

HSBC HOLDINGS PLC
Form 6-K
March 04, 2013

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rule 13a - 16 or 15d - 16 of

the Securities Exchange Act of 1934

For the month of March
HSBC Holdings plc

42nd Floor, 8 Canada Square, London E14 5HQ, England

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F).

Form 20-F Form 40-F

(Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934).

Yes..... No

(If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-.....).

- Pre-tax profit up 19% to HK\$108,729m (HK\$91,370m in 2011).
 - Attributable profit up 23% to HK\$83,008m (HK\$67,591m in 2011).
 - Return on average shareholders' equity of 21.9% (21.6% in 2011).
 - Assets up 8% to HK\$6,065bn (HK\$5,607bn at 31 December 2011).
- Capital adequacy ratio of 14.3%; core capital ratio of 13.7%. (Capital adequacy ratio of 14.6%; core capital ratio of 12.4% at 31 December 2011).
 - Cost efficiency ratio of 42.4% (46.1% in 2011).

This document is issued by The Hongkong and Shanghai Banking Corporation Limited ('the Bank') and its subsidiaries (together 'the group'). References to 'HSBC', 'the Group' or 'the HSBC Group' within this document mean HSBC Holdings plc 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'. The abbreviations 'HK\$m' and 'HK\$bn' represent millions and billions (thousands of millions) of Hong Kong dollars respectively.

Comment by Stuart Gulliver, Chairman

Asian economies entered 2012 with encouraging levels of growth, boosted in part by the positive effects of monetary easing by eurozone authorities. Economic activity was, however, soon impacted as economies in Europe and the US faltered and concerns rose over mainland China's ability to sustain its expansion. The final months of the year saw an improvement in growth and sentiment, with Asian economies picking up and worries over the eurozone moderating. Mainland China avoided a hard landing and there were some improvements in US housing and employment data. Nevertheless, the pace of growth in the West remains slow and there continue to be appreciable risks to the sustainability of economic recovery in the US and Europe. Despite these risks, the picture for Asia in 2013 is brighter than last year, with China's GDP growth forecast to climb back to 8.6%, driving an uplift in regional demand for consumer goods and raw materials. Economic stimulus by Japan is also likely to result in increased investment in economies around the region. Such conditions raise concerns, however, over asset bubbles and inflation and policy makers will face challenges during the year in keeping economies and markets on a steady course.

In the demanding operating environment of 2012 The Hongkong and Shanghai Banking Corporation Limited performed strongly, through sustained adherence to our strategy of focusing on serving our customers, developing our priority growth markets, controlling risk and simplifying the business. Profit before tax was HK\$108,729m, 19% higher than in the previous year. This included gains of HK\$7,687m from the sale of subscale activities and non-core investments in Hong Kong, Japan, Thailand, India and the Philippines. On 5 December 2012, we announced the sale of our shares in Ping An Insurance (Group) Company of China, Ltd., a transaction that completed in February 2013. These disposals represent further progress in our strategy of simplifying the group and focusing our capital and resources on our core businesses.

Profits in Hong Kong grew by 31%, driven by improved deposit spreads, growth in loans and deposit balances, and higher trading revenues, together with a reduction in loan impairment charges. Profits in the Rest of Asia-Pacific were ahead by 8%, including gains on the sale of businesses, increased lending and higher profits from our associates in mainland China. Overall, customer loans grew by 10% during the period, while deposits grew by 9% and, at the year end, the loans to deposits ratio stood at 60.6%. We maintained our focus on improving efficiency and, with income growth of 10% exceeding growth in costs of 1%, the cost income ratio improved to 42.4% from 46.1%. In competitive markets for both loans and deposits, spreads remained broadly stable. Asset quality continued to be strong and loan impairment charges remained at low levels.

We continued to invest in our priority growth markets of Hong Kong, mainland China, India, Singapore, Malaysia, Indonesia, Australia, Taiwan and Vietnam. This included investment in the network, notably in mainland China, where our branch network now numbers 207 outlets, and in Malaysia, where we also have the largest branch network among foreign banks, opening 11 new Islamic branches during the year. We invested a further HK\$13.3bn in Bank of Communications in order to maintain our shareholding of 19.03% in this strategically important associate, and reinforce our position as the leading foreign bank in mainland China.

During 2012 the internationalisation of the renminbi gathered pace and we strengthened our position as the leading international bank for renminbi business worldwide, with HSBC having the largest global network, offering renminbi services in over 50 markets. We maintained our dominant market share of offshore renminbi bonds during the period and led the issue in London of the first renminbi bond outside Chinese sovereign territory. In June we were joint coordinator and the sole foreign bank appointed to manage the issue in Hong Kong of renminbi sovereign bonds by China's Ministry of Finance. We were pleased to receive first place in all seven categories in the Asiamoney Offshore Renminbi Services Survey, including 'Best for overall products and services'.

In Retail Banking and Wealth Management ('RBWM'), profits grew by 24%, with a notably strong performance in Hong Kong, where we maintained our leading market positions in deposits, mortgages, credit cards, life insurance and mandatory provident funds. Lending balances grew, principally residential mortgages, in our priority markets including Hong Kong, Singapore, mainland China, Malaysia and Australia, and we also maintained good deposit growth. Continued investment in our wealth management platform and the productivity of our front line staff resulted in higher wealth revenues, and we successfully launched a number of new funds. During the year we were awarded the Best Wealth Management Award by The Asian Banker. Our continued focus on increasing efficiency resulted in an improvement in the cost efficiency ratio.

Profits in Commercial Banking ('CMB') were 22% higher than in 2011, driven by growth in lending to customers around the region and by increased revenues in trade finance and Payments and Cash Management. We were also successful in growing deposits during the year, particularly in mainland China. Costs continued to be well controlled, growing by less than revenues, which benefited from further successful progress in income from collaboration with Global Banking and Markets ('GB&M'), which increased by 14%. Foreign exchange products remained the largest contributor to revenues from collaboration with GB&M and we also generated good growth in sales of debt capital markets products including high yield bonds. Asset quality remained good, although the loan impairment charge rose as a result of impairments on a small number of specific exposures. We won several major industry awards during the year, including FinanceAsia's Best Commercial Bank and both Best Trade Finance Bank and Best Bank for Cash

Management in Asia from Global Finance.

GB&M profits growth of 9% resulted from higher net interest income, continued growth in lending, and good growth in fees and commissions and trading income in Hong Kong, where we reinforced our leading market position in debt capital markets. Fee income increased, driven by Payments and Cash Management and debt capital markets transactions across the region. Trading income benefited from increased Credit and Rates activity, most notably in Hong Kong. We have continued to invest in broadening our range of products and services and our market presence was recognised during the year with a number of significant industry awards, including six Euromoney Best House awards for Excellence in Asia, five FinanceAsia Best Hong Kong Bank awards, and Asiamoney's Hong Kong awards for No.1 Best Local Brokerage, Best Execution, Best in Sales Trading and Best in Overall Sales services.

While the outlook for Asia's economies is for improved growth and activity this year, structural risks remain. The regulatory outlook continues to be uncertain and we face strong competition in many of our businesses. The group is in good shape for the challenges and growth opportunities of 2013, with strong capital and liquidity, sound asset quality and a simplified and more efficient business that is increasingly focused on our core markets and customers. With this focus, we will continue to connect customers to opportunities and ultimately help them to grow their businesses and realise their ambitions.

Results by Geographic Region

| Geographical regions | Hong Kong | Rest of Asia-Pacific | Intra- segment elimination | Total |
|--|-----------|----------------------|----------------------------|----------|
| | HK\$m | HK\$m | HK\$m | HK\$m |
| Year ended 31 December 2012 | | | | |
| Net interest income | 40,155 | 42,271 | (7) | 82,419 |
| Net fee income | 24,670 | 15,220 | – | 39,890 |
| Net trading income | 9,892 | 9,315 | 7 | 19,214 |
| Net income from financial instruments designated at fair value | 3,799 | 814 | – | 4,613 |
| Gains less losses from financial investments | 2,510 | 124 | – | 2,634 |
| Dividend income | 489 | 33 | – | 522 |
| Net earned insurance premiums | 46,304 | 6,317 | – | 52,621 |
| Other operating income | 14,991 | 4,632 | (4,286) | 15,337 |
| Total operating income | 142,810 | 78,726 | (4,286) | 217,250 |
| Net insurance claims incurred and movement in liabilities to policyholders | (49,401) | (5,582) | – | (54,983) |

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|--|-----------|-----------|-----------|-----------|
| Net operating income before loan impairment charges and other credit risk provisions | 93,409 | 73,144 | (4,286) | 162,267 |
| Loan impairment charges and other credit risk provisions | (603) | (2,975) | – | (3,578) |
| Net operating income | 92,806 | 70,169 | (4,286) | 158,689 |
| Operating expenses | (36,947) | (36,109) | 4,286 | (68,770) |
| Operating profit | 55,859 | 34,060 | – | 89,919 |
| Share of profit in associates and joint ventures | 640 | 18,170 | – | 18,810 |
| Profit before tax | 56,499 | 52,230 | – | 108,729 |
| Share of profit before tax | 52.0% | 48.0% | – | 100.0% |
| Cost efficiency ratio | 39.6% | 49.4% | – | 42.4% |
| Net loans and advances to customers | 1,295,479 | 1,053,564 | – | 2,349,043 |
| Total assets | 3,944,090 | 2,639,425 | (518,188) | 6,065,327 |
| Customer accounts | 2,531,624 | 1,343,260 | – | 3,874,884 |

| Geographical regions | Hong Kong HK\$m | Rest of Asia- Pacific HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|---|--------------------|--------------------------------------|---|----------------|
| Year ended 31 December 2011 | | | | |
| Net interest income | 35,274 | 40,396 | 2 | 75,672 |
| Net fee income | 22,860 | 15,435 | – | 38,295 |
| Net trading income | 7,691 | 12,510 | (2) | 20,199 |
| Net expense from financial instruments designated at fair value | (4,230) | (293) | – | (4,523) |
| Gains less losses from financial investments | 310 | (182) | – | 128 |
| Dividend income | 723 | 6 | – | 729 |

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|--|-----------|-----------|-----------|-----------|
| Net earned insurance premiums | 39,738 | 5,932 | – | 45,670 |
| Other operating income | 13,229 | 2,674 | (4,514) | 11,389 |
| Total operating income | 115,595 | 76,478 | (4,514) | 187,559 |
| Net insurance claims incurred and movement in liabilities to policyholders | (35,778) | (4,611) | – | (40,389) |
| Net operating income before loan impairment charges and other credit risk provisions | 79,817 | 71,867 | (4,514) | 147,170 |
| Loan impairment charges and other credit risk provisions | (938) | (2,121) | - | (3,059) |
| Net operating income | 78,879 | 69,746 | (4,514) | 144,111 |
| Operating expenses | (36,106) | (36,232) | 4,514 | (67,824) |
| Operating profit | 42,773 | 33,514 | – | 76,287 |
| Share of profit in associates and joint ventures | 424 | 14,659 | – | 15,083 |
| Profit before tax | 43,197 | 48,173 | – | 91,370 |
| Share of profit before tax | 47.3% | 52.7% | – | 100.0% |
| Cost efficiency ratio | 45.2% | 50.4% | | 46.1% |
| Net loans and advances to customers | 1,182,442 | 948,429 | – | 2,130,871 |
| Total assets | 3,594,991 | 2,429,228 | (416,739) | 5,607,480 |
| Customer accounts | 2,297,212 | 1,267,789 | – | 3,565,001 |

Results by Geographic Global Business

Hong Kong

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking & Markets HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|--|---|--------------------------------|--|----------------|---|----------------|
|--|---|--------------------------------|--|----------------|---|----------------|

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Year ended 31 December 2012

| | | | | | | |
|--|----------|---------|---------|---------|---------|------------|
| Net interest income/(expense) | 22,194 | 12,636 | 8,436 | (3,744) | 633 | 40,155 |
| Net fee income | 13,723 | 6,594 | 4,255 | 98 | – | 24,670 |
| Net trading income | 1,270 | 1,278 | 7,822 | 157 | (635) | 9,892 |
| Net income/(expense) from financial instruments designated at fair value | 4,098 | (412) | 177 | (66) | 2 | 3,799 |
| Gains less losses from financial investments | (8) | – | 18 | 2,500 | – | 2,510 |
| Dividend income | 1 | 7 | 36 | 445 | – | 489 |
| Net earned insurance premiums | 41,074 | 5,132 | 98 | – | – | 46,304 |
| Other operating income | 5,518 | 1,965 | 738 | 8,853 | (2,083) | 14,991 |
| Total operating income | 87,870 | 27,200 | 21,580 | 8,243 | (2,083) | 142,810 |
| Net insurance claims incurred and movement in liabilities to policyholders | (44,650) | (4,676) | (75) | – | – | (49,401) |
| Net operating income before loan impairment charges and other credit risk provisions | 43,220 | 22,524 | 21,505 | 8,243 | (2,083) | 93,409 |
| Loan impairment (charges) /releases and other credit risk provisions | (754) | 21 | 129 | 1 | – | (603) |
| Net operating income | 42,466 | 22,545 | 21,634 | 8,244 | (2,083) | 92,806 |
| Operating expenses | (14,127) | (5,621) | (9,952) | (9,330) | 2,083 | (36,947) |
| Operating profit/(loss) | 28,339 | 16,924 | 11,682 | (1,086) | – | 55,859 |
| Share of profit in associates and joint ventures | 347 | 49 | 25 | 219 | – | 640 |
| Profit/(loss) before tax | 28,686 | 16,973 | 11,707 | (867) | – | 56,499 |
| Share of profit before tax | 26.4% | 15.6% | 10.8% | (0.8)% | – | 52.0% |
| Net loans and advances to customers | 484,662 | 487,842 | 311,743 | 11,232 | – | –1,295,479 |

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|-------------------|-----------|---------|-----------|---------|----------|------------|
| Total assets | 749,921 | 558,166 | 2,013,635 | 682,226 | (59,858) | 3,944,090 |
| Customer accounts | 1,562,867 | 698,719 | 264,844 | 5,194 | | -2,531,624 |

Hong Kong

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking & Markets HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|--|---|--------------------------------|--|----------------|---|----------------|
| Year ended 31 December 2011 | | | | | | |
| Net interest income/(expense) | 20,114 | 10,251 | 8,189 | (3,613) | 333 | 35,274 |
| Net fee income | 13,551 | 5,501 | 3,693 | 115 | – | 22,860 |
| Net trading income/(expense) | 753 | 1,322 | 6,916 | (965) | (335) | 7,691 |
| Net expense from financial instruments designated at fair value | (3,612) | (565) | (39) | (16) | 2 | (4,230) |
| Gains less losses from financial investments | 19 | 78 | 162 | 51 | – | 310 |
| Dividend income | 1 | 10 | 118 | 594 | – | 723 |
| Net earned insurance premiums | 33,626 | 5,968 | 144 | – | – | 39,738 |
| Other operating income | 3,928 | 1,359 | 606 | 9,212 | (1,876) | 13,229 |
| Total operating income | 68,380 | 23,924 | 19,789 | 5,378 | (1,876) | 115,595 |
| Net insurance claims incurred and movement in liabilities to policyholders | (30,243) | (5,429) | (106) | – | – | (35,778) |
| Net operating income before loan impairment charges and other credit risk provisions | 38,137 | 18,495 | 19,683 | 5,378 | (1,876) | 79,817 |
| Loan impairment (charges)/ releases and other credit risk provisions | (601) | (513) | 176 | – | – | (938) |

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|--|-----------|---------|-----------|---------|-----------|------------|
| Net operating income | 37,536 | 17,982 | 19,859 | 5,378 | (1,876) | 78,879 |
| Operating expenses | (14,121) | (5,540) | (9,700) | (8,621) | 1,876 | (36,106) |
| Operating profit/(loss) | 23,415 | 12,442 | 10,159 | (3,243) | – | 42,773 |
| Share of profit in associates and joint ventures | 47 | 69 | 32 | 276 | – | 424 |
| Profit/(loss) before tax | 23,462 | 12,511 | 10,191 | (2,967) | – | 43,197 |
| Share of profit before tax | 25.7% | 13.7% | 11.2% | (3.3)% | – | 47.3% |
| Net loans and advances to customers | 437,309 | 427,140 | 308,134 | 9,859 | – | –1,182,442 |
| Total assets | 672,402 | 493,407 | 1,881,469 | 707,130 | (159,417) | 3,594,991 |
| Customer accounts | 1,408,484 | 615,431 | 274,080 | (783) | – | –2,297,212 |

Hong Kong reported pre-tax profits were HK\$56,499m compared with HK\$43,197m in 2011, an increase of 31%. Reported profits included gains on the sale of our shares in Global Payments Asia-Pacific Ltd of HK\$1,647m and both the HSBC and Hang Seng Bank general insurance businesses of HK\$905m and HK\$354m respectively.

Excluding these gains, profit increased by 24% driven by higher net interest income in CMB and RBWM, the gain of HK\$2,441m on the sale of our shares in four Indian banks, higher trading revenues in GB&M, increased fee income in both CMB and GB&M and a reduction in loan impairment charges. These favourable movements were partly offset by higher operating expenses.

In RBWM, we continue to develop our wealth management services for our retail customers and launched new investment funds, including the Global High Yield Bond Fund. We completed the sale of both the HSBC and Hang Seng Bank general insurance businesses, enabling us to focus on life insurance manufacturing, where we maintained our market leadership position. We also led the market in deposits, mortgages, mandatory provident funds and credit cards. We maintained our prudent lending approach, with average loan to value ratios of 48% on new mortgage drawdowns and an estimated 32% on the portfolio as a whole.

In CMB, we capitalised on our international connectivity and our standing as a leading trade finance bank to grow trade-related revenues by 10%. The collaboration between CMB and GB&M continued to strengthen, with revenue growth of 13%, most notably from the provision of foreign exchange products to our corporate customers. We won the FinanceAsia award for Best Commercial Bank 2012 and 10 AsiaMoney awards for Payments and Cash Management, including the 'Best Local Cash Management Bank' for small, medium and large corporates.

In GB&M we led the market in Hong Kong dollar bond issuance and were the leading bookrunner for corporate high yield bonds in Asia excluding Japan. We continued to lead the market in offshore renminbi bond issuance. We reinforced our position as a leading international bank for offshore renminbi products, winning the Asia Risk Renminbi House of the Year award and all seven product categories in Asiamoney's Offshore Renminbi Survey.

Net interest income was 14% higher than in 2011, notably in CMB and RBWM, driven by increased customer loans and deposit balances and by growth in the insurance portfolio.

In RBWM we continued to grow our average mortgage balances, reflecting continued strength in the property market. In CMB, average term and trade-related lending balances were higher as we capitalised on trade and capital flows.

Asset spreads were marginally wider in CMB compared with 2011 on trade-related and other lending due to repricing, though they began to narrow towards the end of the year.

Net interest income also rose due to higher average deposit balances, notably in RBWM, in part reflecting reduced net outflows from customer accounts in to investments. In addition, deposit spreads widened.

Net fee income of HK\$24,670m was 8% higher than in 2011. Fees rose from increased transaction volumes in trade services, remittances and account services as we continued to facilitate international trade and capital flows. Fee income also increased in both CMB and GB&M as we arranged debt issues for our customers to satisfy their funding requirements. In RBWM fees from unit trusts rose reflecting increased sales volumes, despite customers increasingly preferring lower risk products with lower fees. These increases were offset by a reduction in brokerage income from lower market turnover as a result of weaker investor sentiment.

Net trading income increased by 29%, from lower adverse fair value movements on derivatives relating to certain provident funds, following reductions in long-term investment return assumptions in 2011. There was also a strong performance in GB&M, notably in Rates trading activities, which reflected increased client demand for risk management products, particularly in yen and renminbi, in part from increased cross-currency debt issuance by corporates. Credit trading revenues also rose in part due to increased client activity. This was partly offset by a net charge as a result of a change in estimation methodology in respect of the valuation adjustments on derivatives.

Net income from financial instruments designated at fair value was HK\$3,799m compared with an expense of HK\$4,230m in 2011, due to net investment gains on assets held by the insurance business compared with net losses in the prior year, as a result of more favourable equity market conditions. To the extent that these investment gains were attributed to policyholders of unit-linked insurance policies and insurance contracts with discretionary participation features, there was a corresponding increase in 'Net insurance claims incurred and movement in liabilities to policyholders'.

Gains less losses from financial investments were HK\$2,510m compared with HK\$310m in 2011, largely from the gain of HK\$2,694m on the sale of our shares in four non-strategic investments in banks in India.

Net earned insurance premiums grew by 17% following increased new sales and renewals of life insurance products. The growth in premiums resulted in a corresponding increase in 'Net insurance claims incurred and movement in liabilities to policyholders'.

Other operating income of HK\$14,991m was HK\$1,762m higher than in 2011. We completed the sales of Global Payments Asia-Pacific Ltd and both the HSBC and Hang Seng general insurance businesses, realising gains of HK\$1,647m, HK\$905m and HK\$354m respectively. While the value of the present value of in-force long term insurance business ('PVIF') asset rose, this was not to the same extent as in 2011 as increased insurance sales in 2012 were more than offset by unfavourable assumption updates and the non-recurrence of the benefit from the refinement to the PVIF asset calculation in 2011. There was also a lower gain on the revaluation of investment properties compared with 2011.

Loan impairment charges and other credit risk provisions reduced to HK\$603m from HK\$938m in 2011, largely due lower specific impairment charges in CMB.

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Operating expenses increased by 2%, primarily due to higher systems implementation and processing costs as we continued to invest in our technology infrastructure, as well as increased property rental and maintenance costs. Salaries and wages were broadly unchanged as wage inflation was largely offset by reduced average staff numbers as we continued to focus on efficiency.

Rest of Asia-Pacific

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking & Markets HK\$m | Global Private Banking HK\$m | Other HK\$m | Intra- segment elimination HK\$m | Total HK\$m |
|--|---|--------------------------------|--|---------------------------------------|----------------|---|----------------|
| Year ended 31 December 2012 | | | | | | | |
| Net interest income | 13,859 | 10,822 | 18,000 | 137 | 911 | (1,458) | 42,271 |
| Net fee income/ (expense) | 6,379 | 3,870 | 4,933 | 91 | (53) | – | 15,220 |
| Net trading income/(expense) | 699 | 1,437 | 8,477 | 10 | (2,766) | 1,458 | 9,315 |
| Net income/(expense) from financial instruments designated at fair value | 844 | 7 | (24) | – | (13) | – | 814 |
| Gains less losses from financial investments | (6) | 9 | (74) | (1) | 196 | – | 124 |
| Dividend income | 3 | – | – | – | 30 | – | 33 |
| Net earned insurance premiums | 4,411 | 1,905 | – | 1 | – | – | 6,317 |
| Other operating income | 1,630 | 500 | 580 | 499 | 1,985 | (562) | 4,632 |
| Total operating income | 27,819 | 18,550 | 31,892 | 737 | 290 | (562) | 78,726 |
| Net insurance claims incurred and movement in liabilities to policyholders | (4,057) | (1,524) | – | (1) | – | – | (5,582) |
| Net operating income before loan impairment charges and other credit risk provisions | 23,762 | 17,026 | 31,892 | 736 | 290 | (562) | 73,144 |

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| Loan impairment (charges) /releases and other credit risk provisions | (1,815) | (1,133) | (24) | 1 | (4) | – | (2,975) |
| Net operating income | 21,947 | 15,893 | 31,868 | 737 | 286 | (562) | 70,169 |
| Operating expenses | (17,133) | (7,702) | (9,695) | (256) | (1,885) | 562 | (36,109) |
| Operating profit/(loss) | 4,814 | 8,191 | 22,173 | 481 | (1,599) | – | 34,060 |
| Share of profit in associates and joint ventures | 2,110 | 11,416 | 4,638 | – | 6 | – | 18,170 |
| Profit/(loss) before tax | 6,924 | 19,607 | 26,811 | 481 | (1,593) | – | 52,230 |
| Share of profit before tax | 6.4% | 18.0% | 24.7% | 0.4% | (1.5)% | – | 48.0% |
| Net loans and advances to customers | 356,729 | 340,839 | 351,905 | 2,811 | 1,280 | – | –1,053,564 |
| Total assets | 428,314 | 458,469 | 1,631,918 | 2,966 | 186,153 | (68,395) | 2,639,425 |
| Customer accounts | 490,059 | 347,729 | 499,705 | 4,905 | 862 | – | –1,343,260 |

Rest of Asia-Pacific

| | Retail Banking and Wealth Management HK\$m | Commercial Banking HK\$m | Global Banking & Markets HK\$m | Global Private Banking HK\$m | Other HK\$m | Intra-segment elimination HK\$m | Total HK\$m |
|--|---|-----------------------------|-----------------------------------|---------------------------------|----------------|------------------------------------|----------------|
| Year ended 31 December 2011 | | | | | | | |
| Net interest income | 14,312 | 9,757 | 16,835 | 176 | 831 | (1,515) | 40,396 |
| Net fee income/(expense) | 6,753 | 3,992 | 4,613 | 155 | (78) | – | 15,435 |
| Net trading income/(expense) | 714 | 1,222 | 9,492 | 58 | (491) | 1,515 | 12,510 |
| Net income/(expense) from financial instruments designated at fair value | (295) | 12 | 7 | – | (17) | – | (293) |
| Gains less losses from financial investments | (3) | 16 | (190) | – | (5) | – | (182) |
| Dividend income | (1) | 1 | – | – | 6 | – | 6 |

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|--|----------|---------|-----------|-------|---------|----------|------------|
| Net earned insurance premiums | 3,840 | 2,092 | – | – | – | – | 5,932 |
| Other operating income | 1,121 | 562 | 511 | 10 | 955 | (485) | 2,674 |
| Total operating income | 26,441 | 17,654 | 31,268 | 399 | 1,201 | (485) | 76,478 |
| Net insurance claims incurred and movement in liabilities to policyholders | (2,727) | (1,884) | – | – | – | – | (4,611) |
| Net operating income before loan impairment charges and other credit risk provisions | 23,714 | 15,770 | 31,268 | 399 | 1,201 | (485) | 71,867 |
| Loan impairment (charges)/ releases and other credit risk provisions | (1,731) | 53 | (443) | 2 | (2) | – | (2,121) |
| Net operating income | 21,983 | 15,823 | 30,825 | 401 | 1,199 | (485) | 69,746 |
| Operating expenses | (18,504) | (7,367) | (9,594) | (470) | (782) | 485 | (36,232) |
| Operating profit/(loss) | 3,479 | 8,456 | 21,231 | (69) | 417 | – | 33,514 |
| Share of profit in associates and joint ventures | 1,887 | 8,994 | 3,756 | – | 22 | – | 14,659 |
| Profit/(loss) before tax | 5,366 | 17,450 | 24,987 | (69) | 439 | – | 48,173 |
| Share of profit before tax | 5.9% | 19.1% | 27.3% | – | 0.4% | – | 52.7% |
| Net loans and advances to customers | 318,257 | 298,326 | 326,666 | 3,706 | 1,474 | – | 948,429 |
| Total assets | 377,128 | 393,895 | 1,584,049 | 8,606 | 152,807 | (87,257) | 2,429,228 |
| Customer accounts | 472,761 | 314,314 | 473,635 | 6,113 | 966 | – | –1,267,789 |

Rest of Asia-Pacific reported pre-tax profits of HK\$52,230m compared with HK\$48,173m in 2011, an increase of 8%. Reported profits included gains from the sale of our RBWM business in Thailand of HK\$811m, our GPB business in Japan of HK\$520m and our interest in a property company in the Philippines of HK\$1,009m.

Excluding the above gains, pre-tax profit increased by 4%. Net interest income increased, notably from Balance Sheet Management in GB&M in mainland China and strong growth in average lending balances across most of the region. We also benefited from increased profits from our associates in mainland China. These factors were partly offset by adverse fair value movements of HK\$2,694m on the contingent forward sale contract related to the disposal of our shares in Ping An Insurance (Group) Company of China, Ltd. ('Ping An'), the effect of which was offset in 2013 on completion of the transaction, and higher operating expenses, in part due to restructuring costs of HK\$990m arising from the ongoing strategic review of our businesses and support functions in the region. Loan impairment charges also rose from a small number of specific corporate impairment charges, but remained low.

We maintained our focus on our key priority growth markets in the region. In mainland China, we continued to invest in our branch network and at the end of the year had 141 HSBC China outlets, 20 HSBC rural bank outlets and 46 Hang Seng Bank outlets. We invested a further HK\$13,264m in Bank of Communications Co., Ltd. ('BoCom') to maintain our interest of 19.03% in this strategically important associate and reinforce our position as the leading foreign bank in mainland China.

Net interest income increased by 5%, notably in mainland China from Balance Sheet Management arising from growth in the debt securities portfolio and improved yields, as well as from increased trade-related and term lending in CMB and GB&M in mainland China and India.

We grew deposit balances, notably in GB&M and CMB from new Payments and Cash Management mandates and deposit acquisition, as well as in RBWM. The benefit of this growth was partly offset by narrower liability spreads reflecting rate cuts and liquidity easing measures by central banks.

In RBWM, residential mortgage balances grew primarily in Singapore, Australia, Malaysia and mainland China, reflecting the continued strength of property markets and expansion of our distribution network. Net interest income was broadly unchanged, however, due to the effect of the sale of the RBWM business in Thailand and narrower asset spreads in a number of countries, attributable to competitive pricing pressures.

Net fee income reduced by HK\$215m. In GB&M, fee income increased from our participation in more debt capital markets transactions across the region, as well as from lower regulatory fee expenses on Foreign Exchange and Rates transactions in mainland China. In RBWM we reported higher income from cards in Australia from increased card issuance and wealth management fees in mainland China. This was more than offset by the discontinuation of our Premier business in Japan and the sale of our RBWM business in Thailand, as well as a fall in fund management fees as we saw a move in to lower yielding products reflecting investor's lower risk appetite.

Net trading income decreased by 26% compared with 2011, mainly from adverse fair value movements on the contingent forward sale contract relating to the sale of our shares in Ping An of HK\$2,694m. Trading income was also lower, primarily in mainland China due to lower GB&M revenues in Foreign Exchange reflecting reduced volatility, and from growth in structured deposits where the related income is recorded under 'Net interest income'. These were partly offset by a net favourable movement as a result of a change in estimation methodology in respect of the valuation adjustments on derivatives.

Net income from financial instruments designated at fair value was HK\$814m in 2012 compared with a net expense of HK\$293m in the prior year, driven by net investment gains on assets held by the insurance business, primarily in Singapore, due to positive equity market movements. To the extent that these investment gains were attributed to policyholders of unit-linked insurance policies and insurance contracts with discretionary participation features, there was a corresponding increase in 'Net insurance claims incurred and movement in liabilities to policyholders'.

Gains less losses from financial investments were HK\$124m compared with net losses of HK\$182m in 2011, due to a disposal gain on investments managed by a private equity fund, and a gain on the sale of government debt securities in India.

Net earned insurance premiums rose by 6% to HK\$6,317m, as a result of increased renewals and new business volumes in mainland China, Singapore and Taiwan. The growth in premiums resulted in a corresponding increase in 'Net insurance claims incurred and movement in liabilities to policyholders'.

Other operating income increased by HK\$1,958m, due to gains on the sale of our RBWM business in Thailand of HK\$811m, our GPB business in Japan of HK\$520m and our interest in a property company in the Philippines of HK\$1,009m.

Loan impairment charges and other credit risk provisions increased by HK\$854m as a result of individually assessed impairments on a single corporate exposure in Australia and a small number of corporate exposures in other countries in the region. These were partly offset by an impairment release in Singapore compared with a charge in 2011.

Operating expenses were broadly unchanged. We incurred restructuring and other related costs of HK\$990m in several countries as part of the ongoing strategic review of our businesses and support functions in the region. This resulted in a net reduction of more than 4,700 staff numbers, which was offset by inflationary pressures and business growth, including branch expansion in mainland China and Malaysia. Costs also increased from a litigation provision of HK\$760m made in respect of a long-standing court case and the write-down by HK\$395m of our interest in a joint venture.

Share of profit from associates and joint ventures increased by HK\$3,511m, driven by higher profits from BoCom and Industrial Bank Co., Ltd. ('Industrial Bank') reflecting loan growth and higher fee income partly offset by increased operating expenses and loan impairment charges.

On 7 January 2013, Industrial Bank completed a private placement of additional share capital to a number of third parties, thereby diluting the group's equity holding from 12.8% to 10.9%. The group ceased to account for the investment as an associate from that date.

Consolidated Income Statement

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|---------------------|---|---|
| Interest income | 115,511 | 107,458 |
| Interest expense | (33,092) | (31,786) |
| Net interest income | 82,419 | 75,672 |
| Fee income | 46,221 | 45,166 |
| Fee expense | (6,331) | (6,871) |
| Net fee income | 39,890 | 38,295 |
| Net trading income | 19,214 | 20,199 |

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| | | |
|--|--------------|--------------|
| Net income/(expense) from financial instruments designated at fair value | 4,613 | (4,523) |
| Gains less losses from financial investments | 2,634 | 128 |
| Dividend income | 522 | 729 |
| Net earned insurance premiums | 52,621 | 45,670 |
| Other operating income | 15,337 | 11,389 |
| Total operating income | 217,250 | 187,559 |
| Net insurance claims incurred and movement in liabilities to policyholders | (54,983) | (40,389) |
| Net operating income before loan impairment charges and other credit risk provisions | 162,267 | 147,170 |
| Loan impairment charges and other credit risk provisions | (3,578) | (3,059) |
| Net operating income | 158,689 | 144,111 |
| Employee compensation and benefits | (37,021) | (37,834) |
| General and administrative expenses | (26,011) | (24,352) |
| Depreciation of property, plant and equipment | (4,014) | (3,878) |
| Amortisation and impairment of intangible assets | (1,724) | (1,760) |
| Total operating expenses | (68,770) | (67,824) |
| Operating profit | 89,919 | 76,287 |
| Share of profit in associates and joint ventures | 18,810 | 15,083 |
| Profit before tax | 108,729 | 91,370 |
| Tax expense | (18,010) | (17,466) |
| Profit for the year | 90,719 | 73,904 |
| Profit attributable to shareholders | 83,008 | 67,591 |
| Profit attributable to non-controlling interests | 7,711 | 6,313 |

Consolidated Statement of Comprehensive Income

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|---------------------|---|---|
| Profit for the year | 90,719 | 73,904 |

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Other comprehensive income

Available-for-sale investments:

| | | |
|--|---------|----------|
| – fair value changes taken to equity | 14,153 | (25,410) |
| – fair value changes transferred to the income statement on disposal | (2,753) | (231) |
| – amounts transferred to the income statement on impairment | 5 | (208) |
| – fair value changes transferred to the income statement on hedged items | | |
| due to hedged risk | (287) | (1,124) |
| – income taxes | (768) | 119 |

Cash flow hedges:

| | | |
|--|---------|-------|
| – fair value changes taken to equity | 3,858 | 303 |
| – fair value changes transferred to the income statement | (3,662) | (399) |
| – income taxes | (33) | 15 |

Property revaluation:

| | | |
|--------------------------------------|---------|---------|
| – fair value changes taken to equity | 7,221 | 12,940 |
| – income taxes | (1,161) | (2,068) |

| | | |
|---|-----|---------|
| Share of other comprehensive income/ (expense) of associates and joint ventures | 638 | (1,259) |
|---|-----|---------|

Actuarial losses on post-employment benefits:

| | | |
|-----------------------|-------|---------|
| – before income taxes | 1,080 | (3,518) |
| – income taxes | (198) | 575 |

| | | |
|----------------------|-----|---------|
| Exchange differences | 925 | (1,235) |
|----------------------|-----|---------|

| | | |
|--|--------|----------|
| Other comprehensive income/ (expense) for the year, net of tax | 19,018 | (21,500) |
|--|--------|----------|

| | | |
|---|---------|--------|
| Total comprehensive income for the year, net of tax | 109,737 | 52,404 |
|---|---------|--------|

Total comprehensive income for the year attributable to:

| | | |
|-----------------------------|---------|--------|
| – shareholders | 100,814 | 45,428 |
| – non-controlling interests | 8,923 | 6,976 |
| | 109,737 | 52,404 |

Consolidated Balance Sheet

| | At 31 December 2012 HK\$m | At 31 December 2011 HK\$m |
|---------------------------|---------------------------------------|---------------------------------------|
| ASSETS | | |
| Cash and short-term funds | 1,111,199 | 919,906 |

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| | | |
|--|------------------|------------------|
| Items in the course of collection from other banks | 23,079 | 34,546 |
| Placings with banks maturing after one month | 184,711 | 198,287 |
| Certificates of deposit | 93,085 | 88,691 |
| Hong Kong Government certificates of indebtedness | 176,264 | 162,524 |
| Trading assets | 419,697 | 447,968 |
| Financial assets designated at fair value | 69,479 | 57,670 |
| Derivatives | 398,956 | 377,296 |
| Loans and advances to customers | 2,349,043 | 2,130,871 |
| Financial investments | 626,042 | 722,433 |
| Amounts due from Group companies | 176,004 | 152,730 |
| Interests in associates and joint ventures | 119,273 | 91,785 |
| Goodwill and intangible assets | 38,634 | 34,839 |
| Property, plant and equipment | 90,179 | 85,294 |
| Deferred tax assets | 2,629 | 2,325 |
| Other assets | 187,053 | 100,315 |
| Total assets | 6,065,327 | 5,607,480 |
| LIABILITIES | | |
| Hong Kong currency notes in circulation | 176,264 | 162,524 |
| Items in the course of transmission to other banks | 35,525 | 47,163 |
| Deposits by banks | 244,135 | 222,582 |
| Customer accounts | 3,874,884 | 3,565,001 |
| Trading liabilities | 183,340 | 171,431 |
| Financial liabilities designated at fair value | 44,270 | 40,392 |
| Derivatives | 397,151 | 383,252 |
| Debt securities in issue | 74,647 | 77,472 |
| Retirement benefit liabilities | 6,725 | 8,097 |
| Amounts due to Group companies | 97,618 | 108,423 |
| Other liabilities and provisions | 94,791 | 108,314 |
| Liabilities under insurance contracts issued | 244,921 | 209,438 |
| Current tax liabilities | 3,842 | 4,126 |
| Deferred tax liabilities | 16,923 | 14,712 |
| Subordinated liabilities | 13,867 | 16,114 |
| Preference shares | 83,346 | 97,096 |
| Total liabilities | 5,592,249 | 5,236,137 |
| EQUITY | | |
| Share capital | 58,969 | 30,190 |
| Other reserves | 133,790 | 112,218 |
| Retained profits | 224,640 | 188,416 |
| Proposed dividend | 20,000 | 10,000 |
| Total shareholders' equity | 437,399 | 340,824 |
| Non-controlling interests | 35,679 | 30,519 |
| Total equity | 473,078 | 371,343 |
| Total equity and liabilities | 6,065,327 | 5,607,480 |

Consolidated Statement of Changes in Equity

| | At 31 December 2012 HK\$m | At 31 December 2011 HK\$m |
|---|---------------------------------------|---------------------------------------|
| Share capital | | |
| At beginning of year | 30,190 | 22,494 |
| Issued during the year | 28,779 | 7,696 |
| | 58,969 | 30,190 |
| Retained profits and proposed dividend | | |
| At beginning of year | 198,416 | 173,254 |
| Dividends paid | (32,500) | (33,000) |
| Movement in respect of share-based payment arrangements | (246) | 91 |
| Other movements | (3) | (3) |
| Transfers | (4,554) | (6,939) |
| Comprehensive income for the year | 83,527 | 65,013 |
| | 244,640 | 198,416 |
| Other reserves | | |
| Property revaluation reserve | | |
| At beginning of year | 38,939 | 29,980 |
| Transfers | (1,010) | (869) |
| Comprehensive income for the year | 5,522 | 9,828 |
| | 43,451 | 38,939 |
| Available-for-sale investment reserve | | |
| At beginning of year | 29,786 | 57,553 |
| Other movements | 8 | (7) |
| Transfers | (2) | - |
| Comprehensive income/ (expense) for the year | 10,788 | (27,760) |
| | 40,580 | 29,786 |
| Cash flow hedging reserve | | |
| At beginning of year | 51 | 106 |
| Comprehensive income/ (expense) for the year | 159 | (55) |
| | 210 | 51 |
| Foreign exchange reserve | | |
| At beginning of year | 14,265 | 15,789 |
| Comprehensive income/ (expense) for the year | 928 | (1,524) |

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| | | |
|---|----------|----------|
| | 15,193 | 14,265 |
| Other | | |
| At beginning of year | 29,177 | 20,954 |
| Movement in respect of share-based payment arrangements | (277) | 694 |
| Transfers | 5,566 | 7,808 |
| Other movements | – | (205) |
| Comprehensive expense for the year | (110) | (74) |
| | 34,356 | 29,177 |
| | | |
| | At | At |
| | 31 | 31 |
| | December | December |
| | 2012 | 2011 |
| | HK\$m | HK\$m |
| Total shareholders' equity | | |
| At beginning of year | 340,824 | 320,130 |
| Issue of ordinary shares | 28,779 | 7,696 |
| Dividends paid | (32,500) | (33,000) |
| Movement in respect of share-based payment arrangements | (523) | 785 |
| Other movements | 5 | (215) |
| Comprehensive income for the year | 100,814 | 45,428 |
| | 437,399 | 340,824 |
| Non-controlling interests | | |
| At beginning of year | 30,519 | 27,305 |
| Dividends paid | (3,765) | (3,764) |
| Movement in respect of share-based payment arrangements | 14 | 26 |
| Other movements | (12) | (24) |
| Comprehensive income for the year | 8,923 | 6,976 |
| | 35,679 | 30,519 |
| Total equity | | |
| At beginning of year | 371,343 | 347,435 |
| Issue of ordinary shares | 28,779 | 7,696 |
| Dividends paid | (36,265) | (36,764) |
| Movement in respect of share-based payment arrangements | (509) | 811 |
| Other movements | (7) | (239) |
| Total comprehensive income for the year | 109,737 | 52,404 |
| | 473,078 | 371,343 |

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Consolidated Cash Flow Statement

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|--|---|---|
| Operating activities | | |
| Cash generated from/(used in) operations | (20,651) | 16,583 |
| Interest received on financial investments | 14,349 | 13,269 |
| Dividends received on financial investments | 464 | 723 |
| Dividends received from associates | 2,297 | 935 |
| Taxation paid | (17,423) | (15,790) |
| Net cash (outflow)/ inflow from operating activities | (20,964) | 15,720 |
| Investing activities | | |
| Purchase of financial investments | (262,280) | (495,823) |
| Proceeds from sale or redemption of financial investments | 350,945 | 588,409 |
| Purchase of property, plant and equipment | (1,990) | (2,870) |
| Proceeds from sale of property, plant and equipment and assets held for sale | 35 | 215 |
| Purchase of other intangible assets | (1,303) | (1,804) |
| Net cash outflow in respect of the acquisition of and increased shareholding in subsidiaries | – | (143) |
| Net cash inflow in respect of the sale of subsidiaries | 1,416 | 1 |
| Net cash outflow in respect of the purchase of interests in associates and joint ventures | (13,521) | (263) |
| Net cash (outflow)/ inflow in respect of the sale of interests in business portfolios | (12,242) | 5,649 |
| Proceeds from the sale of interests in associates | 3,970 | 19 |
| Net cash inflow from investing activities | 65,030 | 93,390 |
| Net cash inflow before financing | 44,066 | 109,110 |
| Financing | | |
| Issue of ordinary share capital | 28,779 | 7,696 |
| Issue of preference shares | 29 | – |
| Redemption of preference shares | (13,566) | (4,280) |
| Repayment of subordinated liabilities | (2,326) | (5,152) |
| Issue of subordinated liabilities | 2,328 | 3,502 |
| Ordinary dividends paid | (32,500) | (33,000) |
| Dividends paid to non-controlling interests | (3,766) | (3,764) |
| Interest paid on preference shares | (2,301) | (2,421) |
| Interest paid on subordinated liabilities | (884) | (793) |
| Net cash outflow from financing | (24,207) | (38,212) |
| Increase in cash and cash equivalents | 19,859 | 70,898 |

Additional Information

1. Net interest income

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|---------------------------------|---|---|
| Net interest income | 82,419 | 75,672 |
| Average interest-earning assets | 4,199,329 | 3,951,997 |
| Net interest margin | 1.96% | 1.91% |
| Net interest spread | 1.85% | 1.81% |

Net interest income increased as a result of loan and deposit growth across key countries, as well as improved deposit spreads, notably in Hong Kong. The insurance business also contributed to increased net interest income as the portfolio grew from increased sales.

Average interest-earning assets increased by HK\$247,332bn or 6% compared with last year. Average customer lending increased by 8%, with notable growth in term lending and mortgages, while financial investments increased by 5%.

Net interest margin increased by five basis points to 1.96% compared with last year. The net interest spread increased by four basis points while the contribution from net free funds increased by one basis point.

In Hong Kong, the Bank recorded an increase in net interest margin of 11 basis points to 1.46% compared with 2011. The net interest spread increased by 10 basis points as asset spreads on mortgages remained broadly stable and deposit spreads improved. Asset spreads on other lending increased marginally, narrowing towards the end of the year.

At Hang Seng Bank, the net interest margin increased by 13 basis points to 2.10% compared with last year. This was driven by improved loan pricing, increased deployment of funds towards customer lending and a wider range of investment opportunities for renminbi deposits.

In the Rest of Asia-Pacific, the net interest margin was 2.14%, four basis points higher than 2011. Both loan and deposit spreads reduced in key markets across the region from competitive pressures and central bank rate cuts. This was more than offset by improved spreads in Balance Sheet Management in mainland China and deployment of more of the commercial surplus to customer lending.

2. Net fee income

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|------------------------|---|---|
| Import/export | 5,115 | 4,793 |
| Remittances | 3,066 | 2,839 |
| Cards | 6,858 | 6,709 |
| Account services | 2,772 | 2,686 |
| Credit facilities | 2,797 | 2,812 |
| Securities/broking | 6,824 | 8,234 |
| Insurance | 1,042 | 712 |
| Unit trusts | 4,523 | 3,832 |
| Funds under management | 4,089 | 4,442 |
| Underwriting | 1,689 | 1,219 |
| Other | 7,446 | 6,888 |
| Fee income | 46,221 | 45,166 |
| Fee expense | (6,331) | (6,871) |
| | 39,890 | 38,295 |

Net fee income increased by HK\$1,595m or 4% in 2012.

Fees from unit trusts rose by 18%, notably in Hong Kong, as increased volumes more than offset the impact of customer preference shifting to lower risk, lower fee products.

Fees from imports/exports and remittances increased by 7% and 8% respectively, driven by growing trade activities from both existing and new-to-bank customers, with larger increases noted in Hong Kong, Singapore and Bangladesh.

Underwriting fees were 39% higher than 2011, driven by the growth of debt capital market transactions in Hong Kong, Singapore and the Philippines, which included our participation in several high-profile deals during the year.

Insurance fees increased by 46% in 2012, primarily due to fees received from external insurance providers from selling non-life products in Hong Kong, coupled with higher broking commissions earned in mainland China and Taiwan.

Fees from securities/stockbroking decreased by 17% as turnover reduced following stock market declines in the latter half of 2011. Fees from funds under management decreased by 8%, notably in Japan and Singapore as we saw customer preference moving towards lower risk products with lower fees and a reduction in client assets due to adverse movements in financial markets in the latter half of 2011.

3. Net trading income

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|--|---|---|
| Dealing profits | 16,633 | 15,590 |
| Net loss from hedging activities | (31) | (71) |
| Net interest income on trading assets and liabilities | 4,520 | 3,958 |
| Dividend income from trading securities | 786 | 722 |
| Ping An contingent forward sale contract (see note 18) | (2,694) | - |
| | 19,214 | 20,199 |

Net trading income decreased by HK\$985m, or 5% compared to 2011.

Dealing profits increased, driven by favourable Rates and Foreign Exchange income, notably in Hong Kong, Australia, India and Indonesia, reflecting increased client activity. Trading income was lower in mainland China due to lower Foreign Exchange revenues reflecting reduced volatility.

Net interest income on trading assets and liabilities rose by 14% on the back of expanded debt securities portfolios in Hong Kong, India, mainland China and Singapore. This was offset by higher interest paid on structured deposits, primarily in mainland China, where the related income is recorded under 'Net interest income'.

4. Gains less losses from financial investments

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|---|---|---|
| Gains on disposal of available-for-sale securities | 2,809 | 470 |
| Impairment of available-for-sale equity investments | (175) | (342) |
| | 2,634 | 128 |

Gains on disposal of available-for-sale securities include the gain of HK\$2,441m on the sale of our shares in four non-strategic investments in banks in India.

5. Other operating income

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| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|--|---|---|
| Rental income from investment properties | 216 | 191 |
| Movement in present value of in-force insurance business | 4,432 | 5,524 |
| Gains on investment properties | 834 | 1,033 |
| Gain/(loss) on disposal of property, plant and equipment, and assets held for sale | 30 | (3) |
| Gain/(loss) on disposal of subsidiaries, associates and business portfolios | 5,246 | (9) |
| Other | 4,579 | 4,653 |
| | 15,337 | 11,389 |

The value of the present value of in-force insurance business ('PVIF') asset rose, though not to the same extent as in 2011 as increased insurance sales in 2012 were more than offset by unfavourable assumption updates and the non-recurrence of the benefit from the refinement to the PVIF asset calculation in 2011.

Reflecting property market conditions in Hong Kong, the value of investment properties rose in 2012, though not to the same extent as 2011.

The gains on disposal of business portfolios include the gains on sale of both the HSBC and Hang Seng Bank general insurance businesses of HK\$905m and HK\$354m respectively, our RBWM business in Thailand of HK\$811m and our Global Private Banking business in Japan of HK\$520m. The gain on disposal of associates includes the gains on sale of Global Payments Asia-Pacific Ltd of HK\$1,647m and a property investment company in the Philippines of HK\$1,009m.

6. Insurance income

Included in the consolidated income statement are the following revenues earned by the insurance business:

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|--|---|---|
| Net interest income | 7,864 | 6,779 |
| Net fee income | 1,216 | 692 |
| Net trading income/(loss) | 56 | (386) |
| Net income/(expense) from financial instruments designated at fair value | 4,538 | (4,460) |
| Net earned insurance premiums | 52,621 | 45,670 |
| Movement in present value of in-force business | 4,432 | 5,524 |

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| | | |
|--|----------|----------|
| Other operating income | 1,308 | 237 |
| | 72,035 | 54,056 |
| Net insurance claims incurred and movement in liabilities to policyholders | (54,983) | (40,389) |
| Net operating income | 17,052 | 13,667 |

Net interest income increased by 16% as funds under management grew, reflecting net inflows from new and renewal insurance business.

Net income from financial instruments designated at fair value was of HK\$4,538m compared with a loss of HK\$4,460m in 2011, from investment gains on assets held by the insurance business, mainly due to movements in equity markets. To the extent that revaluation is due to policyholders, there is an offsetting movement reported under 'Net insurance claims incurred and movement in liabilities to policyholders'.

Net insurance premiums rose by 15% as a result of higher premiums received from policy renewals and successful sales initiatives for annuity products. The growth in premiums resulted in a corresponding increase in 'Net insurance claims incurred and movement in liabilities to policy holders'.

The value of the PVIF asset rose, though not to the same extent as in 2011 as increased insurance sales in 2012 were more than offset by unfavourable assumption updates and the non-recurrence of the benefit from the refinement to the PVIF asset calculation in 2011.

Other operating income includes the gains on sale of both the HSBC and Hang Seng general insurance businesses of HK\$905m and HK\$354m respectively.

7. Loan impairment charges and other credit risk provisions

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|--|---|---|
| Net charge for impairment of customer loans and advances | | |
| – Individually assessed impairment allowances: | | |
| New allowances | 2,201 | 2,254 |
| Releases | (1,230) | (1,204) |
| Recoveries | (237) | (356) |
| | 734 | 694 |
| – Net charge for collectively assessed impairment allowances | 2,596 | 2,401 |
| Net charge/(release) for other credit risk provisions | 248 | (36) |

| | | |
|---|-------|-------|
| Net charge for loan impairment and other credit risk provisions | 3,578 | 3,059 |
|---|-------|-------|

Loan impairment charges and other credit risk provisions increased by HK\$519m in 2012.

The net charge for individually assessed impairment allowances increased by HK\$40m in 2012, due to impairment of a corporate exposure in Australia, coupled with higher individual impairment charges in a number of countries including India, mainland China, New Zealand and Vietnam. These increases were offset by an impairment release in Singapore compared with a charge in 2011, coupled with lower new impairment charges in Hong Kong.

The net charge for collectively assessed impairment allowances rose by HK\$195m, or 8%, in 2012, reflecting the increase in loans and advances to customers.

The net charge for other credit risk provisions was HK\$284m higher, following charges against a corporate exposure in Australia, noted above.

8. Employee compensation and benefits

| | At 31 December 2012 HK\$m | At 31 December 2011 HK\$m |
|---|---------------------------------------|---------------------------------------|
| Wages and salaries | 34,233 | 35,020 |
| Social security costs | 935 | 912 |
| Retirement benefit costs | 1,853 | 1,902 |
| | 37,021 | 37,834 |
| Staff numbers by region – year end full-time equivalent | | |
| Hong Kong | 26,712 | 27,773 |
| Rest of Asia-Pacific | 38,881 | 43,647 |
| Total | 65,593 | 71,420 |

Employee compensation and benefits were broadly unchanged compared with 2011.

As part of the ongoing strategic review of our business and support functions, wages and salaries included termination benefits of HK\$849m, incurred in several countries across the region, compared with HK\$459m in 2011. This has resulted in a net reduction of more than 5,800 staff numbers since last year, or 8%. Excluding termination benefits,

wages and salaries were 2% lower, as reduced staff numbers were partially offset by wage inflation. In mainland China, wages and salaries expenses rose as a result of branch expansion during 2012.

9. General and administrative expenses

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|---|---|---|
| Premises and equipment | | |
| –Rental expenses | 3,292 | 3,102 |
| –Amortisation of prepaid operating lease payments | 18 | 18 |
| –Other premises and equipment | 3,941 | 3,810 |
| | 7,251 | 6,930 |
| Marketing and advertising expenses | 3,578 | 3,969 |
| Other administrative expenses | 15,182 | 13,453 |
| | 26,011 | 24,352 |

General and administrative expenses increased by HK\$1,659m or 7% in 2012.

Premises and equipment costs increased by HK\$321m, or 5%, with higher expenditure in Hong Kong from increased technology development and property rental and maintenance costs. Premises and equipment costs increased in both mainland China and Malaysia from branch expansion.

Other administrative expenses rose by HK\$1,729m, or 13%, in 2012. This included litigation expenses of HK\$760m in Australia and Singapore in respect of a legacy case and the write-down of a joint venture of HK\$395m. Higher costs were incurred in Hong Kong from intercompany expenses, compliance fees and higher corporate donations.

Marketing and advertising expenses decreased by HK\$391m, or 10%, following the implementation of cost control initiatives in a number of countries.

10. Share of profit in associates and joint ventures

Share of profit in associates and joint ventures principally includes the group's share of post-tax profits from Bank of Communications and Industrial Bank.

11. Tax expense

The tax expense in the consolidated income statement comprises:

| | Year ended 31 December 2012 HK\$m | Year ended 31 December 2011 HK\$m |
|------------------------|---|---|
| Current income tax | | |
| –Hong Kong profits tax | 7,790 | 6,540 |
| –Overseas taxation | 10,428 | 9,374 |
| Deferred taxation | (208) | 1,552 |
| | 18,010 | 17,466 |

The effective rate of tax for 2012 was 16.6% compared with 19.1% in 2011.

12. Dividends

| | Year ended 31 December 2012 | | Year ended 31 December 2011 | |
|---|--------------------------------|--------|--------------------------------|--------|
| | HK\$ per share | HK\$m | HK\$ per share | HK\$m |
| Ordinary dividends paid | | | | |
| –fourth interim dividend in respect of the previous financial year, approved and paid during the year | 0.83 | 10,000 | 1.33 | 12,000 |
| –first interim dividend paid | 0.58 | 7,500 | 0.78 | 7,000 |
| –second interim dividend paid | 0.41 | 7,500 | 0.78 | 7,000 |
| –third interim dividend paid | 0.40 | 7,500 | 0.68 | 7,000 |
| | 2.22 | 32,500 | 3.57 | 33,000 |

The Directors have declared a fourth interim dividend in respect of the financial year ended 31 December 2012 of HK\$20,000m (HK\$0.85 per ordinary share).

13. Loans and advances to customers

At At

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| | 31 December 2012 HK\$m | 31 December 2011 HK\$m |
|--|---------------------------------|---------------------------------|
| Gross loans and advances to customers | 2,358,814 | 2,142,172 |
| Impairment allowances: | | |
| –Individually assessed | (5,245) | (6,894) |
| –Collectively assessed | (4,526) | (4,407) |
| | (9,771) | (11,301) |
| Net loans and advances to customers | 2,349,043 | 2,130,871 |
| Allowances as a percentage of gross loans and advances to customers: | | |
| –Individually assessed | 0.22% | 0.32% |
| –Collectively assessed | 0.19% | 0.21% |
| Total allowances | 0.41% | 0.53% |

14. Impairment allowances against loans and advances to customers

| | Individually assessed allowances HK\$m | Collectively assessed allowances HK\$m | Total HK\$m |
|--|---|---|----------------|
| At 1 January 2012 | 6,894 | 4,407 | 11,301 |
| Amounts written off | (2,730) | (3,597) | (6,327) |
| Recoveries of loans and advances written off in previous years | 237 | 1,166 | 1,403 |
| Net charge to income statement | 734 | 2,596 | 3,330 |
| Unwinding of discount of loan impairment | (57) | (94) | (151) |
| Exchange and other adjustments | 167 | 48 | 215 |
| At 31 December 2012 | 5,245 | 4,526 | 9,771 |

15. Impaired loans and advances to customers and allowances

The geographical information shown below has been classified by the location of the principal operations of the subsidiary or, in the case of the Bank, by the location of the branch responsible for advancing the funds.

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| | Hong Kong HK\$m | Rest of Asia-Pacific HK\$m | Total HK\$m |
|---|-----------------------|----------------------------------|----------------|
| At 31 December 2012 | | | |
| Gross loans and advances to customers | | | |
| Individually assessed impaired gross loans and advances | 2,927 | 8,467 | 11,394 |
| Collectively assessed | 1,296,137 | 1,051,283 | 2,347,420 |
| – Impaired loans and advances | 621 | 999 | 1,620 |
| – Non-impaired loans and advances | 1,295,516 | 1,050,284 | 2,345,800 |
| Total gross loans and advances to customers | 1,299,064 | 1,059,750 | 2,358,814 |
| Impairment allowances | (3,585) | (6,186) | (9,771) |
| – Individually assessed | (1,418) | (3,827) | (5,245) |
| – Collectively assessed | (2,167) | (2,359) | (4,526) |
| Net loans and advances | 1,295,479 | 1,053,564 | 2,349,043 |
| Fair value of collateral which has been taken into account in respect of individually assessed impaired loans and advances to customers | 1,264 | 3,790 | 5,054 |
| Individually assessed impaired gross loans and advances as a percentage of gross loans and advances to customers | 0.2% | 0.8% | 0.5% |
| Total allowances as a percentage of total gross loans and advances | 0.3% | 0.6% | 0.4% |

At 31 December 2011

| | | | |
|---|-----------|---------|-----------|
| Gross loans and advances to customers | | | |
| Individually assessed impaired gross loans and advances | 3,881 | 8,490 | 12,371 |
| Collectively assessed | 1,182,989 | 946,812 | 2,129,801 |
| – Impaired loans and advances | 657 | 823 | 1,480 |
| – Non-impaired loans and advances | 1,182,332 | 945,989 | 2,128,321 |
| Total gross loans and advances to customers | 1,186,870 | 955,302 | 2,142,172 |
| Impairment allowances | (4,428) | (6,873) | (11,301) |
| – Individually assessed | (2,174) | (4,720) | (6,894) |
| – Collectively assessed | (2,254) | (2,153) | (4,407) |

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| | | | |
|---|-----------|---------|-----------|
| Net loans and advances | 1,182,442 | 948,429 | 2,130,871 |
| Fair value of collateral which has been taken into account in respect of individually assessed impaired loans and advances to customers | 1,403 | 3,252 | 4,655 |
| Individually assessed impaired gross loans and advances as a percentage of gross loans and advances to customers | 0.3% | 0.9% | 0.6% |
| Total allowances as a percentage of total gross loans and advances | 0.4% | 0.7% | 0.5% |

For individually assessed customer loans and advances where the industry sector comprises not less than 10% of total gross loans and advances to customers, the analysis of gross impaired loans and advances and allowances by major sectors, based on categories and definitions used by the HSBC Group, is as follows:

| | Total gross loans and advances HK\$m | Gross impaired advances HK\$m | Individually assessed allowances HK\$m | Collectively assessed allowances HK\$m |
|--|---|----------------------------------|---|---|
| At 31 December 2012 | | | | |
| Residential mortgages | 686,172 | 2,485 | (428) | (122) |
| Commercial, industrial and international trade | 745,198 | 5,117 | (2,897) | (2,060) |
| Commercial real estate | 249,264 | 533 | (413) | (107) |
| At 31 December 2011 | | | | |
| Residential mortgages | 608,135 | 2,369 | (372) | (166) |
| Commercial, industrial and international trade | 661,308 | 6,970 | (5,184) | (2,049) |
| Commercial real estate | 232,263 | 580 | (268) | (69) |

Collectively assessed allowances refer to impairment allowances which are assessed on a collective basis for those individually assessed loans and advances where an individual impairment has not yet been identified.

16. Overdue and rescheduled loans and advances to customers

The geographical information shown below has been classified by the location of the principal operations of the subsidiary or, in the case of the Bank, by the location of the branch responsible for advancing the funds.

| | | |
|-----------|----------------------|-------|
| Hong Kong | Rest of Asia-Pacific | Total |
|-----------|----------------------|-------|

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| | HK\$m | % | HK\$m | % | HK\$m | % |
|---|---------|-----|---------|-----|---------|-----|
| At 31 December 2012 | | | | | | |
| Gross amounts which have been overdue with respect to either principal or interest for periods of | | | | | | |
| –more than three months but less than six months | 288 | 0.0 | 1,733 | 0.2 | 2,021 | 0.1 |
| –more than six months but less than one year | 166 | 0.0 | 1,283 | 0.1 | 1,449 | 0.1 |
| –more than one year | 1,856 | 0.1 | 2,828 | 0.3 | 4,684 | 0.2 |
| | 2,310 | 0.1 | 5,844 | 0.6 | 8,154 | 0.4 |
| Individually assessed impairment allowances made in respect of amounts overdue | | | | | | |
| | (895) | | (3,008) | | (3,903) | |
| Fair value of collateral held in respect of amounts overdue | | | | | | |
| | 769 | | 2,285 | | 3,054 | |
| Rescheduled loans and advances to customers | | | | | | |
| | 565 | 0.0 | 2,781 | 0.3 | 3,346 | 0.1 |
| At 31 December 2011 | | | | | | |
| Gross amounts which have been overdue with respect to either principal or interest for periods of | | | | | | |
| –more than three months but less than six months | 616 | 0.1 | 3,446 | 0.4 | 4,062 | 0.2 |
| –more than six months but less than one year | 234 | 0.0 | 720 | 0.1 | 954 | 0.0 |
| –more than one year | 1,807 | 0.2 | 2,880 | 0.3 | 4,687 | 0.2 |
| | 2,657 | 0.3 | 7,046 | 0.8 | 9,703 | 0.4 |
| Individually assessed impairment allowances made in respect of amounts overdue | | | | | | |
| | (1,614) | | (4,106) | | (5,720) | |
| Fair value of collateral held in respect of amounts overdue | | | | | | |
| | 825 | | 2,030 | | 2,855 | |
| Rescheduled loans and advances to customers | | | | | | |
| | 1,257 | 0.1 | 1,938 | 0.2 | 3,195 | 0.1 |

Rescheduled loans and advances to customers are those loans and advances which have been restructured or renegotiated because of a deterioration in the financial position of the borrower, or because of the inability of the borrower to meet the original repayment schedule. Rescheduled loans and advances to customers are stated net of any loans and advances which have subsequently become overdue for more than three months and which are included in ‘Overdue and rescheduled loans and advances to customers’.

17. Analysis of loans and advances to customers based on categories used by the HSBC Group

The following analysis of loans and advances to customers is based on categories used by the HSBC Group, including The Hongkong and Shanghai Banking Corporation Limited and its subsidiaries, to manage associated risks.

| | Hong Kong HK\$m | Rest of Asia-Pacific HK\$m | Total HK\$m |
|--|--------------------|----------------------------------|----------------|
| At 31 December 2012 | | | |
| Residential mortgages | 401,855 | 284,317 | 686,172 |
| Credit card advances | 45,961 | 33,489 | 79,450 |
| Other personal | 51,721 | 42,337 | 94,058 |
| Total personal | 499,537 | 360,143 | 859,680 |
| Commercial, industrial and international trade | 342,463 | 402,735 | 745,198 |
| Commercial real estate | 177,339 | 71,925 | 249,264 |
| Other property-related lending | 127,099 | 51,448 | 178,547 |
| Government | 21,995 | 8,804 | 30,799 |
| Other commercial | 96,055 | 133,921 | 229,976 |
| Total corporate and commercial | 764,951 | 668,833 | 1,433,784 |
| Non-bank financial institutions | 31,545 | 30,263 | 61,808 |
| Settlement accounts | 3,031 | 511 | 3,542 |
| Total financial | 34,576 | 30,774 | 65,350 |
| Gross loans and advances to customers | 1,299,064 | 1,059,750 | 2,358,814 |
| Individually assessed impairment allowances | (1,418) | (3,827) | (5,245) |
| Collectively assessed impairment allowances | (2,167) | (2,359) | (4,526) |
| Net loans and advances to customers | 1,295,479 | 1,053,564 | 2,349,043 |
| At 31 December 2011 | | | |
| Residential mortgages | 360,368 | 247,767 | 608,135 |
| Credit card advances | 41,200 | 31,849 | 73,049 |
| Other personal | 51,339 | 38,093 | 89,432 |
| Total personal | 452,907 | 317,709 | 770,616 |
| Commercial, industrial and international trade | 295,729 | 365,579 | 661,308 |
| Commercial real estate | 158,222 | 74,041 | 232,263 |
| Other property-related lending | 134,910 | 49,659 | 184,569 |
| Government | 22,669 | 7,471 | 30,140 |
| Other commercial | 96,398 | 117,205 | 213,603 |
| Total corporate and commercial | 707,928 | 613,955 | 1,321,883 |

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| | | | |
|---|-----------|---------|-----------|
| Non-bank financial institutions | 24,799 | 23,300 | 48,099 |
| Settlement accounts | 1,236 | 338 | 1,574 |
| Total financial | 26,035 | 23,638 | 49,673 |
| Gross loans and advances to customers | 1,186,870 | 955,302 | 2,142,172 |
| Individually assessed impairment allowances | (2,174) | (4,720) | (6,894) |
| Collectively assessed impairment allowances | (2,254) | (2,153) | (4,407) |
| Net loans and advances to customers | 1,182,442 | 948,429 | 2,130,871 |

Loans and advances to customers in Hong Kong increased by HK\$113bn, or 10%, during 2012 largely through growth in corporate and commercial lending of HK\$57bn, reflecting increased demand in international trade and commercial real estate. Residential mortgage lending increased by HK\$41bn as the property market remained active.

In the Rest of Asia-Pacific, loans and advances to customers increased by HK\$105bn, or 11%, including foreign exchange translation effects of HK\$16bn. The underlying increase of HK\$89bn was mainly from growth in corporate and commercial lending of HK\$48bn, supported by trade flows in mainland China, Indonesia, India and Australia. Residential mortgage lending increased by HK\$28bn, notably in Singapore, Australia, Malaysia and mainland China.

18. Other assets

| | At 31 December 2012 HK\$m | At 31 December 2011 HK\$m |
|--------------------------------|------------------------------------|---------------------------------------|
| Current taxation recoverable | 1,029 | 676 |
| Assets held for sale | 48,280 | 8,117 |
| Prepayments and accrued income | 3,823 | 3,135 |
| Accrued interest receivable | 14,992 | 14,524 |
| Acceptances and endorsements | 31,965 | 31,750 |
| Other | 86,964 | 42,113 |
| | 187,053 | 100,315 |

On 5 December 2012, we entered into an agreement to dispose of our entire shareholding in Ping An, consisting of 613,929,279 shares, at a fixed price of HK\$59 per share. The fixing of the sale price gave rise to a contingent forward sale contract, the fair value of which at year end was based on the difference between the agreed sale price and the market price for the shares, adjusted for an assessment of the probability of the transaction being completed. The adverse fair value of this contract was HK\$2,694m at 31 December 2012, recorded in net trading income (see note 3). The investment in Ping An is accounted for as an available-for-sale investment and carried at fair value with unrealised gains or losses recorded in other comprehensive income.

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At 31 December 2012, the fair value of our investment in Ping An was HK\$39,813m, included in 'Assets held for sale', with HK\$31,701m accumulated unrealised gains in other comprehensive income. These unrealised gains include HK\$3,591m of gains which arose after the date of the sale agreement and represent the difference between Ping An's share price at the year end and the agreed sale price. The gain from this transaction is HK\$28,110m, being the proceeds of HK\$36,222m based on the agreed sale price of HK\$59 per share, less the original cost of HK\$8,112m. The income statement impact of this transaction is a loss of HK\$2,694m in 2012 and a net gain in 2013 of HK\$30,804m.

Gold bullion balances were reclassified from 'Loans and advances to customers' to 'Other assets' during the year to reflect the substance of the gold lending business.

19. Customer accounts

| | At 31 December 2012 HK\$m | At 31 December 2011 HK\$m |
|------------------------|---------------------------------------|---------------------------------------|
| Current accounts | 831,256 | 696,435 |
| Savings accounts | 2,063,565 | 1,826,893 |
| Other deposit accounts | 980,063 | 1,041,673 |
| | 3,874,884 | 3,565,001 |

Customer accounts increased by HK\$310bn, or 9%, during 2012. In Hong Kong, customer accounts increased by HK\$235bn, or 10%, and in the Rest of Asia-Pacific customer accounts increased by HK\$75bn or 6% compared with 31 December 2011.

The group's advances-to-deposits ratio increased to 60.6% at 31 December 2012, from 59.8% at 31 December 2011, as more of the commercial surplus was deployed to customer lending.

20. Other liabilities and provisions

| | At 31 December 2012 HK\$m | At 31 December 2011 HK\$m |
|--|---------------------------------------|---------------------------------------|
| Accruals and deferred income | 24,705 | 23,286 |
| Liabilities held for sale | 4,811 | 21,970 |
| Provisions for liabilities and charges | 2,144 | 1,686 |
| Acceptances and endorsements | 31,965 | 31,750 |
| Share-based payment liability to HSBC Holdings plc | 2,560 | 2,729 |
| Other liabilities | 28,606 | 26,893 |

94,791 108,314

21. Contingent liabilities and commitments

a Off-balance sheet contingent liabilities and commitments

| | At 31 December 2012 HK\$m | At 31 December 2011 HK\$m |
|---|---------------------------------------|---------------------------------------|
| Contingent liabilities and financial guarantee contracts | | |
| Guarantees and irrevocable letters of credit pledged as collateral security | 225,483 | 192,428 |
| Other contingent liabilities | 345 | 359 |
| | 225,828 | 192,787 |
| Commitments | | |
| Documentary credits and short-term trade-related transactions | 39,902 | 44,524 |
| Forward asset purchases and forward deposits placed | 3,000 | 2,524 |
| Undrawn formal standby facilities, credit lines and other commitments to lend | 1,561,277 | 1,425,590 |
| | 1,604,179 | 1,472,638 |

The above table discloses the nominal principal amounts of off-balance sheet items. Contingent liabilities and commitments are mainly credit-related instruments that include non-financial guarantees and commitments to extend credit. Contractual amounts represent the amounts at risk should contracts be fully drawn upon and clients default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contractual amounts is not representative of future liquidity requirements.

b Guarantees (including financial guarantee contracts)

The group provides guarantees and similar undertakings on behalf of both third-party customers and other entities within the group. These guarantees are generally provided in the normal course of the banking business. The principal types of guarantees provided, and the maximum potential amount of future payments that the group could be required

to make, were as follows:

| | At 31 December 2012 HK\$m | At 31 December 2011 HK\$m |
|--|---------------------------------------|---------------------------------------|
| Guarantees in favour of third parties | | |
| Financial guarantee contracts | 34,735 | 26,694 |
| Standby letters of credit that are financial guarantee contracts | 20,620 | 19,684 |
| Other direct credit substitutes | 42,551 | 38,211 |
| Performance bonds | 64,220 | 54,429 |
| Bid bonds | 2,752 | 2,169 |
| Standby letters of credit related to particular transactions | 20,608 | 12,169 |
| Other transaction-related guarantees | 29,773 | 31,892 |
| | 215,259 | 185,248 |
| Guarantees in favour of other HSBC Group entities | 10,224 | 7,180 |
| | 225,483 | 192,428 |

The amounts disclosed in the above table reflect the group's maximum exposure under a large number of individual guarantee undertakings. The risks and exposures from guarantees are captured and managed in accordance with HSBC's overall credit risk management policies and procedures. Guarantees are subject to HSBC's credit review process.

22. Foreign exchange exposure

Foreign exchange exposures may be divided broadly into two categories: structural and non-structural. Structural exposures are normally long-term in nature and include those arising from investments in subsidiaries, branches, associates and strategic investments as well as capital instruments denominated in currencies other than Hong Kong dollars. Non-structural exposures arise primarily from trading positions and balance sheet management activities and can arise and change rapidly. Foreign currency exposures are managed in accordance with the group's risk management policies and procedures.

The group had the following structural foreign currency exposures that were not less than 10% of the total net structural exposure in all foreign currencies:

| | At 31 December 2012 | At 31 December 2011 |
|--|------------------------------|------------------------------|
|--|------------------------------|------------------------------|

| | HK\$m | HK\$m |
|-------------------------|---------|---------|
| Net structural position | | |
| Chinese renminbi | 189,446 | 145,347 |

23. Capital adequacy

The Hong Kong Monetary Authority ('HKMA') supervises the group on a consolidated basis and therefore receives information on the capital adequacy of, and sets capital requirements for, the group as a whole. Individual banking subsidiaries and branches are directly regulated by their local banking supervisors, who set and monitor their capital adequacy requirements. In most jurisdictions, non-banking financial subsidiaries are also subject to the supervision and capital requirements of local regulatory authorities.

The group uses the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures and the internal ratings-based (securitisation) approach to determine credit risk for its banking book securitisation exposures. For market risk, the group uses an internal models approach to calculate its general market risk for the risk categories of interest rate, foreign exchange (including gold), and equity exposures. The group uses an internal models approach to calculate its market risk in respect of specific risk for the interest rate and equity risk categories. The group uses the standardised (market risk) approach for calculating other market risk positions as well as trading book securitisation exposures, and the standardised (operational risk) approach to calculate its operational risk.

During the year, the individual entities within the group and the group itself complied with all of the externally imposed capital requirements of the HKMA.

There are no relevant capital shortfalls in any of the group's subsidiaries that are not included in its consolidation group for regulatory purposes.

| | 2012 | 2011 |
|------------------------|------|------|
| | % | % |
| Capital ratios | | |
| Core capital ratio | 13.7 | 12.4 |
| Capital adequacy ratio | 14.3 | 14.6 |

| | HK\$m | HK\$m |
|--------------------------|-----------|-----------|
| Risk weighted assets | | |
| Credit risk | 1,455,675 | 1,350,467 |
| Counterparty credit risk | 81,409 | 71,270 |

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| | | |
|------------------|-----------|-----------|
| Market risk | 116,911 | 38,585 |
| Operational risk | 250,139 | 221,429 |
| | 1,904,134 | 1,681,751 |

Impact of Basel III

The Banking (Capital) (Amendment) Rules 2012 came into effect on 1 January 2013 to implement the first phase of the Basel III capital standards in Hong Kong ('Basel III rules'). The group has estimated the pro-forma impact of the Basel III rules on the group's capital position at 31 December 2012. The capital requirements that came in to effect on 1 January 2013 in Hong Kong are estimated to result in capital ratios that are above the minimum requirements.

The pro-forma capital position prepared in accordance with the Basel III rules would be higher than the 31 December 2012 position under the existing rules, for the following reasons:

- introduction of concessionary thresholds for deduction of capital investments in non-consolidated financial institutions;
 - the timing of the recognition of dividends;
 - the removal of the cap on unrealised gains on own-use and investment properties; and
 - the full recognition of unrealised gains on available-for-sale and designated at fair value securities.

Following the implementation, capital ratios for the half-year ending 30 June 2013 will be calculated in accordance with the Basel III rules.

| | 2012 HK\$m | 2011 HK\$m |
|---|---------------|---------------|
| Core capital: | | |
| Share capital per balance sheet | 58,969 | 30,190 |
| Revaluation reserve capitalisation issue | (1,454) | (1,454) |
| Paid-up ordinary share capital | 57,515 | 28,736 |
| Paid-up irredeemable non-cumulative preference shares | 51,570 | 51,681 |
| Reserves per balance sheet | 378,430 | 310,634 |
| Proposed dividend | (20,000) | (10,000) |
| Unconsolidated subsidiaries | (40,088) | (32,672) |
| Cash flow hedging reserve | (210) | (51) |
| Regulatory reserve | (19,426) | (17,108) |

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| | | |
|---|----------|----------|
| Reserves arising from revaluation of property and unrealised gains on available-for-sale equities and debt securities | (86,111) | (73,570) |
| Unrealised gains on equities and debt securities designated at fair value | (20) | (77) |
| Own credit spread | (218) | (429) |
| Total reserves included in core capital | 212,357 | 176,727 |
| Non-controlling interests per balance sheet | 35,679 | 30,519 |
| Non-controlling interests in unconsolidated subsidiaries | (3,478) | (2,838) |
| Regulatory adjustments to non-controlling interests | (3,291) | (2,976) |
| Non-controlling interests | 28,910 | 24,705 |
| Goodwill, intangible assets and valuation adjustments | (21,191) | (19,663) |
| 50% of unconsolidated investments | (67,692) | (53,749) |
| 50% of securitisation positions and other deductions | (16) | (140) |
| Deductions | (88,899) | (73,552) |
| Total core capital | 261,453 | 208,297 |
| Supplementary capital: | | |
| Paid-up irredeemable cumulative preference shares | 16,510 | 16,546 |
| Perpetual subordinated debt | 9,355 | 9,386 |
| Paid-up term preference shares | 15,115 | 28,742 |
| Term subordinated debt | 16,418 | 16,327 |
| Property revaluation reserves | 7,977 | 7,977 |
| Unrealised gains on available-for-sale equities and debt securities | 2,534 | 2,318 |
| Unrealised gains on equities and debt securities designated at fair value | 9 | 35 |
| Regulatory reserve | 2,333 | 2,267 |
| Collective impairment allowances | 496 | 545 |
| Excess impairment allowances over expected losses | 8,400 | 7,655 |
| Supplementary capital before deductions | 79,147 | 91,798 |
| 50% of unconsolidated investments | (67,692) | (53,749) |
| 50% of securitisation positions and other deductions | (16) | (140) |
| Deductions | (67,708) | (53,889) |
| Total supplementary capital | 11,439 | 37,909 |
| Capital base | 272,892 | 246,206 |

24. Liquidity ratio

The Hong Kong Banking Ordinance requires banks operating in Hong Kong to maintain a minimum liquidity ratio of 25%, calculated in accordance with the provisions of the Fourth Schedule of the Banking Ordinance. This requirement applies separately to the Hong Kong branches of the Bank and to those subsidiary companies that are Authorised Institutions under the Banking Ordinance in Hong Kong.

| | 2012 % | 2011 % |
|--|-----------|-----------|
| The average liquidity ratio for the year was as follows: | | |
| Hong Kong branches of the Bank | 38.3 | 33.6 |

25. Property revaluation

The group's land and buildings and investment properties were revalued at 30 November 2012 and updated for any material changes at 31 December 2012. The basis of valuation for land and buildings and investment properties was open market value, depreciated replacement cost or surrender value. In determining the open market value of investment properties, expected future cash flows have been discounted to their present values. The net book value of 'Land and buildings' includes HK\$10,108m in respect of properties which were valued using the depreciated replacement cost method or surrender value.

The surplus on property revaluation for the year was HK\$8,057m. Amounts of HK\$5,327m and HK\$836m were credited to the property revaluation reserve and the income statement respectively. The amount credited to the property revaluation reserve of HK\$5,327m is stated after deduction of non-controlling interests of HK\$841m and deferred tax of HK\$1,053m. The amount credited to the income statement comprises the surplus of HK\$834m on revaluation of investment properties and HK\$2m relating to the reversal of previous revaluation deficits.

Land and buildings and investment properties in Hong Kong, the Macau SAR and mainland China, representing 95% by value of the group's properties subject to valuation, were valued by DTZ Debenham Tie Leung Limited who has recent experience in these locations and types of properties. The valuations were carried out by qualified valuers who are members of the Hong Kong Institute of Surveyors. Properties in 11 countries, which represent 5% by value of the group's properties, were valued by different independent professionally qualified valuers.

26. Accounting policies

The accounting policies and methods of computation adopted by the group for this news release are consistent with those described on pages 36 to 57 of the 2011 Annual Report and Accounts. A number of new and revised Hong Kong Financial Reporting Standards have become effective in 2012. None has a material impact on the group.

27. Events after the balance sheet date

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On 5 December 2012, we announced an agreement to sell our shares in Ping An. This transaction completed on 6 February 2013. See note 18 for further details on the transaction.

On 7 January 2013, Industrial Bank Co., Ltd. ('Industrial Bank') completed a private placement of additional share capital to a number of third parties, thereby diluting the group's equity holding from 12.8% to 10.9%. As a result of this and other factors, the group considers it is no longer in a position to exercise significant influence over Industrial Bank and ceased to account for the investment as an associate from that date, giving rise to an accounting gain of approximately HK\$9.5bn. Thereafter, the holding is recognised as an available-for-sale financial investment.

28. Statutory accounts

The information in this news release is not audited and does not constitute statutory accounts.

Certain financial information in this news release is extracted from the financial statements for the year ended 31 December 2012, which were approved by the Board of Directors on 4 March 2013 and will be delivered to the Registrar of Companies and the HKMA. The Auditors expressed an unqualified opinion on those financial statements in their report dated 4 March 2013. The Annual Report and Accounts for the year ended 31 December 2012, which include the financial statements, can be obtained on request from Communications (Asia), The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong, and will be made available on our website: www.hsbc.com.hk. A further press release will be issued to announce the availability of this information.

29. Ultimate holding company

The Hongkong and Shanghai Banking Corporation Limited is an indirectly-held, wholly-owned subsidiary of HSBC Holdings plc.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HSBC Holdings plc

By:

Name: P A Stafford

Title: Assistant Group Secretary

Date: 04 March 2013