rose, augmented by

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higher lending balances as existing clients increased their leverage.

Net fee income increased by 15 per cent to US\$1.0 billion, mainly due to a 10 per cent increase in funds under management in Switzerland with discretionary and advisory funds generating higher annual fees. Client investments in structured products and brokerage fees also contributed to the rise in fee income. In the UK, fees increased by 10 per cent, driven by a rise in wealth and loan fees.

Trading income was 63 per cent higher at US\$170 million, mainly driven by foreign exchange trading by clients in Switzerland.

Gains from financial investments decreased by 23 per cent to US\$115 million. This primarily related to a gain from a partial disposal of a seed capital investment in the Hermitage Fund which was lower than that recognised from an earlier disposal in 2006.

Client assets, which include deposits and funds under management, grew by 19 per cent to US\$258.4 billion. The large growth in client assets was driven by positive market performance and US\$20.2 billion of net new money, with Switzerland contributing US\$7.1 billion and the UK and Monaco contributing US\$3.7 billion and US\$3.6 billion each. The growth in cross-referrals continued, with inward referrals from other customer groups contributing US\$3.9 billion to total client assets.

Operating expenses were 15 per cent higher than in 2006, driven by business expansion. More front-office staff, higher performance-related bonuses, IT and marketing costs all contributed to the rise. The overall increase in operating expenses was partially offset by the effect of a change in pension arrangements.

Within **Other**, fair value movements in HSBC's own debt and related derivatives resulted in gains of US\$1.3 billion, largely as a consequence of movements in credit spreads. These movements will reverse through the income statement over the life of the debt unless the debt is repaid before its contractual maturity. This segment also benefited from a US\$73 million adjustment to the embedded value of HSBC's associate, HSBC Assurances, prior to the acquisition of its remaining capital, from which date it was accounted for as a subsidiary.

Year ended 31 December 2006 compared with year ended 31 December 2005

Economic briefing

UK GDP growth increased in 2006 to 2.9 per cent from 1.8 per cent in 2005. This followed a recovery in both household and company spending. CPI inflation increased through the year from 1.9 per cent in January to 3 per cent in December, following large increases in the price of petrol and gas. The Bank of England raised interest rates from 4.5 per cent to 5 per cent, citing concerns about spare capacity, rapid money growth and the possibility of inflation staying above target for some time. House price inflation remained strong but consumer spending appeared unaffected. Secured lending continued to increase although unsecured lending plateaued. There was evidence that a number of households were struggling with the burden of debt as personal insolvencies and repossessions increased. Employment rose, although by less than the increase in available workers as migrant inflows remained strong and the participation rate of UK residents in the labour force increased. As a result, the unemployment rate increased, contributing to constrained wage growth throughout the year despite relatively high rates of headline inflation.

The recovery in the **eurozone** economy gathered momentum through the course of 2006. GDP rose by approximately 2.7 per cent, the fastest rate since 2000. Much of the improvement reflected increases in exports and investment, as global demand remained strong and corporate activity and profits rose. Consumer spending remained subdued, despite a gradual rise in employment. German growth improved sharply, while growth in France and Italy was less impressive. Eurozone inflation was heavily affected by rises in energy and food prices. Inflation, excluding energy and food, remained contained at just 1.7 per cent. The ECB increased the key policy interest rate from 2.25 per cent at the beginning of 2006 to 3.5 per cent in December. The ECB continued to describe monetary policy as "accommodative", thereby effectively ending the year with a bias towards tightening.

Turkey's economy slowed markedly in the third quarter, with year-on-year GDP growth of 3.4 per cent, down from 7.8 per cent in the second quarter. The current account deficit continued to widen, reaching 8 per cent of GDP in December, partly from high-energy prices but also from the increasing substitution of imported materials for local ones due to the overvalued currency. More than half of the deficit was financed by healthy foreign direct investment inflows. The International

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*Europe > 2006***Reconciliation of reported and underlying profit before tax**

Year ended 31 December 2006 compared with year ended 31 December 2005

Europe	2005 as reported US\$m	Currency translation ¹ US\$m	2005 at 2006 exchange rates US\$m	Acqui- sitions and disposals ² US\$m	Underlying change US\$m	2006 as reported US\$m	Reported change %	Underlying change %
Net interest income	8,221	7	8,228	□	61	8,289	1	1
Net fee income	6,299	82	6,381	□	727	7,108	13	11
Other income ³	6,284	189	6,473	(11)	1,213	7,675	22	19
Net operating income ⁴	20,804	278	21,082	(11)	2,001	23,072	11	9
Loan impairment charges and other credit risk provisions	(1,929)	(25)	(1,954)	□	(201)	(2,155)	(12)	(10)
Net operating income	18,875	253	19,128	(11)	1,800	20,917	11	9
Operating expenses	(12,639)	(131)	(12,770)	□	(1,101)	(13,871)	(10)	(9)
Operating profit	6,236	122	6,358	(11)	699	7,046	13	11
Income from associates	120	6	126	(19)	(179)	(72)	(160)	(142)
Profit before tax	6,356	128	6,484	(30)	520	6,974	10	8

For footnotes, see page 130.

Monetary Fund's programme for Turkey remained on track.

Review of business performance

European operations reported a pre-tax profit of US\$7.0 billion compared with US\$6.4 billion in 2005, an increase of 10 per cent. On an underlying basis, pre-tax profits grew by 8 per cent. Underlying net operating income increased by 8 per cent, in line with operating expenses. Commercial Banking delivered a third successive year of growth, driven by strong balance sheet growth in the UK and organic expansion in Turkey. Record profits in Private Banking were driven by strong client asset inflows, a more sophisticated product mix and lending growth. Global Banking and Markets made encouraging gains in trading activities, and operating expenses rose in line with net operating income. In Personal Financial Services, net operating income growth slowed as HSBC tightened its underwriting criteria on unsecured credit. An emphasis on deposit, wealth and insurance products contributed to an increase in costs, which were driven by infrastructure investment both in the physical environment and direct channels.

The following commentary is on an underlying basis.

Personal Financial Services reported a pre-tax profit of US\$1.9 billion, 2 per cent lower than in 2005. Net operating income rose by 4 per cent and loan impairment charges increased by slightly more than revenues as increasing numbers of debtors sought formal protection from their obligations.

Costs grew by 7 per cent, reflecting investment in infrastructure throughout the region, and the cost efficiency ratio rose by 1.2 percentage points to 59.2 per cent.

In the UK, HSBC responded to concerns over high levels of consumer indebtedness and the growth in personal bankruptcies and individual voluntary arrangements (IVAs) by adopting more selective underwriting criteria and reducing credit origination. Revenues from credit-related insurance declined as a consequence. In response, HSBC increased its focus on non credit-related income streams, particularly savings and high-value current accounts. Strong balance growth in these products was achieved through marketing initiatives, competitive pricing and the success of innovative propositions such as the packaged Plus and Passport current accounts, the latter supported by the implementation during the year of a more refined approach to customer segmentation.

Considerable strategic attention was given to enhancing product distribution and channel management. The branch refurbishment programme continued and improvements were made to direct banking, notably the introduction of self-service machines and the upgrading of cash machine service offerings. HSBC's internet offering was also enhanced to offer personalised content and sales capabilities, with improved customer accessibility.

In France, a marked improvement in brand awareness after the 2005 rebranding to HSBC France, supported by competitive pricing, aided the recruitment of target customers and consequential

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balance sheet growth, most notably in residential property lending. Despite this growth, there was a decline in profit before tax, due to competitive pressures on margin and the time lag between incurring costs on customer acquisition and earning incremental revenue from future opportunities to cross-sell.

In Turkey profit before tax declined by 2 per cent, as revenue growth was offset by investment costs. Organic development was furthered by the opening of 37 new branches during the year, bringing the total to 193, and a number of marketing initiatives to build brand awareness. Balance sheet and revenue growth accelerated as a result, as did customer recruitment. Overall customer numbers stood at 2.3 million at the end of 2006.

Net interest income increased by 5 per cent to US\$5.7 billion, substantially from balance sheet growth throughout the region.

In the UK, net interest income was driven by growth in savings, deposit and current accounts, with higher balances achieved through targeted sales and marketing efforts. Interest income from credit cards and mortgages also increased.

A focus on liabilities helped boost new UK savings account volumes markedly in a buoyant yet highly competitive savings market. HSBC's competitive internet-based products were the key driver of growth. Cash invested in First Direct's 'e-savings' product trebled; balances in HSBC's 'Online Saver' increased sixfold. Overall, average savings balances, excluding money market investments, increased by 28 per cent and net interest income rose by 25 per cent.

Current account balances in the UK increased by 6 per cent to US\$26.0 billion. Within this, the proportion of value-added packaged current accounts attracting fees rose significantly. The number of HSBC's fee-based accounts more than doubled during 2006. In aggregate, packaged current account balances increased by 25 per cent and represented nearly half of the overall increase in current accounts. Spreads remained broadly in line with 2005.

Average UK credit card balances rose by 5 per cent, to US\$13.7 billion, driven by promotional campaigns and marketing. Growth was strongest in M&S branded cards, which represented 4 percentage points of the increase, driven by an increased sales focus which included extensive media advertising. This was partly offset by declining balances within the store cards business and the cards business of HFC Bank Ltd ('HFC'), reflecting HSBC's more restricted credit appetite. Spreads increased modestly compared with 2005.

Average UK mortgage balances rose by 11 per cent to US\$68.9 billion, primarily in fixed rate mortgages. Growth was achieved through competitive pricing and targeted marketing strategies, including the launch of new fixed, discount and tracker-rate mortgages during the year. A slight narrowing of spreads reflected a change in mix away from variable rate mortgages to fixed rate mortgages, and the competitive positioning referred to above.

Average unsecured lending balances in the UK declined by 4 per cent, reflecting HSBC's decision to contain growth through stricter underwriting criteria. Spreads narrowed, following the introduction in 2005 of preferential pricing for lower-risk customers, and a change in mix towards higher-value but lower-yielding loans.

In France, net interest income fell by 8 per cent. Spreads narrowed as older higher-yielding investments matured, while competitive pricing reduced lending yields, particularly in the residential mortgage market. These pressures on margin were only partially offset by strong balance sheet growth. Marketing campaigns building on the 'HSBC France' brand aided strong sales and customer recruitment, most notably in residential property lending and current accounts and also increased future cross-selling opportunities.

In Turkey, net interest income rose by 14 per cent. Lending grew strongly, substantially funded by deposit growth. Overall, deposit balances rose by over 50 per cent, largely driven by customer recruitment aided by the branch network expansion referred to above. Spreads widened following increases in overnight interest rates and the value of funds rose as a consequence. Marketing initiatives and cross-sales with credit card customers helped more than double average unsecured lending balances. Mortgage lending was also strong, with a 60 per cent increase in balances. Credit card balances rose by 22 per cent, with growth dampened by credit calming

measures imposed by government regulation.

Net fee income increased by 8 per cent to US\$2.5 billion. In the UK, rising sales of fee-earning packaged current accounts, travel money and investment products drove fee growth. Fees from unsecured lending also rose. These benefits were partly offset by lower creditor protection income, reflecting the steps taken by HSBC to constrain lending growth. Reduced loan sales and smaller average loans (the result of this initiative) led to both

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lower insurance sales and a reduction in average premiums.

In France, banking fees rose through higher sales of packaged current accounts. Transactional and overdraft fees and insurance distribution fees also increased, reflecting growth in the customer base. In Turkey, strong growth in lending volumes and, to a lesser extent, credit cards, helped drive fee income growth. Additional sales staff were recruited to reinforce the emphasis on wealth management, and the launch of new pension products also helped boost fees.

In 2006, MasterCard became publicly listed through an IPO, and the US\$37 million gain from financial investments mainly reflected Personal Financial Services' share of the proceeds of the IPO.

Responding to changes in work and shopping patterns among its customers and the increasing acceptance of direct channels. HSBC appraised its UK property portfolio during the year, and higher other operating income reflected Personal Financial Services' share of revenue from branch sale and lease-back transactions. Personal Financial Services' US\$37 million share income on the sale of HSBC's stake in Cyprus Popular Bank was also included within other operating income.

Lower sales of life and creditor repayment protection, which were driven by the constraints on personal lending growth referred to above, and a change in reinsurance arrangements at the end of 2005, contributed to the decrease in net earned insurance premiums. Lower sales of investment-linked insurance products, together with the effect of market movements on related insurance and investment assets, contributed to the decline in net income from financial instruments designated at fair value. This was largely offset by a corresponding decrease in net insurance claims and movements in policyholders' liabilities.

Loan impairment charges and other credit risk provisions of US\$1.8 billion were 6 per cent higher than in 2005, largely reflecting lending growth in the region.

In the UK, the 8 per cent rise in loan impairment charges was broadly in line with lending growth. Actions taken on underwriting and collection activities mitigated a continuation of the rising trend in personal bankruptcies and IVAs seen since the legislative change in 2004. In 2006, IVAs became the main driver of loan impairment growth across the industry as the availability and marketing of third-party debt reduction services increased.

Within the UK, loan impairment was most pronounced in consumer finance unsecured portfolios, in which delinquency also rose as the effect of interest rate increases on relatively high levels of indebtedness put pressure on household cash flows. In HSBC's other portfolios, action undertaken by HSBC during 2005 and early 2006, predominantly tightening underwriting criteria and collections procedures, proved successful in improving credit quality indicators on more recently written debt. In the second half of 2006, HSBC strengthened the measures available to manage insolvencies and impaired debt including, *inter alia*, the further development of predictive modelling to enhance underwriting decisions.

In France, credit quality was sound notwithstanding strong growth in customer advances, and the loan impairment charge remained low. In Turkey, overall credit quality was also sound, and delinquency on credit cards improved following enhanced collections efforts and changes in government regulation. This was reflected in a 36 per cent reduction in loan impairment charges.

Operating expenses increased by 7 per cent. A US\$57 million write-down of intangibles was attributed to card portfolios acquired in the UK which were written off in the light of the higher impairment charges being experienced. Excluding this item, the increase was 6 per cent, primarily reflecting investment in upgrading and expanding capacity and infrastructure across the region.

In the UK, 104 branches were refurbished during 2006. Responding to changing customer preferences and upgrading its customer service, HSBC extended its opening hours in certain branches, necessitating the recruitment of additional counter staff, and increased its IT investment in self-service machines and other direct banking channels, in the process improving cost efficiency.

In France, there was a 4 per cent rise in operating expenses, driven by the recruitment of additional sales staff, higher marketing expenditure to attract new customers, and the migration to a common IT infrastructure. In Turkey, the opening of 37 new branches and associated growth in numbers of sales staff and infrastructure costs drove a 26 per cent rise in costs. Marketing expenditure also increased in support of the growing consumer lending, insurance and pensions businesses.

Commercial Banking reported a pre-tax profit of US\$2.2 billion, an increase of 14 per cent compared with 2005. Adjusting for the sale of the UK fleet management and vehicle finance leasing business, which was sold in the autumn of 2005,

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profit before tax grew by 17 per cent, driven by growth of 10 per cent in net operating income compared with just 4 per cent in costs. Revenues increased by 9 per cent through balance sheet growth, customer recruitment and improved cross-sales in the UK, and expansion of the middle market, small and micro-businesses in Turkey. The 4 per cent growth in operating expenses primarily reflected investment to support business expansion throughout the region. Credit quality was stable.

In the UK, HSBC invested to expand sales capacity and improve service through recruitment and the opening of commercial centres. To support HSBC's strategic intention to lead the market in international commercial banking, a dedicated International Banking Centre was created which, as part of a global network, simplified cross-border account opening. HSBC also simplified and launched new foreign currency accounts. Significant progress was made in enhancing the functionality of HSBC's award-winning internet banking, including the implementation of the UK's first same-day high-value payments offering and the launch of HSBC's first commercial direct banking proposition, Business Direct, which attracted over 19,000 small and micro business accounts during the year.

In France, HSBC increased customer recruitment by approximately one third by concentrating on improving brand awareness among commercial businesses. HSBC became the principal banker for the majority of new customers recruited. In Turkey, the establishment of eight centres, the recruitment of additional relationship management staff and a focus on maintaining high service levels contributed to a 40 per cent increase in the number of active customers as HSBC successfully sustained its efforts to grow its share of middle market, small and micro-business banking.

Net interest income increased by 8 per cent, largely driven by increases in the UK and Turkey. In France, the benefit of strong balance sheet growth was more than offset by competitive pressure on margins.

HSBC slowed the rate of growth in lending in the UK during 2006 by refining underwriting criteria and emphasising non-lending related revenue streams and, consequently, average lending balances rose by 8 per cent during the year and spreads remained broadly flat. Increased priority was given to raising deposits through transactional and savings accounts and, as a result, deposit balances rose by 37 per cent and current account balances by 8 per cent. The benefit of this volume growth was partly offset by spread compression on sterling-

denominated accounts as customers were offered more attractive pricing.

HSBC boosted the recruitment of small and micro business customers in the UK by holding commercial theme weeks and increasing client contact by embedding business specialists in selected branches. These initiatives delivered increases in the number of start-up accounts and the number of customers who switched their business from other banks to HSBC. Higher-value international and foreign currency accounts rose as a consequence.

Net interest income in France was broadly in line with 2005 as the benefit of strong balance sheet growth, driven by the acquisition of new customers and improved levels of customer retention, was offset by narrowing spreads from competitive market pressures and lower earnings from free funds.

Net interest income in Turkey increased by 41 per cent, driven by a doubling in lending balances. HSBC extended its geographic coverage through expansion of the branch network, including the launch of eight new centres dedicated to smaller commercial customers, and these boosted customer recruitment. The introduction of pre-approved credit limits for existing customers also contributed to lending growth, and the focus on attracting liability products helped more than double deposit balances.

Net fee income increased by 4 per cent to US\$1.7 billion. Current account and money transmission fees rose as a result of customer recruitment and higher transaction volumes in most countries. In the UK, client workshops and other promotional activities were deployed to support increased sales of treasury products, boosting treasury revenue as foreign exchange volumes grew. In France a 2 per cent increase in income was largely in transactional current account fees, reflecting growth in the customer base.

Other operating income was 41 per cent lower than in 2005 and reflected lower asset finance revenues following the sale of the UK fleet management business referred to above. This was partly offset by the inclusion of Commercial Banking's share of the gain on the sale of HSBC's stake in Cyprus Popular Bank (US\$38 million),

and the income from UK branch sale and lease-back transactions.

Credit quality in Commercial Banking was stable in most countries. In the UK, loan impairment charges and other credit risk provisions fell by 16 per cent, largely due to the non-recurrence of an individual loan impairment allowance against a single customer in 2005. Excluding this, there was a

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modest decline in UK impairment charges, as the effect of lending growth was more than offset by improved credit quality, particularly in relation to HSBC's larger exposures. In France, loan impairment charges, while remaining low, returned to a more normal level after relatively high recoveries in 2005. In Turkey, higher loan impairment charges reflected growth in lending.

Operating expenses decreased by 1 per cent. Excluding the sale of the UK fleet management activities referred to above, costs were 4 per cent higher than in 2005, reflecting investment to drive business growth throughout the region. As a result of revenues growing significantly faster than costs, there was a 3.1 percentage point improvement in the cost efficiency ratio. In the UK, increased costs reflected the recruitment of additional sales staff and higher IT expenditure. Costs in France fell by 2 per cent compared with 2005 as savings from cost control offset increases from the recruitment of additional sales staff and expenses associated with the migration to common IT platforms. In Turkey, recruitment and marketing costs incurred in support of the growing small and micro businesses drove a 38 per cent rise in expenses.

Global Banking and Markets reported a pre-tax profit of US\$2.3 billion, an increase of 5 per cent, compared with 2005. A reduction in recoveries of loan impairment charges and lower private equity gains masked strong growth in core operating activities. Global Markets' revenues were 36 per cent higher than in 2005 as robust performances in the global capital markets and securities services businesses were complemented by strong trading gains. The cost efficiency ratio improved modestly compared with 2005.

Total operating income was US\$6.6 billion, 17 per cent higher than in 2005. This was despite the fact that in the UK, France and Turkey, balance sheet management revenues continued to fall, resulting in an overall decline of 56 per cent. This shortfall was partly offset by higher net interest income in securities services as customer volumes grew in higher-value products such as securities lending and foreign exchange. The lending business delivered a 13 per cent increase in corporate balances and corporate spreads remained broadly in line with 2005.

Net interest income in the payments and cash management business rose as deposit balances increased by 18 per cent. Surplus liquidity in the market fed higher business volumes. Increased transaction volumes resulting from new client

acquisitions and recent expansion initiatives also contributed to higher revenues.

Net fee income rose by 23 per cent, reflecting a 63 per cent fee increase in the global capital markets business and fees more than doubling in the securities services business. The financing and advisory businesses benefited from a higher number of deals mandated and a broader product range. Assets under custody grew by 22 per cent with notable increases in alternative fund assets, particularly from Ireland and Luxembourg.

In HSBC Global Asset Management, revenues increased significantly, boosted by a 4 per cent increase in funds under management and higher performance fees allied to revenues from disposals of property and structured finance fund investments.

Trading income increased with positive revenue trends in the key product areas where HSBC has invested, notably Credit and Rates, foreign exchange and structured derivatives. Revenues increased substantially, particularly in the area of interest rate derivatives, which benefited from opportunities created by a relatively volatile market. Additional gains were reported in emerging market bonds due to higher volumes, as investors adjusted their risk appetite and responded to a general improvement in market sentiment towards developing economies. Higher foreign exchange revenue was driven by greater customer volumes and increased trading

opportunities offered by a combination of US dollar volatility and more uncertain economic conditions in emerging markets. Structured derivatives income increased by 88 per cent as HSBC leveraged its investment in this business to meet the needs of its institutional clients.

Gains from sales of financial investments, at US\$413 million, were in line with 2005. Notable among the investments realised in the year were the sales of specialist property and structured finance fund investments by HSBC Global Asset Management.

Other income declined by 26 per cent as one-off gains from restructuring and syndication of assets in Global Investment Banking were not repeated.

The overall credit environment remained favourable with market liquidity supporting debt reconstruction as credit spreads tightened. As a result, HSBC achieved net recoveries for the third year in succession, albeit at a lower level than in 2005, when HSBC benefited from a release of collective impairment allowances in the second half.

Operating expenses were 14 per cent higher at US\$4.2 billion, largely supporting volume growth

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in various businesses and performance-related compensation in Global Markets, where revenues increased by 36 per cent. Costs in 2006 also reflected the full-year effect of the investment made throughout 2005 as well as ongoing investment in product development, particularly in structured derivatives and Credit and Rates. In HSBC Global Asset Management, a robust performance resulted in higher staff and support costs.

A rise in operational expenditure was driven by increased volumes as well as new business won in respect of payments and cash management funds administration, securities services and Group Investment Businesses.

The decline in HSBC's share of profits in associates and joint ventures reflected a loss arising from an impairment charge on a private equity investment within an associate. This was compounded by the non-recurrence of one-off gains realised in 2005, a significant proportion of which were recognised in the second half of the year.

Private Banking delivered a record pre-tax profit of US\$805 million in Europe, an increase of 48 per cent compared with 2005. The cost efficiency ratio improved by 6.7 percentage points to 55.7 per cent. There was a US\$108 million gain on the partial sale of an investment in the Hermitage Fund and, excluding this, pre-tax profit increased by 28 per cent. This result was achieved through growth in client assets, increased lending and transaction volumes and distribution of a broader and more sophisticated product range. Growth in intra-Group referrals with other customer groups was encouraging and also contributed to increased revenues.

Net interest income was 23 per cent higher at US\$675 million, driven by balance sheet growth, primarily in the UK and Switzerland. Lending balances were 24 per cent higher and were funded by increased deposits. In the UK, the 31 per cent expansion of the lending book resulted primarily from growth in mortgage balances driven by a market which remained buoyant at the upper end. In Switzerland, an 18 per cent rise in lending largely reflected client appetite for leverage to facilitate equity and alternative investment opportunities.

Fee income increased by 19 per cent to US\$869 million. This growth resulted from increased funds under management and a favourable mix change towards higher fee-generating discretionary and advisory managed funds, including the continued success of the Structured Investment Solutions (SIS) and Core Investment Solutions (CIS) products and the launch of the Actively

Managed Portfolio product. A significant performance fee came from the Hermitage Fund, a public equity fund dedicated to Russia, which was US\$23 million greater than in 2005. The expansion of HSBC's residential property advisory business, which opened new offices in the UK and France, also contributed to fee income growth.

Gains from financial investments in both 2005 and 2006 arose mainly from the sale of debt and investment holdings. Gains in 2006 included US\$108 million from the partial disposal of HSBC's investment in the Hermitage Fund.

Excluding gains from financial investments, trading and other operating income was marginally lower than in 2005.

Client assets, including deposits, rose by 18 per cent to US\$218 billion. Net new money was US\$19 billion, with the largest inflows arising in Switzerland and the UK. In Switzerland, improved brand awareness, successful product placement and cross-referrals with other customer groups, all contributed to significant net new money of US\$11 billion. In the UK, net new money of US\$3 billion was garnered from referrals from Commercial Banking and the retail network, new regional offices and continued growth in the underlying business. Net new money in Monaco and Germany exceeded US\$1 billion and US\$2 billion, respectively, also contributing to the growth in client assets. The value of clients' investments in HSBC's discretionary managed suite of SIS and CIS products grew very strongly, reaching US\$1.7 billion.

Operating expenses were 13 per cent higher than in 2005 due to higher performance-related remuneration, recruitment of client-facing professionals across the region to support the growth of the business, and continued investment in the recently opened UK regional offices. The combination of HSBC's principal trust businesses in Switzerland also added to costs in 2006 but is expected to bring efficiency gains in subsequent years. Overall

increased expenses were more than offset by greater revenue generation which contributed to the 6.7 per cent improvement in the cost efficiency ratio.

In **Other**, increases in US interest rates led to higher earnings on capital, which were partly offset by increased subordinated debt-servicing costs.

Movements in the fair value of own debt and associated hedges were US\$33 million, compared with an adverse movement of US\$15 million in 2005, principally from movements in HSBC's own credit spread. The fair value of own debt

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

incorporates an element attributable to the credit spread on HSBC's debt instruments. As HSBC's credit spreads narrow, accounting losses are reported, and the reverse is true in the event of spreads widening. These valuation adjustments do

not alter the cash flows envisaged as part of the documented interest rate management strategy.

Operating expenses decreased by 5 per cent, driven by the non-recurrence of litigation expenses in France.

Profit/(loss) before tax and balance sheet data by customer group and global business

Year ended 31 December 2007

Europe	Personal		Global Banking & Markets US\$m	Private Banking US\$m	Other US\$m	Inter- segment elimination ¹⁴ US\$m	Total US\$m
	Financial Services US\$m	Commercial Banking 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/(expense) 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/(expense) ⁵	53	66	2,047	170	90	4,517	6,943
Net income 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)	<u>54</u>	<u>(35)</u>	<u>853</u>	<u>8</u>	<u>301</u>	<u>12</u>	<u>1,193</u>
Total operating income	13,459	6,236	7,647	2,125	1,567	12	31,046
Net insurance claims ⁶	<u>(3,214)</u>	<u>(265)</u>	<u>□</u>	<u>□</u>	<u>□</u>	<u>□</u>	<u>(3,479)</u>
Net operating income⁴	10,245	5,971	7,647	2,125	1,567	12	27,567
Loan impairment (charges)/ recoveries and other credit risk provisions	<u>(2,044)</u>	<u>(515)</u>	<u>26</u>	<u>(4)</u>	<u>(5)</u>	<u>□</u>	<u>(2,542)</u>
Net operating income	8,201	5,456	7,673	2,121	1,562	12	25,025
Total operating expenses	<u>(6,635)</u>	<u>(2,941)</u>	<u>(5,150)</u>	<u>(1,208)</u>	<u>(579)</u>	<u>(12)</u>	<u>(16,525)</u>
Operating profit	1,566	2,515	2,523	913	983	□	8,500
Share of profit in associates and joint ventures	<u>15</u>	<u>1</u>	<u>4</u>	<u>2</u>	<u>73</u>	<u>□</u>	<u>95</u>
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
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m

Balance sheet data⁷

Loans and advances to customers (net)	151,687	106,846	163,066	30,195	481	452,275
Total assets	200,432	124,464	794,673	60,010	4,736	1,184,315
Customer accounts	178,757	99,704	163,713	62,055	725	504,954
The following assets and liabilities were significant to Global Banking and Markets:						
□ loans and advances to banks (net)			89,651			
□ trading assets, financial instruments designated at fair value, and financial investments			395,617			
□ deposits by banks			85,315			

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Year ended 31 December 2006

	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Private Banking US\$m	Other US\$m	Inter- segment elimination ¹⁴ US\$m	Total US\$m
Europe							
Net interest income	5,653	2,923	1,222	675	14	(2,198)	8,289
Net fee income	2,533	1,707	1,673	869	326	□	7,108
Trading income/(expense) excluding net interest income	119	27	2,636	99	(39)	□	2,842
Net interest income/(expense) on trading activities	(6)	15	(523)	2	1	2,198	1,687
Net trading income/(expense) ⁵	113	42	2,113	101	(38)	2,198	4,529
Net income from financial instruments designated at fair value	80	27	11	□	26	□	144
Gains less losses from financial investments	37	22	413	149	3	□	624
Dividend income	2	3	171	5	2	□	183
Net earned insurance premiums .	979	110	□	□	209	□	1,298
Other operating income	128	103	957	13	256	(29)	1,428
Total operating income	9,525	4,937	6,560	1,812	798	(29)	23,603
Net insurance claims ⁶	(331)	(19)	□	□	(181)	□	(531)
Net operating income⁴	9,194	4,918	6,560	1,812	617	(29)	23,072
Loan impairment (charges)/ recoveries and other credit risk provisions	(1,838)	(386)	64	2	3	□	(2,155)
Net operating income	7,356	4,532	6,624	1,814	620	(29)	20,917
Total operating expenses	(5,447)	(2,298)	(4,224)	(1,010)	(921)	29	(13,871)
Operating profit/(loss)	1,909	2,234	2,400	804	(301)	□	7,046
Share of profit/(loss) in associates and joint ventures	□	□	(96)	1	23	□	(72)
Profit/(loss) before tax	1,909	2,234	2,304	805	(278)	□	6,974

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	%	%	%	%	%	%
Share of HSBC's profit before tax	8.6	10.1	10.4	3.6	(1.2)	31.5
Cost efficiency ratio	59.2	46.7	64.4	55.7	149.3	60.1

	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m
Balance sheet data ⁷						
Loans and advances to customers (net)	147,507	81,430	140,277	23,283	2	392,499
Total assets	174,865	98,073	502,340	49,440	3,983	828,701
Customer accounts	152,411	80,312	139,416	47,223	3	419,365

The following assets and liabilities were significant to Global Banking and Markets:

□ loans and advances to banks (net)			63,788			
□ trading assets, financial instruments designated at fair value, and financial investments			219,304			
□ deposits by banks			65,963			

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*Europe > Profit/(loss) before tax by customer group/Hong Kong*Profit/(loss) before tax and balance sheet data by customer group and global business (*continued*)

	Year ended 31 December 2005						
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Private Banking US\$m	Other US\$m	Inter- segment elimination ¹⁴ US\$m	Total US\$m
Europe							
Net interest income	5,309	2,659	827	548	95	(1,217)	8,221
Net fee income	2,314	1,621	1,339	730	295	□	6,299
Trading income/(expense) excluding net interest income	81	16	1,493	93	(23)	□	1,660
Net interest income/(expense) on trading activities	3	2	159	□	(5)	1,217	1,376
Net trading income/(expense) ⁵	84	18	1,652	93	(28)	1,217	3,036
Net income/(expense) from financial instruments designated at fair value	305	71	17	□	(31)	□	362
Gains less losses from financial investments	(4)	4	396	27	16	□	439
Dividend income	2	7	27	9	18	□	63
Net earned insurance premiums .	1,220	115	□	□	264	□	1,599
Other operating income	42	178	1,252	18	329	(216)	1,603
Total operating income	9,272	4,673	5,510	1,425	958	(216)	21,622
Net insurance claims ⁶	(577)	(62)	□	□	(179)	□	(818)
Net operating income⁴	8,695	4,611	5,510	1,425	779	(216)	20,804
Loan impairment (charges)/ recoveries and other credit risk provisions	(1,711)	(378)	155	5	□	□	(1,929)

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Net operating income	6,984	4,233	5,665	1,430	779	(216)	18,875
Total operating expenses	(5,058)	(2,301)	(3,647)	(891)	(958)	216	(12,639)
Operating profit/(loss)	1,926	1,932	2,018	539	(179)	□	6,236
Share of profit in associates and joint ventures	6	7	96	□	11	□	120
Profit/(loss) before tax	1,932	1,939	2,114	539	(168)	□	6,356

% % % % % %

Share of HSBC's profit before tax	9.2	9.2	10.1	2.6	(0.8)		30.3
Cost efficiency ratio	58.2	49.9	66.2	62.5	122.9		60.8
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m

Balance sheet data⁷

Loans and advances to customers (net)	120,302	66,965	107,899	17,368	3		312,537
Total assets	143,095	80,864	367,893	40,971	3,880		636,703
Customer accounts	122,118	61,789	109,086	41,206	1		334,200

The following assets and liabilities were significant to Global Banking and Markets:

□ loans and advances to banks (net)			34,218				
□ trading assets, financial instruments designated at fair value, and financial investments			168,062				
□ deposits by banks			45,075				

For footnotes, see page 130.

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

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
Personal Financial Services	4,212	2,880	2,628
Commercial Banking	1,619	1,321	955
Global Banking and Markets	1,578	955	922
Private Banking	305	201	190
Other	(375)	(175)	(178)
	7,339	5,182	4,517

Profit before tax

	Year ended 31 December		
	2007 US\$m	2006 US\$m	2005 US\$m
Net interest income	5,483	4,685	4,064
Net fee income	3,362	2,056	1,674
Net trading income	1,242	617	546
Net income/(expense) from financial instruments designated at fair value	676	260	(6)
Gains less losses from financial investments	94	162	108
Dividend income	31	61	41
Net earned insurance premiums	2,797	2,628	2,334
Other operating income	845	834	805
Total operating income	14,530	11,303	9,566
Net insurance claims incurred and movement in liabilities to policyholders .	(3,208)	(2,699)	(2,059)
Net operating income before loan impairment charges and other credit risk provisions	11,322	8,604	7,507
Loan impairment charges and other credit risk provisions	(231)	(172)	(146)
Net operating income	11,091	8,432	7,361
Total operating expenses	(3,780)	(3,269)	(2,867)
Operating profit	7,311	5,163	4,494
Share of profit in associates and joint ventures	28	19	23
Profit before tax	7,339	5,182	4,517
	%	%	%
Share of HSBC's profit before tax	30.3	23.5	21.5
Cost efficiency ratio	33.4	38.0	38.2
Year-end staff numbers (full-time equivalent)	27,655	27,586	25,931

Balance sheet data⁷

	At 31 December		
	2007	2006	2005
	US\$m	US\$m	US\$m
Loans and advances to customers (net)	89,638	84,282	83,208
Loans and advances to banks (net)	63,737	50,359	42,751
Trading assets, financial instruments designated at fair value, and financial investments	102,180	103,734	81,631
Total assets	332,691	272,428	235,376
Deposits by banks	6,420	4,799	4,708
Customer accounts	234,488	196,691	173,726

For footnote, see page 130.

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HSBC HOLDINGS PLC

Report of the Directors: Business Review (continued)*Hong Kong > 2007*

Year ended 31 December 2007 compared with year ended 31 December 2006

Economic briefing

Hong Kong's economy remained robust during 2007, with the annual rate of growth of 6.3 per cent. Domestic consumption was the major contributor to economic expansion, supported by the strong labour market. The unemployment rate fell to 3.4 per cent, a nine year low, as the supply of labour remained very tight. Global increases in food and oil prices affected Hong Kong, but the territory also experienced wage inflation, rising import prices and growth in property rental costs. Inflation increased as a result, exceeding 3 per cent in the final quarter of the year.

In response to interest rate cuts in the US and capital inflows into the local market, Hong Kong's main interest rate was cut on three separate occasions during the final months of 2007, with the prime rate ending the year at 6.75 per cent, down by one per cent from its high for the year. Local asset markets benefited accordingly. The previously very strong levels of export growth slowed in the second half of 2007, as demand from the US moderated and the reduction in mainland China's export tax rebate in July temporarily affected Hong Kong's re-exports. Despite relatively modest trade growth, external demand for Hong Kong's services remained strong due to the buoyant tourism sector and increasing cross-border business activities, especially within the financial sector.

Reconciliation of reported and underlying profit before tax

Year ended 31 December 2007 compared with year ended 31 December 2006

	2006 as reported	Currency translation ¹	2006 at 2007 exchange rates	Acquisitions, and dilution disposals and gains ²	Underlying change	2007 as reported	Reported change	Underlying change
Hong Kong	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	4,685	(15)	4,670	□	813	5,483	17	17
Net fee income	2,056	(6)	2,050	□	1,312	3,362	64	64
Other income ³	1,863	(6)	1,857	□	620	2,477	33	33
Net operating income⁴	8,604	(27)	8,577	□	2,745	11,322	32	32
Loan impairment charges and	(172)	1	(171)	□	(60)	(231)	(34)	(35)

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growth in loan and deposit balances, generated a rise in net operating income of 37 per cent. The cost efficiency ratio improved to 27.2 per cent. Increased business volumes fed through to higher costs, but these were considerably lower than revenue gains as efficiencies were attained from productivity gains in the sales force and the increased use of automated channels and straight-through processing.

Net interest income grew by 16 per cent to US\$3.3 billion in 2007, due to better margins and growth of average deposit balances. Effective balance sheet management and the successful marketing of key products, including HSBC Premier, further contributed to deposit growth.

Average customer deposits grew by 10 per cent, driven by a series of tactical campaigns and new deposit initiatives, including Deposits SmartPicks, which led to new customer acquisition. The relaunch of Premier, which incorporates seamless international banking connectivity and enhanced service benefits, supported strong growth in the number of customers using the service. At the end of 2007, the number of Premier customers was 15 per cent higher than at the end of 2006, at more than 290,000.

An active property market was underpinned by strong economic conditions and stable domestic interest rates throughout most of the year. The volume of new mortgages grew but spreads tightened in a competitive market. The cross-selling of mortgage-related insurance products, including HomeSure, enhanced overall revenue and customer value. Premier customers were responsible for 45 per cent of new mortgage balances while the launch of a deposit-linked mortgage repayment plan was successful in strengthening customer relationships.

A number of credit card programmes were launched in 2007 which successfully increased overall card balances by 15 per cent, and the total number of cards in circulation rose by 6 per cent to 4.9 million at the end of the year. HSBC's credit card business maintained its leading position in terms of cards in circulation, spending and balances.

HSBC's development of its investment and wealth management platforms benefited from the buoyant stock market in Hong Kong. This led to an increase in fees from the sale of retail securities and retail investment funds, leading to a 103 per cent increase in net fee income to US\$2.0 billion. This was mainly due to higher trading volumes, reflecting rising market turnover and value gains compared with the prior year.

The volume of retail securities transactions registered over 167 per cent growth with 80 per cent of trades performed online. In response to significant increases in market volumes during the year, online trading capacity was augmented to handle a four-fold increase in the peak number of users. In the fourth quarter, credit-related liquidity concerns, fears of a US recession and the implementation of measures in mainland China to dampen the economy led to equity market falls which slowed the rate of growth of fee income from share dealing and investment activities.

Over the course of 2007, investment market sentiment together with continued IPO activity, largely from mainland China, drove total funds under management higher. The introduction of new funds and the launch of awareness campaigns helped to boost income from retail investment funds and structured investment products by 144 per cent. WealthMaster, a new portfolio wealth management sales tool, was introduced during 2007 to support branch staff sales of these products. Equity market performance was a catalyst for significant increases in broking income in Hong Kong.

Credit card fee income rose by 20 per cent, as promotional campaigns led to increased cards in circulation and contributed to a 17 per cent rise in cardholder spending.

Life insurance commission income increased by 50 per cent, boosted by the launch of new products, LifeInvest and LifeSave, a medical cover policy incorporating retirement savings. HSBC extended its market leadership position for share of life insurance new business premiums. Emphasis on lower cost online channels increased the percentage of non-life policies sold through them to 53 per cent, while distribution through telemarketing channels also contributed to increased sales.

Loan impairment charges rose by 47 per cent due to increased card balances. Despite a rise in bankruptcies in Hong Kong, credit quality was stable and non-performing loans as a percentage of advances fell by 10 basis points.

Operating expenses rose by 16 per cent due to higher performance-related pay and a rise in premises costs as demand for space in Hong Kong put upward pressure on rents. Increased marketing expenses reflected business growth and the launch of new initiatives. Higher IT costs were also incurred as new systems were developed. The cost efficiency ratio improved as increased revenues were delivered by sales productivity gains and the use of direct channels.

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HSBC HOLDINGS PLC

Report of the Directors: Business Review

(continued)

Hong Kong > 2007

Commercial Banking reported pre-tax profits of US\$1.6 billion, 23 per cent higher than in 2006, due to strong balance sheet growth. The rise in asset balances was supported by active marketing efforts and increased trade volumes in Hong Kong. Higher customer numbers across all segments helped to boost deposits and fee income rose as a result of a wider product range and increased sales of investment products. The cost efficiency ratio improved by 1.2 percentage points. While strong economic growth was a stimulus to revenue growth, HSBC also actively increased its customer base by opening business banking branches and adding frontline staff. Market share increased for key products, including remittances and the integrated account package, Business Vantage, which attracted 36,000 new accounts. Revenues from payments and cash management rose by 17 per cent. A series of reward programmes and customer events strengthened existing client relationships. The launch of SmartForms for cross-border as well as domestic account openings further improved accessibility to services for small businesses. Total customer numbers grew by 9 per cent.

Net interest income rose by 15 per cent as a result of higher deposits, as strong economic growth generated demand for savings products. New customers based in mainland China increased the small and mid-market client base and generated an increase in Hong Kong dollar deposits. Foreign currency deposits, including US dollars, also increased significantly as global interest rates rose and spreads were actively managed in a highly competitive market.

Overall, loans and advances to customers grew by 10 per cent as HSBC continued to increase its lending to manufacturers who were expanding their operations in mainland China, while intra-Asian trade flows continued to accelerate. HSBC also promoted its Green Equipment Financing option to borrowers in Hong Kong to enable them to finance energy-efficient equipment. Successful cross-border referrals rose by 95 per cent, due to continued initiatives promoting regional interaction. Hang Seng Bank also targeted the cross-border activity of small and medium-sized businesses by promoting its import and export products. Market competition squeezed asset spreads on lending to corporate and mid-market business customers.

Increased sales of packaged products to small and micro businesses were partially driven by lending campaigns for equipment financing and micro lending.

The business card launched by HSBC in 2006 was quickly adopted; in 2007, over 21,000 new business credit cards were issued. Spreads, however, tightened due to competitive pressures.

Net fee income of US\$526 million was 16 per cent higher, driven by increased sales of investment products, remittances, and trade services. Demand from commercial clients for retail securities, unit trusts and structured products helped fee income from these products to rise by 173 per cent. Remittance income rose by 26 per cent, boosted by an increase in transaction volumes. In addition, a focus on straight-through processing and simplified account opening procedures attracted customers to fee-based products as the convenience of the internet and other direct options provided them with more flexible options for their business operations.

As a result of several commercial insurance marketing campaigns launched during the year, and a realigned sales force, insurance fee income increased by 11 per cent and net earned insurance premiums rose by 37 per cent. Composite sales teams were established to enable general insurance sales managers to also sell life products.

Improved trading income was underpinned by exchange rate volatility, which drove increased payments and trade activity as well as income from foreign exchange and derivatives. Targeted marketing and the enhancement of Business Internet Banking (BIB) to include forward contracts helped to increase transactions. Trading between US and Hong Kong dollars and the hedging of renminbi transactions also led to higher transaction volumes.

Loan impairment charges fell sharply by 59 per cent due to releases of provisions in a stable credit environment.

Expenses rose by 12 per cent as a result of higher staff costs and rising commercial rents. Staff cost increases reflected a combination of wage inflation, performance-related compensation and the costs of additional client-facing staff to support enhanced product offerings. In addition, marketing costs rose to support branding and campaign activity.

A total of 176,000 customers were registered as internet users at the end of 2007, reflecting wide adoption of direct channel offerings. The BIB site was relaunched in the first quarter of the year, leading to processing cost efficiencies. Call centres were also re-engineered to promote the sale of packaged products. Transactions through direct channels constituted 40 per cent of the total number of transactions.

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Global Banking and Markets in Hong Kong reported a pre-tax profit of US\$1.6 billion, which represented a rise of 65 per cent compared with 2006. This was principally due to a recovery in balance sheet management revenues, a strong performance in Global Markets, including significant growth in fees from securities services, and higher income from payments and cash management. The cost efficiency ratio improved by 10.5 percentage points.

Total operating income increased by 43 per cent to US\$2.6 billion, rising significantly as balance sheet management revenues recovered and Global Markets benefited from market volatility, boosting trading income from structured derivatives, foreign exchange and equities.

Along with the improvement in balance sheet management performance, net interest income growth was driven by the continued rise in deposit balances and related margins, reflecting the buoyant local markets.

Net fee income rose by 28 per cent as the strong equities market and healthy investor confidence drove increases in volumes in securities services. Assets under custody rose by 56 per cent due to strong growth in new business.

Trading income increased by 20 per cent, mainly from foreign exchange, structured derivatives, equities and rates. Global Markets benefited from interest rate volatility during the year and a buoyant equity market backed by mainland Chinese stocks listed in Hong Kong, as well as currency volatility as regional currencies rose against the US dollar. Structured products generated strong earnings, particularly due to higher sales of products incorporating equity derivatives. Initiatives taken in previous years to extend the product range, ongoing investments in technical and operating capabilities, and sustained cross-sales efforts stimulated revenue growth.

The corporate credit environment remained benign with a small loan impairment charge, compared with a net release in 2006.

Operating expenses of US\$1.0 billion rose by 13 per cent, 30 percentage points less than revenue growth. The expansion of certain businesses, including equities, structured derivatives and securities services resulted in higher operational expenses. Staff cost growth reflected performance incentives in line with the rise in revenues, and higher staff numbers.

Private Banking reported a pre-tax profit of US\$305 million. Excluding a US\$39 million geographical reclassification, the underlying increase was 72 per cent. Client demand for structured products increased, encouraged by the buoyant stock market. The cost efficiency ratio improved by 6.4 percentage points to 43.1 per cent.

Excluding a US\$42 million geographic reclassification, net interest income grew substantially. A significant rise was recorded in both deposits and lending. An increase in relationship managers and HSBC's brand reputation attracted new deposits, and clients continued to leverage their investments due to the relatively low cost of borrowing. This was supported by improved treasury performance, as US dollar and Hong Kong dollar interest rates declined.

Fee income rose by 46 per cent as more clients invested in mutual funds to take advantage of the local stock market performance. In addition, the promotion of discretionary products further contributed to the rise in revenues. The SIS product, which provides clients with externally managed portfolios tailored to their specific needs, proved particularly popular.

Trading income also benefited from the strength of equity markets, with a 59 per cent increase to US\$280 million. Demand for alternative funds and structured equity products was high, particularly for the Forward Accumulator, a product linked to the Hong Kong Stock Exchange.

Client assets grew by 43 per cent to US\$72.7 billion. Net new money contributed to 49 per cent of the increase, driven by a rise in the number of relationship managers and a wide variety of discretionary products. Cross-referrals from other customer groups also increased, with inward referrals from other customer groups contributing US\$898 million of net new money.

Operating expenses were 17 per cent higher at US\$231 million, mainly due to increased employee numbers, predominantly in the front office, higher remuneration and performance-related bonuses awarded in order to retain key staff in a very buoyant market.

Within **Other**, the non-recurrence of gains in 2006 from the sale of properties and investments, notably the sale of UTI Bank Limited and the then Hang Seng head office building, resulted in a higher pre-tax loss in this segment.

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Year ended 31 December 2006 compared with year ended 31 December 2005

Economic briefing

Hong Kong experienced sustained economic expansion in the second half of 2006 with growth, particularly in exports, regaining momentum following a mild slowdown in the second quarter. Domestic demand underpinned the economy throughout 2006 despite volatility in the stock market, which suffered a correction in the second quarter but recovered strongly in the second half of the year. Falling unemployment, improved household incomes and positive longer-term economic prospects were the key elements supporting domestic consumption. Hong Kong's unemployment rate fell to a six-year low of 4.4 per

cent towards the end of 2006, and the labour market began to tighten in certain sectors, with wage pressure increasingly evident. Despite this, inflation remained low, averaging 2 per cent in 2006. Investment growth surged in the second half of the year as the local interest rate cycle peaked. The residential property market divided, with prices of luxury property exceeding levels last seen in the boom in 1997 while, elsewhere in the sector, activity and prices remained flat. At the same time, investment in the construction sector was weak in the absence of large-scale infrastructure projects and general uncertainty. Externally, trade performance improved in the second half of 2006 following difficulties in the first half of the year due to volatile external demand from western markets.

Reconciliation of reported and underlying profit before tax

Year ended 31 December 2006 compared with year ended 31 December 2005

	2005 as reported	Currency translation ¹	2005 at 2006 exchange rates	Acquisitions and disposals ²	Underlying change	2006 as reported	Reported change	Underlying change
Hong Kong	US\$m	US\$m	US\$m	US\$m	US\$m	US\$m	%	%
Net interest income	4,064	5	4,069	□	616	4,685	15	15
Net fee income	1,674	2	1,676	□	380	2,056	23	23
Other income ³	1,769	1	1,770	□	93	1,863	5	5
	<u>7,507</u>	<u>8</u>	<u>7,515</u>	<u>□</u>	<u>1,089</u>	<u>8,604</u>	<u>15</u>	<u>14</u>

Net operating income ⁴								
Loan impairment charges and other credit risk provisions	(146)	□	(146)	□	(26)	(172)	(18)	(18)
Net operating income	7,361	8	7,369	□	1,063	8,432	15	14
Operating expenses	(2,867)	(3)	(2,870)	□	(399)	(3,269)	(14)	(14)
Operating profit	4,494	5	4,499	□	664	5,163	15	15
Income from associates	23	□	23	□	(4)	19	(17)	(17)
Profit before tax	4,517	5	4,522	□	660	5,182	15	15

For footnotes, see page 130.

Review of business performance

HSBC's operations in Hong Kong reported a pre-tax profit of US\$5.2 billion compared with US\$4.5 billion in 2005, an increase of 15 per cent. On an underlying basis, pre-tax profit also grew by 15 per cent. Underlying net operating income increased by 14 per cent, driven by widening deposit spreads in Personal Financial Services and Commercial Banking and strong net fee income growth in all customer groups. In Global Banking and Markets, an increase in trading income offset the negative impact of lower balance sheet management income. Underlying operating expenses rose by 14 per cent.

The following commentary is on an underlying basis.

Personal Financial Services pre-tax profits increased by 9 per cent to US\$2.9 billion. Net operating income before impairment charges grew by 13 per cent, driven by higher income from savings and current accounts and increased fee income. Marketing activities were successful, helping HSBC enlarge its share of the credit card and mortgage markets and attract higher deposit balances. As a result, customer numbers increased by over 100,000. The cost efficiency ratio improved by 1.1 percentage points as cost growth of 9 per cent was restricted to less than the increase in net revenue. Credit quality remained favourable and

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loan impairment charges were low, although higher than in 2005 when a modest recovery was recorded.

Net interest income of US\$2.9 billion was 10 per cent higher than in 2005, principally as a result of deposit growth and wider liability spreads. Average savings balances increased by 7 per cent to US\$119 billion, reflecting the success of promotional campaigns and HSBC's competitive pricing strategy, and supported by increased demand for deposit products in the rising interest rate environment. Effective deposit pricing amid rising interest rates led to wider deposit spreads.

HSBC increased its share of new mortgage business to 33 per cent, the highest of any lender, benefiting from the launch of a simplified, transparent pricing structure in the first half of 2006 which was supported by extensive media coverage. The relaunch of a number of key products and the introduction of a two-month interest free offer in the fourth quarter of 2006 also contributed to the increase in market share. Excluding the reduction in balances under the Government Home Ownership Scheme, HSBC's mortgage portfolio grew by 7 per cent to US\$23 billion.

Average cardholder balances increased by 16 per cent to US\$3.5 billion and HSBC issued over 1 million new cards during 2006, which led to a 17 per cent rise in cards in issue to a record 4.6 million. The launch of a mass card acquisition programme comprising increased promotional activity, direct marketing and the use of incentives to increase cardholder spending contributed directly to this rise. As a result, HSBC's share of the Hong Kong credit card market increased to 46 per cent of card receivable balances.

Net fee income increased by 32 per cent to US\$977 million. Buoyant regional and global stock markets led to increased demand for equity-based products among local investors and HSBC responded by launching 69 new investment funds, including a number of innovative fund products, designed to meet investors' changing demands in a rising interest rate environment. These launches were supported by greater marketing activity, improved pricing transparency and the development of new customer retention activities. As a result, sales of unit trusts rose by 61 per cent and fee income from the sale of investment products, and custody and broking activities increased by 39 per cent.

The increase in cards in issue led to a 24 per cent rise in credit card fees. Expansion of the current account base, partly due to higher sales of packaged products, led to increased remittance and account

servicing fees. HSBC focused on attracting additional funds from existing Premier customers during 2006 and deposits managed on their behalf increased by 29 per cent, reflecting the success of marketing campaigns and enhanced customer benefits.

Insurance fee income increased by 21 per cent and insurance premiums rose by 13 per cent. The development of HSBC's retirement planning proposition was reflected in the launch of new savings, protection and medical insurance products, supported by increased promotional and marketing activity and the successful development of internet and telephone distribution channels. As a result, sales of life and non-life insurance products rose.

Gains less losses from financial investments increased to US\$14 million, reflecting proceeds from the MasterCard Incorporated IPO. In July 2006, HSBC transferred most of its Asian card acquiring business into a joint venture with Global Payments Inc. HSBC retained a 44 per cent stake in the new venture and recognised an overall gain on transfer of US\$55 million, of which US\$12 million was allocated to the Hong Kong Personal Financial Services business and reported in "Other operating income".

Following a net release in 2005, loan impairment charges of US\$119 million reflected asset growth and lower releases and recoveries. In 2005, rising property prices led to the release of impairment allowances against HSBC's mortgage lending portfolio and against restructured lending facilities, neither of which were repeated in 2006.

Increased staff numbers, additional marketing activity and higher IT expenditure led to a 9 per cent rise in operating expenses. Staff recruited to support extended opening hours, together with higher performance-related remuneration and annual pay rises, led to increased employment costs. These were mitigated by a reduction in

branch back-office staff numbers as customers utilised lower-cost distribution channels for an increasing proportion of their banking business. Rising Hong Kong commercial property rental yields in 2006 coincided with the expansion of certain branches with high growth potential and resulted in higher premises costs. Marketing costs rose in support of promotional activity related to credit cards, insurance and wealth management products. Similarly, IT expenditure rose as improved portfolio management systems and enhanced channel capabilities were delivered in order to drive revenue growth.

In **Commercial Banking** , pre-tax profits increased significantly by 38 per cent to

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HSBC HOLDINGS PLC

Report of the Directors: Business Review

(continued)

Hong Kong >2006

US\$1.3 billion. Net operating income grew by 32 per cent, driven by higher deposit balances and fee income, increased liability spreads and lower loan impairment charges. Cost growth was comfortably within the growth in revenues, and the cost efficiency ratio improved by 1.1 percentage points to 26.1 per cent.

During 2006, HSBC launched a number of initiatives designed to further its position in the small business banking market, including customer service enhancements, improvements to account opening procedures and targeted promotional activity. As a result, Commercial Banking customer numbers increased (by 13,000 to 377,000), as did the number of products sold per customer. Investments to enhance the attractiveness of HSBC's distribution channels improved customer service, facilitated customer acquisition and encouraged the migration of routine transactions to automated channels.

Net interest income rose by 23 per cent to US\$1.3 billion. Deposit and current account balances increased by 10 per cent, partly due to the deployment of a team dedicated to attracting deposits from small businesses, and other service enhancements. BusinessVantage, HSBC's market leading integrated account for business, reinforced its leadership position through increased promotional activity, including a new referral programme. HSBC opened over 25,000 new BusinessVantage accounts in 2006, 21 per cent more than in 2005. Interest rate rises led to a 30 basis point widening of deposit and current account spreads and contributed to increased demand for savings products.

Non-trade lending balances increased by 16 per cent to US\$16.8 billion. The continued strength of the Hong Kong economy and, most importantly, its proximity to the strongly growing mainland Chinese market, led to increased business activity among mid-market clients, resulting in higher demand for credit. Lending to the property and retail sectors was particularly strong, while manufacturers with operations in mainland China raised borrowings to fund further expansion and take advantage of both the growing Chinese domestic market and the strong export climate. HSBC's regional alignment programme, which is designed to identify and capitalise on cross-border financing opportunities between Hong Kong, mainland China, Taiwan and Vietnam was instrumental in contributing to the growth in mid-market lending balances.

Growth in small business lending was facilitated through a streamlined lending process and the adoption of a new credit scorecard. As a result, the number of small business customers borrowing from

HSBC increased by 12 per cent and small business lending balances rose by 9 per cent. Increased competition led to a 12 basis point narrowing of asset spreads.

Net fee income of US\$454 million was 13 per cent higher than in 2005. Cash management and remittance fees increased by 18 per cent, driven by growth in the number of current account customers, enhancements to the product range and increased cross-border remittances. Robust local equity markets prompted the launch of 88 new investment products amid resurgent demand. Sales of unit trusts were consequently 15 per cent higher, while derivative and structured product sales rose by 83 per cent.

The establishment of a new Commercial Banking insurance business in October 2005 contributed to life insurance policy sales more than doubling and an 18 per cent rise in non-life policies in force. As a result, insurance fee income more than doubled and premium income increased by 23 per cent.

Effective promotion contributed to a 31 per cent rise in receivables finance fee income, while increased hedging activity and a rise in the value of multi-currency transactions by Commercial Banking customers contributed to a 57 per cent increase in treasury income.

The transfer of the majority of HSBC's card acquiring business into a joint venture with Global Payments Inc. realised a gain of US\$13 million for Commercial Banking, reported in "Other operating income". Fee income in HSBC's remaining card acquiring business not included in the transfer rose by 43 per cent, reflecting an increase in the number of merchant customers and higher transaction values.

Loan impairment charges decreased by 59 per cent, principally due to the non-recurrence of significant charges against a single client in 2005. Credit quality remained strong and non-performing loans as a proportion of lending balances fell by 22 basis points to 62 basis points, reflecting prudent lending policies and risk mitigation procedures.

Operating expenses increased by 17 per cent to US\$491 million to support the strong revenue opportunities evident in the market. The recruitment of additional sales and support staff and the development of the Commercial Banking insurance business contributed to higher staff numbers which, together with the effect of pay rises, resulted in higher staff costs. Marketing costs rose as HSBC stepped up its advertising and promotional activity, including the launch of the global Commercial

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Banking campaign to build market share. Cost efficiency was improved by the continuing migration of sales and transaction activity to lower-cost direct channels.

Global Banking and Markets reported a pre-tax profit of US\$955 million, an increase of 3 per cent compared with 2005. Global Markets performance remained robust, with encouraging revenue growth in areas in which HSBC has invested, complemented by strong income growth in the securities services business. The cost efficiency ratio increased slightly, primarily due to the first full year effect of various growth initiatives taken in 2005.

Total operating income of US\$1.8 billion was 7 per cent higher. Although balance sheet management reported an overall decline, revenues recovered modestly in the second half of 2006 as lower yielding positions matured. In Global Banking, net interest income from payments and cash management activity rose sharply as a 6 per cent increase in deposits was complemented by wider spreads. Revenues benefited from improved customer flows following the launch of services offered through HSBCnet in the latter part of 2005. Income from lending activities decreased as the benefit of higher lending balances was more than offset by the effect of spread compression resulting from an abundance of credit in a highly competitive market.

Net fee income rose by 24 per cent. Securities services reported a 28 per cent increase in fees as buoyant stock markets drove higher customer activity. Debt underwriting volumes increased as tightening credit spreads encouraged issuers to lock in to the favourable credit environment by extending the term of finance or by raising new debt in local markets. By contrast, equity underwriting fees declined.

HSBC Global Asset Management used HSBC's extensive distribution network to take advantage of the global trend of strong investment flows to emerging markets. Higher fees reflected strong performance fees from HSBC's emerging market funds. Client funds under management grew by 23 per cent to US\$35 billion, as HSBC launched new funds to capture increased demand for equity-based investments. Fees from the asset and structured finance business also rose.

Net trading income increased by 18 per cent. HSBC retained its leadership position in foreign exchange, with revenues strengthening as trading activity increased in response to volatility in the value of the US dollar and economic conditions in

certain local markets. Investments in equity sales and trading operations in previous years led to higher revenues. HSBC also benefited from internal synergies linking product structuring and hedging capabilities with distribution scale, as foreign exchange option-linked deposits and other instruments were offered to retail and corporate customers.

Private Equity investments also performed strongly. However, Credit and Rates were adversely affected by lower volumes due to unfavourable market conditions in a rising interest rate environment.

The overall credit environment remained stable with a net recovery of US\$27 million.

Operating expenses increased by 12 per cent to US\$911 million, primarily due to the first full year effect of initiatives implemented in the second half of 2005 which extended the product range in Global Markets and strengthened the regional investment banking platform in Hong Kong.

Additional cost increase reflected a rise in performance-related remuneration coupled with higher operational costs in line with increased volumes, particularly in payments and cash management and securities services businesses.

Private Banking contributed a pre-tax profit of US\$201 million, an increase of 5 per cent compared with 2005. Growth in client assets and rising sales of higher fee-generating discretionary managed products were partially offset by the adverse effect of a flattening yield curve on income from the investment of surplus liquidity. Demand for experienced private banking staff in Hong Kong was fierce as competitors built up their locally-based operations and, despite strong revenue growth, the resultant increase in staff costs led to a 5.2 percentage points

deterioration in the cost efficiency ratio to 49.5 per cent.

Net interest income was US\$76 million, in line with 2005. Steady growth in deposit balances was offset by competitive pressure on deposit rates and by a challenging interest rate environment for treasury management activities. Loans and advances to customers at 31 December 2006 were marginally lower than at the same point in 2005 as higher interest rates reduced clients' appetite for credit.

There was excellent growth in fee income, which increased to US\$123 million, a rise of 31 per cent. Growth in funds under management and success in increasing the proportion of clients' assets invested in higher fee-earning discretionary managed assets contributed towards increased fee revenue.

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Hong Kong >2006 / Profit/(loss) before tax by customer group

Fee income growth also benefited from increased client holdings of funds and alternative investments. Trading and other revenues were 18 per cent higher at US\$199 million, driven largely by sales of bonds and structured products.

Client assets increased by 27 per cent to US\$51 billion, with net new money inflows of US\$8 billion. This growth was assisted by better marketing and successful product placement, including a broadening of the discretionary managed product range. Sales of HSBC's discretionary managed SIS and CIS products, in which the value of investments by clients reached US\$1.4 billion, continued to be a key driver of this asset class. Continued investment in relationship management, improved stock market performance and growing cross-referrals from within the Group, primarily the retail and commercial networks, also added to the growth.

Operating expenses were 31 per cent higher than in 2005, primarily due to increased staff costs driven by recruitment and the retention of front office staff in a competitive market, where demand for

experienced private bankers was high. Performance-related remuneration rose, reflecting strong revenue growth and a 19 per cent increase in customer relationship staff. Increased marketing expenditure and technology costs were incurred in support of growing the business.

The sale of part of HSBC's interest in UTI Bank Limited resulted in gains of US\$101 million, recognised in **Other**. The disposal of Hang Seng's head office building realised a gain of US\$100 million and the resulting reduction in HSBC's investment property portfolio, together with slower growth in the Hong Kong property market, led to lower property revaluation gains.

Increased US interest rates led to higher costs of servicing US dollar denominated floating rate subordinated debt, partly offset by higher earnings on centrally held funds. In 2006, HSBC benefited from higher dividend income from strategic investments. Hong Kong head office and central IT costs rose, reflecting increased activity in support of HSBC's growing Asian businesses, offset by higher recoveries from other customer groups.

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Profit/(loss) before tax and balance sheet data by customer group and global business

Year ended 31 December 2007

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 ¹⁴ US\$m	Total 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 ⁹	193	63	794	280	224	(312)	1,242
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 ⁶	(3,116)	(82)	(10)	□	□	□	(3,208)
Net operating income⁴	6,021	2,193	2,630	536	279	(337)	11,322
Loan impairment	(175)	(28)	(28)	□	□	□	(231)

charges and
other credit
risk provisions

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
	US\$m	US\$m	US\$m	US\$m	US\$m		US\$m

Balance sheet data⁷

Loans and advances to customers (net)	38,197	25,890	19,171	4,329	2,051		89,638
Total assets	72,386	35,366	185,933	14,138	24,868		332,691
Customer accounts	129,159	51,562	37,364	15,649	754		234,488

The following assets and liabilities were significant to Global Banking and Markets:

□loans and advances to banks (net)	53,725
□trading assets, financial instruments designated at fair value, and financial investments	74,189
□deposits by banks	6,251

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Hong Kong > Profit/(loss) before tax by customer group

Profit/(loss) before tax and balance sheet data by customer group and global business (continued)

	Year ended 31 December 2006						Total US\$m
	Personal Financial Services US\$m	Commercial Banking US\$m	Global Banking & Markets US\$m	Private Banking US\$m	Other US\$m	Inter- segment elimination ¹⁴ US\$m	
Hong Kong							
Net interest income/(expense)	2,882	1,344	553	76	(646)	476	4,685
Net fee income/(expense)	977	454	534	123	(32)	□	2,056
Trading income excluding net interest income	84	57	573	176	34	□	924
Net interest income on trading activities	4	□	88	□	77	(476)	(307)
Net trading income ⁵	88	57	661	176	111	(476)	617
Net income/(expense) from financial instruments designated at fair value	373	(53)	5	1	(66)	□	260
Gains less losses from financial investments	14	□	(1)	9	140	□	162
Dividend income	1	1	2	□	57	□	61
Net earned insurance premiums	2,519	95	14	□	□	□	2,628
Other operating income	202	33	81	13	781	(276)	834
Total operating income	7,056	1,931	1,849	398	345	(276)	11,303
Net insurance claims ⁶	(2,638)	(50)	(11)	□	□	□	(2,699)
Net operating income⁴	4,418	1,881	1,838	398	345	(276)	8,604
Loan impairment (charges)/recoveries and other credit risk provisions	(119)	(69)	27	□	(11)	□	(172)

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Net operating income	4,299	1,812	1,865	398	334	(276)	8,432
Total operating expenses	(1,422)	(491)	(911)				